PJSC LUKOIL

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the three-month periods ended 31 March 2017 and 2016

The following report contains a discussion and analysis of the financial position of PJSC LUKOIL at 31 March 2017 and the results of its operations for the first quarter of 2017, compared to the first quarter of 2016, as well as significant factors that may affect its future performance. It should be read in conjunction with our International Financial Reporting Standards ("IFRS") condensed interim consolidated financial statements, including notes.

References to "LUKOIL," "the Company," "the Group," "we" or "us" are references to PJSC LUKOIL and its subsidiaries and equity affiliates. All ruble amounts are in millions of Russian rubles ("RUB"), unless otherwise indicated. Income and expenses of our foreign subsidiaries were translated to rubles at rates which approximate actual rates at the date of the transaction. Tonnes of crude oil and natural gas liquids produced were translated into barrels using conversion rates characterizing the density of crude oil from each of our oilfields and the actual density of liquids produced at our gas processing plants. Hydrocarbon extraction expenses per barrel were calculated using these actual production volumes. Other operational indicators expressed in barrels were translated into barrels using an average conversion rate of 7.33 barrels per tonne. Translations of cubic meters to cubic feet were made at the rate of 35.31 cubic feet per cubic meter. Translations of barrels of crude oil into barrels of oil equivalent ("BOE") were made at the rate of 1 barrel per BOE and of cubic feet – at the rate of 6 thousand cubic feet per BOE.

This report includes forward-looking statements – words such as "believes," "anticipates," "expects," "estimates," "intends," "plans," etc. – that reflect management's current estimates and beliefs, but are not guarantees of future results.

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Business overview

The primary activities of LUKOIL and its subsidiaries are crude oil exploration, production, refining, marketing and distribution.

LUKOIL is one of the world's largest publicly traded vertically integrated energy companies in terms of hydrocarbon reserves and production. Our proved reserves under SEC standards amounted to 16.4 billion BOE at 1 January 2017 and comprised of 12.5 billion barrels of crude oil and 23.5 trillion cubic feet of gas. Most of our reserves are conventional. We undertake exploration for and production of crude oil and natural gas in Russia and internationally. In Russia, our major oil producing regions are Western Siberia, Timan-Pechora, Ural and Volga region. Our international upstream segment includes stakes in PSA's and other projects in Kazakhstan, Azerbaijan, Uzbekistan, Romania, Iraq, Egypt, Ghana, Norway, Cameroon, Nigeria and Mexico. Our daily hydrocarbon production in the first quarter of 2017 amounted to 2.2 million BOE with liquid hydrocarbons representing approximately 81% of our overall production volumes.

LUKOIL has geographically diversified downstream assets portfolio primarily in Russia and Europe. Our downstream operations include crude oil refining, petrochemical and transport operations, marketing and trading of crude oil, natural gas and refined products, power generation, transportation and sales of electricity, heat and related services.

We own and operate four refineries located in European Russia and three refineries located outside Russia – in Bulgaria, Romania, and Italy. Moreover, we have a 45% interest in the Zeeland refinery in the Netherlands. We also own two petrochemical plants in Russia and petrochemical capacities at our refineries in Bulgaria and Italy. Along with our own production of refined products we refine crude oil at third party refineries depending on market conditions and other factors. Our refinery throughput in the first quarter of 2017 amounted to 1.3 million barrels per day, and we produced 0.3 million tonnes of petrochemicals.

We are marketing our own and third-party crude oil and refined products through our wholesale and retail channels in Russia, Europe, South-East Asia, Central and North America and other regions. We own petrol stations in 18 countries. Most of our retail networks are located close to our refineries. Our retail sales in the first quarter of 2017 amounted to 3.3 million tonnes of refined products.

We are involved in production, distribution and marketing of electrical energy and heat both in Russia and internationally. In the first quarter of 2017, our total output of electrical energy was 5.3 billion kWh.

Our operations and finance activities are coordinated from our headquarters in Moscow. We divide our operations into three main business segments: "Exploration and production", "Refining, marketing and distribution" and "Corporate and other".

Key financial and operational results

	3 months of 2017	2016	Change, %
	(millions of rubles)		
Sales	1,431,599	1,177,674	21.6
EBITDA(1), including	207,645	191,992	8.2
Exploration and production segment	127,777	129,586	(1.4)
Refining, marketing and distribution segment	70,527	63,510	11.0
EBITDA(1) net of West Qurna-2 project	204,702	170,498	20.1
Profit for the period attributable to LUKOIL shareholders	62,306	42,825	45.5
Capital expenditures	130,228	125,807	3.5
Free cash flow(2)	1,375	38,589	(96.4)
Free cash flow before changes in working capital	67,096	57,429	16.8
	(thousand BOE per day)		
Production of hydrocarbons, including our share in equity affiliates	2,244	2,413	(7.0)
Crude oil and natural gas liquids	1,822	2,006	(9.2)
Gas	422	407	3.7
Refinery throughput at the Group refineries	1,319	1,274	3.5

(1) Profit from operating activities before depreciation, depletion and amortization.

(2) Cash flow from operating activities less capital expenditures.

In the first quarter of 2017, profit attributable to LUKOIL shareholders amounted to 62 billion RUB, an increase of 45.5% to the first quarter of 2016.

Our financial results were supported by an increase in average hydrocarbon prices that was sizably offset by significant strengthening of the ruble.

In the first quarter of 2017, our EBITDA amounted to 208 billion RUB, an increase of 8.2% to the first quarter of 2016. This increase was a result of an increase in share of high-margin volumes in crude oil production structure, better refineries' slate, and a decrease in selling, general and administrative expenses. The increase was partially offset by the ruble appreciation and an increase in transportation tariffs. Our EBITDA was sizably affected by the decrease in volumes of compensation crude oil within the West Qurna-2 project. Net of this project, the Group's EBITDA increased by 20.1% compared to the first quarter of 2016.

Our free cash flow amounted to 1 billion RUB, compared to 39 billion RUB in the first quarter of 2016. It was affected by an increase in working capital together with increase in our capital expenditures.

The Group's average daily hydrocarbon production in the first quarter of 2017 decreased by 7.0% compared to the first quarter of 2016, which was primarily driven by lower volume of compensation crude oil from the West Qurna-2 project and production cuts driven by external limitations due to the agreement with OPEC.

In the first quarter of 2017, production of refined products at own refineries increased by 2.5% compared to the first quarter of 2016 mainly due to the higher utilization rates at refineries in Perm, Volgograd and in Bulgaria.

Changes in Group structure

In December 2016, the Company entered into a contract with a company of the "Otkrytie Holding" group to sell the Group's 100% interest in JSC "Arkhangelskgeoldobycha" ("AGD"), a company developing the diamond field named after V.P. Grib located in Arkhangelsk region of Russia. The transaction's closing was subject to governmental approvals and was completed on 24 May 2017. The value of the transaction is the Russian ruble equivalent of $1.45 billion, including debt repayment by AGD to the Company, which can be subject to actual working capital adjustment at closing date.

In February 2017, LUKOIL completed the sale of wholly owned subsidiary – LUKOIL Chemical B.V., which owns "Karpatneftekhim" petrochemical plant located in Ivano-Frankovsk area of Ukraine.

In line with the Company's strategy of optimizing its downstream operations in Europe, we sold petrol station networks in Poland, Latvia, Lithuania and Cyprus in 2016.

Main macroeconomic factors affecting our results of operations

International crude oil and refined products prices

The price at which we sell crude oil and refined products is the primary driver of the Group's revenues.

The dynamics of our realized prices on international markets generally matches the dynamics of commonly used spot benchmarks such as Brent crude oil price, however our average prices are usually different from such benchmarks due to different delivery terms, quality mix, as well as specifics of regional markets in case of petroleum product sales.

During the first quarter of 2017, the price for Brent crude oil fluctuated between $49 and $56 per barrel, reached its maximum of $56.3 in the end of February and then minimum of $49.2 in the end of March, and averaged 58.2% higher than in the first quarter of 2016. Nevertheless, as a result of the ruble appreciation, the prices expressed in rubles increased less significantly.

The following tables show the average crude oil and refined product prices.

	3 months of		**Change, %**
	2017	**2016**	
	(in US dollars per barrel, except for figures in percent)		
Brent crude	53.69	33.94	58.2
Urals crude (CIF Mediterranean)	52.52	32.72	60.5
Urals crude (CIF Rotterdam)	51.88	31.66	63.9
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam)	290.17	135.28	114.5
Diesel fuel 10 ppm (FOB Rotterdam)	479.02	312.55	53.3
High-octane gasoline (FOB Rotterdam)	544.90	386.04	41.2
Naphtha (FOB Rotterdam)	480.66	316.44	51.9
Jet fuel (FOB Rotterdam)	509.96	337.42	51.1
Vacuum gas oil (FOB Rotterdam)	352.38	222.56	58.3

Source: Platts.

	3 months of		**Change, %**
	2017	**2016**	
	(in rubles per barrel, except for figures in percent)		
Brent crude	3,159	2,533	24.7
Urals crude (CIF Mediterranean)	3,090	2,442	26.5
Urals crude (CIF Rotterdam)	3,052	2,362	29.2
	(in rubles per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam)	17,072	10,096	69.1
Diesel fuel 10 ppm (FOB Rotterdam)	28,184	23,325	20.8
High-octane gasoline (FOB Rotterdam)	32,060	28,809	11.3
Naphtha (FOB Rotterdam)	28,281	23,615	19.8
Jet fuel (FOB Rotterdam)	30,004	25,181	19.2
Vacuum gas oil (FOB Rotterdam)	20,733	16,609	24.8

Translated into rubles using average exchange rate for the period.

Domestic crude oil and refined products prices

Most of the crude oil in Russia is produced and then refined or exported by vertically integrated oil companies. As a result, there is no liquid spot market for crude oil in Russia and no publicly available spot price benchmark. Domestic prices may deviate significantly from export netbacks and they also vary between different regions of Russia driven by supply demand balance on regional markets.

Domestic prices for refined products correlate to some extent with export netbacks, but are also materially affected by supply demand balance on regional markets.

The table below represents average domestic wholesale prices of refined products.

	3 months of 2017	3 months of 2016	Change, %
	(in rubles per metric tonne, except for figures in percent)		
Fuel oil	9,682	4,555	112.6
Diesel fuel	31,453	27,186	15.7
High-octane gasoline (Regular)	35,387	31,637	11.9
High-octane gasoline (Premium)	35,233	33,497	5.2

Source: InfoTEK (excluding VAT).

Changes in ruble exchange rate and inflation

A substantial part of our revenue is either denominated in US dollars or euro or is correlated to some extent with US dollar crude oil prices, while most of our costs are settled in Russian rubles. Therefore, a devaluation of the ruble against the US dollar and euro generally causes our revenues to increase in ruble terms, and vice versa. Ruble inflation also affects the results of our operations.

The following table provides data on inflation in Russia and change in the ruble-dollar and ruble-euro exchange rates.

	3 months of 2017	3 months of 2016
Ruble inflation (CPI), %	1.0	2.1
Ruble to US dollar exchange rate		
Average for the period	58.8	74.6
At the beginning of the period	60.7	72.9
At the end of the period	56.4	67.6
Ruble to euro exchange rate		
Average for the period	62.6	82.3
At the beginning of the period	63.8	79.7
At the end of the period	60.6	76.5

Source: CBR, Federal State Statistics Service.

Taxation

In 2015-2017, the Russian Government is implementing the tax manoeuvre in the oil industry which envisages reduction of export duty rate and increase in the crude oil extraction tax and excise tax rates. Changes within this tax manoeuvre effective from January and April 2016 had a negative impact on our upstream, refining and marketing margins. Changes effective from January 2017 had a positive impact on our upstream margins and a negative impact on our refining and marketing margins, while overall impact of tax changes on our financial results wasn't significant.

The following tables represent average enacted rates for taxes specific to the oil industry in Russia for the respective periods.

	3 months of 2017	3 months of 2016	Change, %
	(in US dollars per tonne, except for figures in percent)		
Export duties on crude oil	86.43	55.00	57.2
Export duties on refined products			
Light and middle distillates	25.90	21.99	17.8
Fuel oil	86.43	45.05	91.9
Gasoline	25.90	33.51	(22.7)
Straight-run gasoline	47.51	39.01	21.8
Diesel fuel	25.90	21.99	17.8
Mineral extraction tax(1)			
Crude oil	135.31	54.67	147.5
Natural gas (Nakhodkinskoe field)	4.27	2.79	53.0

(1) Translated from rubles using average exchange rate for the period.

	3 months of		
	2017	2016	Change, %
	(in rubles per tonne, except for figures in percent)		
Export duties on crude oil[1]	5,086	4,104	23.9
Export duties on refined products[1]			
Light and middle distillates	1,524	1,641	(7.1)
Fuel oil	5,086	3,362	51.3
Gasoline	1,524	2,500	(39.1)
Straight-run gasoline	2,795	2,911	(4.0)
Diesel fuel	1,524	1,641	(7.1)
Mineral extraction tax			
Crude oil	7,961	4,080	95.1
Natural gas (Nakhodkinskoe field)	251	208	20.7

[1] Translated to rubles using average exchange rate for the period.

The table below illustrates the impact of tax incentives for different fields and deposits in our portfolio at \$50 per barrel Urals price.

	Mineral extraction tax	Export duty	Total	As % of oil price
	(in US dollars per barrel, except for figures in percent)			
Under 2017 tax formulae				
Standard	**17.5**	**11.5**	**29.0**	**58.1**
Yaregskoye field	0.0	1.8	1.8	3.6
Yu. Korchagin field	7.3	0.0	7.3	14.5
V. Filanovsky field	7.5	0.0	7.5	15.0
Usinskoye (Permian layers)	7.3	11.5	18.8	37.5
Pyakakhinskoye field	7.3	11.5	18.8	37.5
V. Vinogradov field	9.3	11.5	20.8	41.6
Highly depleted fields	10.4-17.5	11.5	21.9-29.0	43.7-58.1
Small sized fields	11.1-17.5	11.5	22.6-29.0	45.2-58.1
Tyumen deposits	15.5	11.5	27.0	54.0

The rates of taxes specific to the oil industry in Russia are linked to international crude oil prices and are changed in line with them. The methods to determine the rates for such taxes are presented below.

Crude oil extraction tax rate is changed monthly. Crude oil extraction tax is payable in rubles for metric tonnes extracted and is calculated according to the formula below:

$$Rate = Base\ Rate \times (Price - 15) \times \frac{Exchange\ Rate}{261} - Incentive + Fixed\ Component,$$

where *Price* is a Urals blend price in US dollars per barrel and *Exchange Rate* is an average ruble exchange rate to US dollar during the period. The *Base Rates* and *Fixed Components* (where applicable) are presented below:

	2016	2017	2018	2019	2020
			(in rubles)		
Base Rate	857	919	919	919	919
Fixed Component	–	306	357	428	0

There are different types of tax *Incentives* on the mineral extraction tax on crude oil applied to our fields and deposits:

- A special reducing coefficient is applied to the standard tax rate depending on location, depletion, type of reserves, size and complexity of a particular field. This type of incentive with different coefficients is applied to our highly depleted fields (more than 80% depletion), our Yu. Korchagin field located in the Caspian offshore, the Permian layers of our Usinskoye field in Timan-Pechora producing high-viscous crude oil, our Pyakyakhinskoye field located in the Yamal-Nenets region of Western Siberia, a number of fields in the Nenets Autonomous region, as well as to our new small-sized fields (recoverable reserves less than 5 million tonnes) and fields and deposits with low permeability like V.N. Vinogradov field and Tyumen deposits;

- A fixed tax rate of 15% of the international Urals price is applied to our V. Filanovsky field, located in the Caspian offshore;
- A zero tax rate is applied to our Yaregskoye field producing extra-viscous crude oil, as well as to unconventional deposits (Bazhenov and others).

Some of the mineral extraction tax incentives are limited in time or by cumulative oil production volumes.

The table on the p. 8 illustrates the impact of crude oil extraction tax incentives on the tax rate at $50 per barrel Urals price.

The tax rate is zero when the average international Urals price is less than, or equal to, $15.00 per barrel. In the first quarter of 2017, each $1.00 per barrel increase in the international Urals price above $15.00 per barrel results in an increase in the tax rate by $0.48 per barrel ($0.45 per barrel in the first quarter of 2016).

Natural gas extraction tax rate is calculated using a special formula depending on average wholesale natural gas price in Russia, share of gas production in total hydrocarbon production, regional location and complexity of particular gas field. Associated petroleum gas and reinjected natural gas are subject to zero extraction tax rate.

Crude oil export duty rate is denominated in US dollars per tonne of crude oil exported and is calculated on a progressive scale according to the table below.

International Urals price	Export duty rate
Less than, or equal to, $109.5 per tonne ($15 per barrel)	$0 per tonne
Above $109.5 but less than, or equal to, $146 per tonne ($20 per barrel)	35% of the difference between the actual price and $109.5 per tonne (or $0.35 per barrel per each $1 increase in the Urals price over $15)
Above $146 but less than, or equal to, $182.5 per tonne ($25 per barrel)	$12.78 per tonne plus 45% of the difference between the actual price and $146 per tonne (or $1.75 plus $0.45 per barrel per each $1 increase in the Urals price over $20)
Above $182.5 per tonne ($25 per barrel)	**2015–2016:** $29.2 per tonne plus 42% of the difference between the actual price and $182.5 per tonne (or $4 plus $0.42 per barrel per each $1 increase in the Urals price over $25) **Starting from 1 January 2017:** $29.2 per tonne plus 30% of the difference between the actual price and $182.5 per tonne (or $4 plus $0.3 per barrel per each $1 increase in the Urals price over $25)

The export duty rate changes every month with the rate for the next month being based on average Urals price for the period from the 15th day of the previous month to the 14th day of the current month. This calculation methodology results in the so-called "export duty lag effect", when export duty rate lags the oil price changes, which may result in sizeable impact on our financial results in the periods of high oil price volatility.

The table below illustrates the impact of the "export duty lag effect" on the Urals price net of taxes.

	3 months of		Change, %
	2017	2016	
	(in US dollars per barrel, except for figures in percent)		
Enacted export duty on crude oil	11.84	7.53	57.2
Lag effect	0.24	(0.69)	(135.0)
Urals price (Argus)	51.94	31.78	63.4
Net Urals price(1)	21.57	16.70	29.2
Net Urals price(1) assuming no lag	21.33	17.38	22.7

(1) Urals price net of export duty and crude oil extraction tax.

Crude oil produced at some of our fields is subject to special export duty rates calculated according to special formulas, which are lower than standard rates. A reduced rate is applied to crude oil produced at our Yaregskoye field producing extra-viscous crude oil and our Yu. Korchagin field in the Caspian offshore. A zero rate applies to crude oil of our V. Filanovsky field also located in the Caspian offshore.

The table on the p. 8 illustrates the impact of crude oil export duty incentives on the duty rate at $50 per barrel Urals price.

Export duty rates on refined products are calculated by multiplying the current crude oil export duty rate by a coefficient according to the table below.

	2017 and further	2016
Multiplier for:		
Light and middle distillates	0.30	0.40
Diesel fuel	0.30	0.40
Gasolines	0.30	0.61
Straight-run gasoline	0.55	0.71
Fuel oil	1.00	0.82

Crude oil and refined products exports from Russia are subject to two steps of customs declaration and duty payments: temporary and complete. A temporary declaration is submitted based on preliminary exports volumes and the duty is paid in rubles translated from US dollars at the date of the temporary declaration. A complete declaration is submitted after receiving the actual data on the exported volumes, but no later than six months after the date of the temporary declaration. The final amount of the export duty is adjusted depending on the actual volumes, the US dollar exchange rate at the date of the complete declaration (except for pipeline deliveries when the exchange rate at the temporary declaration date is used) and the export duty rate. If temporary and complete declarations are submitted in different reporting periods, the final amount of the export duty is adjusted in the period of submission of the complete declaration. The high volatility of the ruble-dollar exchange rates may lead to significant adjustments. For the purposes of the IFRS consolidated financial statements, data from temporary declarations at the reporting period end is translated to rubles from US dollars using the period-end exchange rate.

Crude oil and refined products exported to member countries of the Customs Union in the Eurasian Economic Union of Russia, Belarus, Kazakhstan, Armenia and the Kyrgyz Republic (Customs Union) are not subject to export duties.

Excise on refined products. The responsibility to pay excises on refined products in Russia is imposed on refined product producers (except for straight-run gasoline). Only domestic sales volumes are subject to excises.

In other countries where the Group operates, excises are paid either by producers or retailers depending on the local legislation.

Excise rates on refined products in Russia are tied to the ecological class of fuel. Excise tax rates for the first quarter of 2017 and 2016 are listed below.

	3 months of 2017	3 months of 2016	Change, %
	(in rubles per tonne, except for figures in percent)		
Gasoline			
Below Euro-5	13,100	10,500	24.8
Euro-5	10,130	7,530	34.5
Diesel fuel			
All ecological classes	6,800	4,150	63.9
Motor oils	5,400	6,000	(10.0)
Straight-run gasoline	13,100	10,500	24.8

Excise tax rates starting from 2017 are listed below.

	2019 and further	2018	2017
	(in rubles per tonne)		
Gasoline			
Below Euro-5	13,100	13,100	13,100
Euro-5	10,957	10,535	10,130
Diesel fuel			
All ecological classes	7,355	7,072	6,800
Motor oils	5,400	5,400	5,400
Straight-run gasoline	13,100	13,100	13,100

Income tax. Until 2017, the federal income tax rate was 2.0% and the regional income tax rate varied between 13.5% and 18.0%. In 2017–2020, the federal income tax rate is 3.0% and the regional income tax rate may vary between 12.5% and 17.0%.

The Company and its Russian subsidiaries file income tax returns in Russia. A number of Group companies in Russia are paying income tax as a consolidated taxpayers' group ("CTG"). This allows taxpayers to offset taxable losses generated by certain participants of a CTG against taxable profits of other participants of the CTG.

The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

Transportation tariffs on crude oil, natural gas and refined products in Russia

Many of our production assets are located relatively far from our customers. As a result, transportation tariffs are an important factor affecting our profitability.

Crude oil produced at our fields in Russia is transported to refineries and exported primarily through the trunk oil pipeline system of the state-owned company, Transneft. In some cases, crude oil is also transportated via railway infrastructure of the state-owned company, Russian Railways.

Refined products produced at our Russian refineries are transported primarily by railway (Russian Railways) and the pipeline system of Transnefteproduct, a subsidiary of Transneft.

Gas that is not sold at the wellhead is transported by the Unified Gas Supply System owned and operated by Gazprom.

Transneft, Russian Railways and Gazprom are state-controlled natural transportation infrastructure monopolies and their tariffs are regulated by the Federal Antimonopoly Service of Russia and set in rubles.

The following table sets forth the changes in the average tariffs charged by the state-controlled transportation service providers in Russia.

	1st quarter of 2017 to 4th quarter of 2016	**1st quarter of 2017 to 1th quarter of 2016**
Transneft		
Crude oil	3.3%	3.3%
Transnefteproduct		
Refined products	0.0%	7.8%
Russian Railways		
Crude oil and refined products	6.0%	6.0%

Segments highlights

Our operations are divided into three main business segments:

- **Exploration and Production** – which includes our exploration, development and production operations related to crude oil and gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, Uzbekistan, the Middle East, Northern and Western Africa, Norway, Romania and Mexico.
- **Refining, Marketing and Distribution** – which includes refining, petrochemical and transport operations, marketing and trading of crude oil, natural gas and refined products, generation, transportation and sales of electricity, heat and related services.
- **Corporate and other** – which includes operations related to our headquarters (which coordinates the operations of Group companies), finance activities, production of diamonds and certain other activities.

Each of our segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the "Domestic crude oil and refined products prices" section on p. 6, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of crude oil refining and other factors. We present the financial data for each segment in Note 29 "Segment information" to our condensed interim consolidated financial statements.

Exploration and production

	3 months of	
	2017	**2016**
	(millions of rubles)	
EBITDA in Russia	112,059	97,688
EBITDA outside Russia[(1)]	15,718	31,898
EBITDA	**127,777**	**129,586**
Hydrocarbon extraction expenses	49,867	54,077
- in Russia	42,952	39,711
- outside Russia[(2)]	2,593	4,163
- in Iraq	4,322	10,203
	(ruble per BOE)	
Hydrocarbon extraction expenses[(2)]	237	225
- in Russia	243	222
- outside Russia[(2)]	167	255
	(US dollar per BOE)	
Hydrocarbon extraction expenses[(2)]	4.02	3.01
- in Russia	4.13	2.98
- outside Russia[(2)]	2.84	3.42

[(1)] Including EBITDA of the West Qurna-2 project in the amounts of 2,943 million RUB and 21,494 million RUB in the first quarter of 2017 and 2016, respectively.
[(2)] Excluding expenses at the West Qurna-2 field.

Our upstream EBITDA was relatively flat to the first quarter of 2016. Our EBITDA in Russia was supported by the increase in crude oil prices, a shift in production structure towards high-margin projects, and a positive impact of tax maneuver. On the other hand, our upstream earnings were affected by a decrease in production volumes. Outside Russia, the decrease in EBITDA of the West Qurna-2 project and the effect of ruble appreciation outweighed the positive impact of crude oil price increase.

Crude oil and natural gas liquids production. In the first quarter of 2017, we produced (including the Company's share in equity affiliates) 21,802 thousand tonnes or 161.0 million barrels of crude oil, compared to 24,495 thousand tonnes or 179.2 million barrels of crude oil in the first quarter of 2016.

In the first quarter of 2017, the output of natural gas liquids at the Group gas processing plants in Western Siberia, Ural and Volga regions of Russia was 3.0 million BOE, compared to 3.4 million BOE in the first quarter of 2016.

	3 months of	
	2017	**2016**
	(thousand BOE per day)	
Crude oil and natural gas liquids[1]		
Consolidated subsidiaries		
Western Siberia	821	865
Timan-Pechora	321	346
Ural region	324	323
Volga region	183	133
Other in Russia	34	36
Total in Russia	1,683	1,703
Iraq[2]	31	196
Other outside Russia	47	48
Total outside Russia	78	244
Total consolidated subsidiaries	**1,761**	**1,947**
Our share in equity affiliates		
in Russia	22	19
outside Russia	39	40
Total share in equity affiliates	**61**	**59**
Total crude oil and natural gas liquids	**1,822**	**2,006**
Natural and petroleum gas[3]		
Consolidated subsidiaries		
Western Siberia	209	190
Timan-Pechora	36	32
Ural region	17	17
Volga region	19	22
Other in Russia	1	1
Total in Russia	282	262
Total outside Russia	126	131
Total consolidated subsidiaries	**408**	**393**
Share in equity affiliates		
in Russia	2	1
outside Russia	12	13
Total share in production of equity affiliates	**14**	**14**
Total natural and petroleum gas	**422**	**407**
Total daily hydrocarbon production	**2,244**	**2,413**

(1) Natural gas liquids produced at the Group gas processing plants.
(2) Compensation oil that represented approximately 8% of production from the West Qurna-2 field in the first quarter of 2017 and 47% in the first quarter of 2016.
(3) Natural and petroleum gas production less flaring, reinjection, and direction to Group's gas processing plants.

The following table presents our crude oil production in the first quarter of 2017 and 2016 by major regions.

(thousands of tonnes)	3 months of 2017	Change to 2016 Total, %	Change in structure	Organic change	3 months of 2016
Western Siberia	9,810	(6.0)	–	(627)	10,437
Timan-Pechora	4,002	(8.1)	–	(352)	4,354
Ural region	3,755	(0.5)	–	(19)	3,774
Volga region	2,189	34.5	–	561	1,628
Other in Russia	422	(7.7)	–	(35)	457
Crude oil produced in Russia	20,178	(2.3)	–	(472)	20,650
Iraq[1]	405	(84.4)	–	(2,196)	2,601
Other outside Russia	517	(7.8)	–	(44)	561
Crude oil produced outside Russia	922	(70.8)	–	(2,240)	3,162
Total crude oil produced by consolidated subsidiaries	**21,100**	**(11.4)**	**–**	**(2,712)**	**23,812**
Our share in crude oil produced by equity affiliates:					
in Russia	264	16.8	–	38	226
outside Russia	438	(4.2)	–	(19)	457
Total crude oil produced	**21,802**	**(11.0)**	**–**	**(2,693)**	**24,495**

[1] Compensation oil that represented approximately 8% of production from the West Qurna-2 field in the first quarter of 2017 and 47% in the first quarter of 2016.

The main oil producing region for the Company is Western Siberia where we produced 46.5% of our crude oil in the first quarter of 2017 (43.8% in the first quarter of 2016).

In October 2016, we started commercial production at two new major fields, the V. Filanovsky field in the Caspian Sea (Volga region) and the Pyakyakhinskoye field in the Bolshekhetskaya depression (Western Siberia). These fields have a major positive impact on our financial results due to high quality reserve base and tax incentives. In the first quarter of 2017, the Group produced 888 thousand tonnes of crude oil at the V. Filanovsky field and 348 thousand tonnes of liquids at the Pyakyakhinskoye field.

A decrease in our production volumes in the first quarter of 2017 was mainly a result of an external limitation due to an agreement of OPEC and some of the non-OPEC countries, including Russia, to cut production from October 2016 levels in order to stabilize the global crude oil market. We limited production in our traditional regions (Western Siberia, Timan-Pechora, Ural), while we continued ramping up production at the V. Filanovsky and Pyakyakhinskoye fields. Moreover, crude oil production in Timan-Pechora was affected by weather conditions.

The decrease in our international production was a result of lower volumes of production from the West Qurna-2 oilfield in Iraq attributable to the Company. We were compensated for most of the costs incurred within the construction stage of the project and therefore were eligible for less volumes of compensation crude oil (for details see p. 15).

The increase in our share in crude oil produced by equity affiliates in Russia was due to an increase in production at the Trebs and Titov oilfields by Bashneft-Polus, where the Group holds a 25.1% interest.

Gas production. In the first quarter of 2017, we produced (including our share in equity affiliates) 6,459 million cubic meters (38.0 million BOE) of gas, that is 2.8% more than in the first quarter of 2016.

The following table presents our gas production (excluding flaring, reinjected gas and gas used in production of natural gas liquids) by major regions.

(millions of cubic meters)	3 months of 2017	Change to 2016 Total, %	Change in structure	Organic change	3 months of 2016
Western Siberia	3,193	9.0	–	263	2,930
Timan-Pechora	551	12.4	–	61	490
Ural region	258	(2.9)	–	(8)	266
Volga region	297	(12.7)	–	(43)	340
Other in Russia	8	(9.9)	–	(1)	9
Gas produced in Russia	**4,307**	**6.7**	–	**272**	**4,035**
Gas produced outside Russia	1,924	(5.3)	–	(108)	2,032
Total gas produced by consolidated subsidiaries	**6,231**	**2.7**	–	**164**	**6,067**
Our share in gas produced by equity affiliates:					
in Russia	23	79.8	–	10	13
outside Russia	205	1.9	–	4	201
Total gas produced	**6,459**	**2.8**	**–**	**178**	**6,281**

Our major gas production field is the Nakhodkinskoe field in Western Siberia, which is in natural decline. In January 2017, we started natural gas production at the Pyakyakhinskoye field in Western Siberia, which substantially contributed to our overall gas production in Russia. In the first quarter of 2017, our gas production at the Nakhodkinskoe and the Pyakyakhinskoye fields was 2,109 million cubic meters of natural gas (1,850 million cubic meters in the first quarter of 2016). Our international gas production (including our share in affiliates' production) decreased by 4.7%, compared to the first quarter of 2016.

West Qurna-2 project

The West Qurna-2 field in Iraq is one of the largest crude oil fields discovered in the world, with estimated recoverable oil reserves of 12.9 billion barrels (1.8 billion tonnes). Service agreement for the West Qurna-2 field development and production was signed on 31 January 2010. Currently, the parties of the project are Iraq's state-owned South Oil Company and a consortium of contractors, consisting of a Group company (75% interest) and Iraq's state-owned North Oil Company (25% interest).

The Group launched the "Mishrif Early Oil" stage on the West Qurna-2 field and reached the production of 120 thousand barrels per day in March 2014. According to the service agreement, starting from the second quarter of 2014, we receive cost compensation. The project's target production level is 1.2 million barrels per day and the total term of the contract is 25 years.

Accounting for the cost compensation within the West Qurna-2 project in our consolidated statement of financial position and consolidated statement of profit or loss and other comprehensive income is as follows.

Capital expenditures are recognized in *Property, plant and equipment*. Extraction expenses are recognized in *Operating expenses* in respect of all the volume of crude oil production at the field regardless of the volume of compensation crude oil the Group is eligible for. As the compensation revenue is recognized, capitalized costs are amortized.

There are two steps of revenue recognition:

- The Iraqi party, on a quarterly basis, approves invoice for cost recovery and remuneration fee for which the Group is eligible in the reporting period. Amount of the invoice depends on crude oil production volumes during the period and current crude oil market prices. Approved invoice amount and the remuneration fee for the reporting quarter are recognized in crude oil sales revenue.
- Based on the approved invoices, the Iraqi party arranges schedule of crude oil shipments against its liability for cost compensation and remuneration. As this crude oil is actually shipped, its cost is recognized at current market price in Cost of purchased crude oil, gas and products. Further, revenue from sales of this crude oil, or products from its refining, is recognized in *Sales*. Unsold crude oil and refined products are recognized in *Inventories*.

The following table summarizes data on capital and operating cost incurred, compensation crude oil received, costs yet unrecovered and remuneration fee.

	Costs incurred [1]	Remuneration fee	Crude oil received	Crude oil to be received
		(millions of US dollars)		
Cumulative at 31 December 2016	7,532	272	7,275	529
Change during the first quarter of 2017	109	19	142	(14)
Cumulative at 31 March 2017	**7,641**	**291**	**7,417**	**515**

[1] Including prepayments.

The amount of remuneration within the West Qurna-2 project decreased approximately threefold since February 2017 following the provisions of the service contract due to lower than target production volumes.

The West Qurna-2 project's summary is presented below:

	3 months of 2017		3 months of 2016	
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production[1]	35,960	5,242	38,018	5,542
Production related to cost compensation and remuneration[1]	2,775	405	17,840	2,601
Shipment of compensation crude oil[1] [2]	2,984	435	17,527	2,555
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)
Cost compensation[3]	6,488	110	29,479	395
Remuneration fee	1,146	19	2,439	33
	7,634	129	31,918	428
Cost of compensation crude oil, received as liability settlement (included in *Cost of purchased crude oil, gas and products*)[2]	8,332	142	29,476	395
Extraction expenses	4,322	73	10,203	137
Depreciation, depletion and amortization	2,246	38	19,377	257
EBITDA	2,943	50	21,494	288
Capital expenditures	2,034	36	9,083	127

[1] Translated into barrels using conversion rate characterizing the density of the field.
[2] This crude oil is sold to third party customers or delivered to our refineries. After realization of these products, respective sales revenues are recognized.
[3] Excluding deferred income in the amount of $17 million in the first quarter of 2017.

Refining, marketing and distribution

The following table summarized key figures on our Refining, marketing and distribution segment:

	3 months of 2017	3 months of 2016
	(millions of rubles)	
EBITDA in Russia	37,847	43,893
EBITDA outside Russia	32,680	19,617
EBITDA	**70,527**	**63,510**
Refining expenses at the Group refineries	21,011	22,450
- in Russia	10,149	10,135
- outside Russia	10,862	12,315
	(ruble per tonne)	
Refining expenses at the Group refineries	1,297	1,420
- in Russia	966	1,009
- outside Russia	1,909	2,137
	(US dollar per tonne)	
Refining expenses at the Group refineries	22.05	19.03
- in Russia	16.42	13.52
- outside Russia	32.44	28.63

Our domestic refineries' earnings in the first quarter of 2017 were negatively impacted by the changes in export duties and excise rates within the tax maneuver that was partially offset by increased production volumes, better product slate as a result of completed modernization program and continued throughput optimization. At the same time, our retail earnings in Russia were affected by an increase in excise rates. Outside Russia, refineries' earnings were positively impacted by the increase in refining margins and better product slate.

Refining and petrochemicals

The following table summarizes key figures for our refining volumes:

	3 months of	
	2017	**2016**
	(thousands of tonnes)	
Refinery throughput at the Group refineries	16,196	15,812
- in Russia	10,506	10,048
- outside Russia, including	5,690	5,764
- crude oil	5,119	4,428
- refined products	571	1,336
Refinery throughput at third party refineries	1,396	92
Total refinery throughput	**17,592**	**15,904**
Production of the Group refineries in Russia	**9,911**	**9,453**
- diesel fuel	3,678	3,247
- gasoline	1,832	1,806
- fuel oil	1,499	1,556
- jet fuel	567	441
- lubricants and components	268	239
- straight-run gasoline	572	503
- vacuum gas oil	796	1,037
- bitumen	142	136
- coke	243	203
- other products	314	285
Production of the Group refineries outside Russia	**5,327**	**5,414**
- diesel fuel	2,312	2,294
- gasoline	1,207	1,167
- fuel oil	748	861
- jet fuel	239	184
- straight-run gasoline	193	158
- vacuum gas oil	21	122
- coke	38	−
- other products	569	628
Refined products produced by the Group	**15,238**	**14,867**
Refined products produced at third party refineries	1,378	88
Total refined products produced	**16,616**	**14,955**
Products produced at petrochemical plants and facilities	**335**	**324**
- in Russia	240	233
- outside Russia	95	91

Compared to the first quarter of 2016, the total volume of refined products produced by the Group increased by 2.5%.

In Russia, our production volumes increased by 4.8% due to higher utilization rates at Perm and Volgograd refineries. We redirected dark products produced at Perm and Ukhta refineries from export deliveries to supply catalytic cracking unit at our refinery in Nizhny Novgorod and also partially substituted purchased additives with additives of own production that resulted in optimization of operating expenses.

Internationally, the production decreased by 1.6% due to maintenance works at our refineries in Bulgaria and Romania.

In the periods considered, we processed our crude oil at third party refineries in Belarus and Kazakhstan. Moreover, in the end of 2016, a Group company entered into a processing agreement with a Canadian refinery. In the first quarter of 2017, attributable refined products output amounted to 1,336 thousand tonnes. The agreement is valid through 2019.

Marketing and trading

In addition to our production, we purchase crude oil in Russia and on international markets. In Russia, we primarily purchase crude oil from affiliated producing companies and other producers. Then we either refine or export purchased crude oil. Crude oil purchased on international markets is normally used for trading activities, for supplying our international refineries or for processing at third party refineries.

In Russia, we purchase refined products on occasion, primarily to manage supply chain bottlenecks. Refined products purchases outside Russia are either traded or supplied to our international refineries.

We undertake trading operations on international markets through our 100% subsidiary LITASCO. We use traditional physical volumes hedging techniques to hedge our trading operations to secure trading margin.

The following table shows the volumes of crude oil purchases by the Group during the periods considered.

	3 months of	
	2017	**2016**
	(thousands of tonnes)	
Crude oil purchases		
in Russia	247	208
for trading internationally	7,637	6,295
for refining internationally	5,613	3,342
Shipment of the West Qurna-2 compensation crude oil	435	2,555
Total crude oil purchased	**13,932**	**12,400**

The table below summarizes figures for our refined products marketing and trading activities.

	3 months of	
	2017	**2016**
	(thousands of tonnes)	
Retail sales	3,316	3,239
Wholesale sales	28,634	26,237
Total refined products sales	**31,950**	**29,476**
Refined products purchased in Russia	436	384
Refined products purchased internationally	16,115	15,387
Total refined products purchased	**16,551**	**15,771**

In 2016, in line with the strategy to optimize our downstream operations, a Group company sold distribution companies operating in Poland, Lithuania, Latvia and Cyprus.

Exports of crude oil and refined products from Russia. The volumes of crude oil and refined products exported from Russia by our subsidiaries and export revenues (both to the Group companies and third parties) are summarized as follows:

	3 months of	
	2017	**2016**
	(thousands of tonnes)	
Exports of crude oil to Customs Union	635	982
Exports of crude oil beyond Customs Union	8,770	7,873
Total crude oil exports	**9,405**	**8,855**
Exports of crude oil through Transneft and other third party infrastructure	7,100	6,942
including volumes exported through ESPO pipeline	240	300
Exports or crude oil through the Group's transportation infrastructure	2,305	1,913
Total crude oil exports	**9,405**	**8,855**
	(millions of rubles)	
Exports of crude oil to Customs Union	10,673	12,410
Exports of crude oil beyond Customs Union	185,458	122,610
Total crude oil exports	**196,131**	**135,020**

	3 months of	
	2017	2016
	(thousands of tonnes)	
Refined products exports		
- diesel fuel	2,519	2,200
- gasoline	40	185
- fuel oil	1,018	947
- jet fuel	28	74
- motor oils	151	158
- gas refinery products	218	150
- other products	966	1,367
Total refined products exports	**4,940**	**5,081**
	(millions of rubles)	
Total refined products exports	**117,659**	**89,849**

In the first quarter of 2017, the volume of our crude oil exports from Russia increased by 6.2%, and we exported 46.6% of our domestic crude oil production (42.9% in the first quarter of 2016) and 116 thousand tonnes of crude oil purchased from our affiliates and third parties (105 thousand tonnes in the first quarter of 2016). The increase in export volumes was a result of lower domestic sales. The volume of our refined products exports decreased by 4.2% compared to the first quarter of 2016.

Substantially, we use the Transneft infrastructure to export our crude oil. Nevertheless, a sizeable amount of crude oil is exported through our own infrastructure. All the volume of crude oil exported that bypassed Transneft was routed beyond the Customs Union.

The Company also exports its light crude oil through the Caspian Pipeline Consortium and Eastern Siberia – Pacific Ocean pipelines that allows us to preserve the premium quality of crude oil and thus enables us to achieve higher netbacks compared to traditional exports.

Priority sales channels. We develop our priority sales channels aiming at increasing our margin on sale of refined products produced by the Group.

In the first quarter of 2017, we sold 2.4 million tonnes of motor fuels via our domestic retail network, that represented an increase of 9.9% against the first quarter of 2016. Outside Russia, retail sales decreased to 1.0 million tonnes, or by 12.2%, mostly as a result of divestment of our retail networks in Poland, the Baltic states and Cyprus.

We also supply jet fuel to airports in and outside Russia and bunker fuel to sea and river ports in Russia.

Power generation. We established a vertically integrated chain from generation to transportation and sale of power and heat for third party customers (commercial generation) and own consumption. We own commercial generation facilities in the Southern regions of European Russia. We also own renewable energy capacity in Russia and abroad. In the first quarter of 2017, our total output of commercial electrical energy was 5.3 billion kW-h (5.4 billion kW-h in the first quarter of 2016), and our total output of commercial heat energy was approximately 4.9 million Gcal (5.4 million Gcal in the first quarter of 2016).

Financial results

The table below sets forth data from our consolidated statements of profit or loss and other comprehensive income for the periods indicated.

	3 months of	
	2017	**2016**
	(millions of rubles)	
Revenues		
Sales (including excise and export tariffs)	1,431,599	1,177,674
Costs and other deductions		
Operating expenses	(107,492)	(113,244)
Cost of purchased crude oil, gas and products	(742,569)	(537,733)
Transportation expenses	(73,714)	(86,699)
Selling, general and administrative expenses	(36,286)	(47,823)
Depreciation, depletion and amortization	(80,774)	(84,348)
Taxes other than income taxes	(153,682)	(83,553)
Excise and export tariffs	(109,447)	(114,949)
Exploration expenses	(764)	(1,681)
Profit from operating activities	**126,871**	**107,644**
Finance income	3,299	3,831
Finance costs	(9,470)	(10,371)
Equity share in income of affiliates	3,730	2,353
Foreign exchange loss	(43,494)	(45,378)
Other expenses	(2,487)	(3,343)
Profit before income taxes	**78,449**	**54,736**
Current income taxes	(12,756)	(10,476)
Deferred income taxes	(3,009)	(1,290)
Total income tax expense	**(15,765)**	**(11,766)**
Profit for the period	**62,684**	**42,970**
Profit for the period attributable to non-controlling interests	(378)	(145)
Profit for the period attributable to PJSC LUKOIL shareholders	**62,306**	**42,825**
Basic and diluted earnings per share of common stock attributable to PJSC LUKOIL shareholders (in Russian rubles)	87.39	60.07

The analysis of the main financial indicators of the financial statements is provided below.

Sales revenues

Sales breakdown	3 months of	
	2017	**2016**
	(millions of rubles)	
Crude oil		
Export and sales on international markets other than Customs Union	382,203	248,228
Export and sales to Customs Union	6,583	12,402
Domestic sales	8,902	21,340
	397,688	**281,970**
Cost compensation and remuneration at the West Qurna-2 project	7,634	31,918
	405,322	**313,888**
Refined products[(1)]		
Export and sales on international markets		
Wholesale	714,341	556,584
Retail	62,707	81,452
Domestic sales		
Wholesale	67,904	50,565
Retail	94,466	81,697
	939,418	**770,298**
Petrochemicals		
Export and sales on international markets	12,126	10,158
Domestic sales	9,746	9,179
	21,872	**19,337**
Gas		
Sales on international markets	9,598	11,259
Domestic sales	7,033	7,152
	16,631	**18,411**
Sales of energy and related services		
Sales on international markets	3,387	3,728
Domestic sales	20,062	19,036
	23,449	**22,764**
Other		
Sales on international markets	14,630	22,757
Domestic sales	10,277	10,219
	24,907	**32,976**
Total sales	**1,431,599**	**1,177,674**

Sales volumes	3 months of	
	2017	**2016**
	(thousands of tonnes)	
Crude oil		
Export and sales on international markets other than Customs Union	17,007	15,020
Export and sales to Customs Union	392	973
Domestic sales	558	1,882
	17,957	**17,875**
Crude oil volumes related to cost compensation and remuneration at the West Qurna-2 project	405	2,601
	18,362	**20,476**
Refined products[(1)]		
Export and sales on international markets		
Wholesale	25,767	23,487
Retail	957	1,093
Domestic sales		
Wholesale	2,867	2,750
Retail	2,359	2,146
	31,950	**29,476**
Petrochemicals		
Export and sales on international markets	232	247
Domestic sales	189	166
	421	**413**

[(1)] Including revenue from, and volumes of, gas refined products sales.

Realized average sales prices

		3 months of	
		2017	**2016**
Average realized price on international markets			
Crude oil (beyond Customs Union) (1)	(RUB/barrel)	3,066	2,255
Crude oil (Customs Union)	(RUB/barrel)	2,291	1,739
Refined products			
Wholesale	(RUB/tonne)	27,723	23,697
Retail	(RUB/tonne)	65,524	74,555
Petrochemicals	(RUB/tonne)	52,267	41,126
Crude oil (beyond Customs Union)(1)	($/barrel)	52.11	30.21
Crude oil (Customs Union)	($/barrel)	38.95	23.30
Refined products			
Wholesale	($/tonne)	471.19	317.54
Retail	($/tonne)	1.133.66	999.03
Petrochemicals	($/tonne)	888.35	551.07
Average realized price within Russia			
Crude oil	(RUB/barrel)	2,176	1,547
Refined products			
Wholesale	(RUB/tonne)	23,684	18,389
Retail	(RUB/tonne)	40,045	38,062
Petrochemicals	(RUB/tonne)	51,566	55,295

(1) Excluding cost compensation and remuneration at the West Qurna-2 project.

In the first quarter of 2017, our revenues increased by 254 billion RUB, or by 21.6%, compared to the first quarter of 2016. Our revenues from crude oil sales increased by 91 billion RUB, or by 29.1%, and our revenues from sales of refined products increased by 169 billion RUB, or by 22.0%. The main reason for that was the increase in international hydrocarbon prices as well as the increase in crude oil and refined products trading volumes. That was partially compensated for by the effect of the ruble appreciation on our revenues denominated in other currencies.

Sales of crude oil

Our international crude oil sales revenue increased by 54.0%, or by 134 billion RUB, compared to the first quarter of 2017. Our international sales volumes (beyond the Customs Union) increased by 1,987 thousand tonnes, or by 13.2%, in the first quarter of 2017 mainly due to higher volumes of crude oil trading. Our average international ruble realized prices increased by 36.0% compared to the first quarter of 2016.

Our realized domestic crude oil sales price increased by 40.7% compared to the first quarter of 2016. Our domestic sales volumes decreased by 1,324 thousand tonnes, or by 70.4%, in favor of export deliveries and refining and also as a result of lower production. As a consequence, in the first quarter of 2017, our domestic sales revenue decreased by 58.3%, or by 12 billion RUB.

Cost compensation and remuneration at the West Qurna-2 project

Included in Group's revenue is the cost compensation and remuneration fee related to the West Qurna-2 project in Iraq.

In the first quarter of 2017, the volumes of crude oil related to cost compensation and remuneration fee significantly decreased to the first quarter of 2016. Therefore the amount of cost compensation and remuneration fee decreased by 24 billion RUB. For details see p. 15.

Sales of refined products

Compared to the first quarter of 2016, our revenue from the wholesale of refined products outside Russia increased by 158 billion RUB, or by 28.3%, that was both price and volume driven. Our sales volumes increased by 9.7%, largely as a result of the increase in volumes of trading. Our dollar and ruble realized prices increased by 48.4% and 17.0%, respectively.

In the first quarter of 2017, our dollar and ruble realized retail prices outside Russia increased by 11.5% and decreased by 12.1%, respectively. Our sales volumes decreased by 12.4% as a consequence of sale of our retail networks in Eastern Europe. As a result, our international retail revenue decreased by 19 billion RUB, or by 23.0%, compared to the first quarter of 2016.

In the first quarter of 2017, our revenue from the wholesale of refined products on the domestic market increased by 17 billion RUB, or by 34.3%. Our realized prices increased by 28.8% and our sales volumes increased by 4.3%.

In the first quarter of 2017, our revenue from refined products retail sales in Russia increased by 13 billion RUB, or by 15.6%. Our average domestic retail prices and volumes both increased by 5.2% and 9.9%, respectively.

Sales of petrochemical products

In the first quarter of 2017, our revenue from sales of petrochemical products increased by 3 billion RUB, or by 13.1%, largely as a result of the increased realized prices outside of Russia.

Sales of gas

Compared to the first quarter of 2016, sales of gas decreased by 2 billion RUB, or by 9.7%, mainly as a result of the decrease in gas production outside Russia.

Sales of energy and related services

In the first quarter of 2017, our revenue from sales of energy and related services didn't change significantly and increased by 3.0%.

Other sales

Other sales include non-petroleum sales through our retail network, transportation services, rental revenue, crude oil extraction services, and other revenue of our production and marketing companies from sales of goods and services not related to our primary activities.

In the first quarter of 2017, revenue from other sales decreased by 8 billion RUB, or by 24.5%, compared to the first quarter of 2016. The non-petrol revenue of our retail network decreased by 1 billion RUB, or by 16.5%. Our revenue from transportation services decreased by 2 billion RUB, or by 37.8%. In the first quarter of 2017 and 2016, our other sales also included revenue from sales of diamonds in the amount of 5 billion RUB and 8 billion RUB, respectively. These decreases related to our operations outside Russia and were mostly due to the ruble appreciation.

Operating expenses

Operating expenses include the following:

	3 months of	
	2017	**2016**
	(millions of rubles)	
Hydrocarbon extraction expenses[1]	45,545	43,874
Extraction expenses at the West Qurna-2 field	4,322	10,203
Own refining expenses	21,011	22,450
Refining expenses at third parties refineries	1,075	248
Expenses for crude oil transportation to refineries	10,814	12,311
Power generation and distribution expenses	10,821	10,271
Petrochemical expenses	2,994	3,313
Other operating expenses	10,910	10,574
Total operating expenses	**107,492**	**113,244**

[1] Excluding extraction expenses at the West Qurna-2 field.

The method of allocation of operating expenses above differs from the approach used in preparing the data for Note 29 "Segment information" to our condensed interim consolidated financial statements. Expenditures in the segment reporting are grouped depending on the segment to which a particular company belongs. Operating expenses for the purposes of this analysis are grouped based on the nature of the costs incurred.

Compared to the first quarter of 2016, our operating expenses decreased by 6 billion RUB, or by 5.1%, largely as a result of the effect of the ruble appreciation to US dollar and Euro on the ruble value of foreign subsidiaries' expenses and the decrease in expenses at the West Qurna-2 oilfield. These effects were partially offset by the increase in expenses in Russia as a result of the increase in tariffs and inflation.

Hydrocarbon extraction expenses

Our extraction expenses include expenditures related to repairs of extraction equipment, labor costs, expenses on artificial stimulation of reservoirs, fuel and electricity costs, cost of extraction of natural gas liquids, property insurance of extraction equipment and other similar costs.

	3 months of	
	2017	**2016**
	(millions of rubles)	
Hydrocarbon extraction expenses[1]	45,545	43,874
- in Russia	42,952	39,711
- outside Russia[1]	2,593	4,163
	(ruble per BOE)	
Hydrocarbon extraction expenses[1]	237	225
- in Russia	243	222
- outside Russia[1]	167	255

[1] Excluding expenses at the West Qurna-2 field.

In the first quarter of 2017, our extraction expenses increased by 2 billion RUB, or by 3.8%.

In Russia, average hydrocarbon extraction expenses increased driven by higher costs of materials and services.

Crude oil extraction expenses at the West Qurna-2 field

Crude oil extraction expenses at the West Qurna-2 field represent expenses related to 100% production from the field, while we are only eligible for a share of production that compensates our historically incurred costs and expenses. For details see p. 15.

The decrease in expenses in the first quarter of 2017 was a result of completion of commissioning stage of the field development and consecutive decrease in personnel involved and associated transportation, security and other related services provided.

Own refining expense

	3 months of	
	2017	**2016**
	(millions of rubles)	
Refining expenses at the Group refineries	21,011	22,450
- in Russia	10,149	10,135
- outside Russia	10,862	12,315
	(ruble per tonne)	
Refining expenses at the Group refineries	1,297	1,420
- in Russia	966	1,009
- outside Russia	1,909	2,137

In the first quarter of 2017, our own refining expenses decreased by 1 billion RUB, or by 6.4%.

Despite the inflation, refining expenses at our domestic refineries were flat year-on-year (while per tonne expenses decreased) as a result of consumption of additives of own production following our refineries' upgrade that compensated cost inflation.

Refining expenses at our refineries outside Russia decreased by 1 billion RUB, or by 11.8%, compared to the first quarter of 2016, largely due to the effect of the ruble appreciation.

Expenses for crude oil transportation to refineries

Expenses for crude oil transportation to refineries include pipeline, railway, freight and other costs related to delivery of crude oil and refined products to refineries for further processing.

Our expenses for crude oil transportation to refineries decreased by 1 billion RUB, or by 12.2%, compared to the first quarter of 2016, largely as a result of the effect of the ruble appreciation and lower volumes of supplies of own crude to our refineries outside Russia.

Petrochemical expenses

In the first quarter of 2017, operating expenses of our petrochemical plants and facilities decreased by 0.3 billion RUB, or by 9.6%, largely as a result of a decrease in raw materials cost in Russia and the effect of the ruble appreciation.

Other operating expenses

Other operating expenses include expenses of the Group's upstream and downstream entities that do not relate to their core activities, namely rendering of transportation and extraction services, costs of other services provided and goods sold by our production and marketing companies, and of non-core businesses of the Group.

In the first quarter of 2017, other operating expenses didn't change significantly.

Cost of purchased crude oil, gas and products

Cost of purchased crude oil, gas and products includes the cost of crude oil and refined products purchased for trading or refining, gas and fuel oil to supply our power generation entities and the result of hedging of crude oil and refined products sales.

	3 months of	
	2017	**2016**
	(millions of rubles)	
Cost of purchased crude oil in Russia	4,207	2,373
Cost of purchased crude oil outside Russia	289,188	161,418
Compensation crude oil related to West Qurna-2 project	8,332	29,476
Cost of purchased crude oil	**301,727**	**193,267**
Cost of purchased refined products in Russia	12,577	9,750
Cost of purchased refined products outside Russia	441,846	346,546
Cost of purchased refined products	**454,423**	**356,296**
Other purchases	12,049	9,301
Net gain from hedging of trading operations	(24,140)	(1,228)
Change in oil and petroleum products inventory	(1,490)	(19,903)
Total cost of purchased crude oil, gas and products	**742,569**	**537,733**

In the first quarter of 2017, the cost of purchased crude oil, gas and products increased by 205 billion RUB, or by 38.1%, following the increase in hydrocarbon prices and volumes of trading. Crude oil purchases also included 8 billion RUB related to 435 thousand tonnes of compensation crude oil received from Iraq's state-owned South Oil Company within the West Qurna-2 project (29 billion RUB related to 2,555 thousand tonnes of compensation crude oil in the first quarter of 2016).

Transportation expenses

	3 months of	
	2017	**2016**
	(millions of rubles)	
Crude oil transportation expenses	24,866	24,547
Refined products transportation expenses	43,783	58,457
Other transportation expenses	5,065	3,695
Total transportation expenses	**73,714**	**86,699**

In the first quarter of 2017, our transportation expenses decreased by 13 billion RUB, or 15.0%, compared to the first quarter of 2016.

Our expenses for transportation of crude oil in Russia were flat to the first quarter of 2016 as the increase in tariffs was compensated for by the decrease in volumes transported. Outside Russia, the decrease in crude oil transportation expenses as a result of the ruble appreciation outweighed the effect of the increase in trading volumes.

Our domestic expenses for transportation of refined products increased largely as a result of the increase in tariffs. Outside Russia, the decrease compared to the first quarter of 2016 was mainly a result of a decrease in tariffs amplified by the effect of the ruble appreciation.

Selling, general and administrative expenses

Selling, general and administrative expenses include payroll costs (excluding extraction entities', refineries' and power generation entities' production staff costs), insurance costs (except for property insurance related to extraction and refinery equipment), costs of maintenance of social infrastructure, movement in bad debt provision and other expenses. Our selling, general and administrative expenses are roughly equally split between domestic and international operations.

	3 months of	
	2017	**2016**
	(millions of rubles)	
Labor costs included in selling, general and administrative expenses	15,831	18,473
Other selling, general and administrative expenses	21,880	24,873
(Decrease) increase in liability related to share-based remuneration program	(4,250)	2,761
Expenses on provision for doubtful debts	2,825	1,716
Total selling, general and administrative expenses	**36,286**	**47,823**

Our selling, general and administrative expenses decreased by 12 billion RUB, or by 24.1%. In Russia, expenses decreased mostly as a result of decrease of liabilities within share-based compensation program due to LUKOIL share price decline during the first quarter of 2017. Internationally, our expenses outside Russia decreased largely as a result of the effect of the ruble appreciation on the expenses of our foreign subsidiaries and the divestment of retail networks in Poland, Lithuania, Latvia and Cyprus.

Depreciation, depletion and amortization

Our depreciation, depletion and amortization expenses decreased by 4 billion RUB, or by 4.2%. The effect of the increase in the depreciation rate of upstream assets following the decrease in hydrocarbon proved reserves was offset by the decrease of expenses related to the West Qurna-2 project. Our depreciation, depletion and amortization expenses for the first quarter of 2017 and 2016 included 2 billion RUB and 19 billion RUB, respectively, related to the West Qurna-2 field. Depreciation, depletion and amortization expenses of our downstream assets increased following the increase in value of depreciable assets.

Equity share in income of affiliates

The Group has investments in equity method affiliates and corporate joint ventures. These companies are primarily engaged in crude oil exploration, production, marketing and distribution operations in the Russian Federation, crude oil production and marketing in Kazakhstan. Currently, our largest affiliates are Tengizchevroil, exploration and production company, operating in Kazakhstan, Bashneft-Polus, an exploration and production company that develops the Trebs and Titov oilfelds in Timan-Pechora, Russia, South Caucasus Pipeline Company and Caspian Pipeline Consortium, midstream companies in Azerbaijan and Kazakhstan.

Our share in income of affiliates increased by 1 billion RUB, or by 58.5%, compared to the first quarter of 2016, mostly as a result of the increase in hydrocarbon prices.

Taxes other than income taxes

	3 months of	
	2017	**2016**
	(millions of rubles)	
In Russia		
Mineral extraction taxes	139,388	69,738
Social security taxes and contributions	6,690	6,027
Property tax	4,789	4,538
Other taxes	807	455
Total in Russia	**151,674**	**80,758**
International		
Social security taxes and contributions	1,251	1,573
Property tax	170	526
Other taxes	587	696
Total internationally	**2,008**	**2,795**
Total	**153,682**	**83,553**

Our taxes other than income taxes increased by 70 billion RUB, or by 83.9%, compared to the first quarter of 2016. This was driven by the increase in the mineral extraction tax rate in Russia resulted from the increase in crude oil prices and mineral extraction tax base rate.

The following table summarizes data on application of reduced and zero mineral extraction tax rates for crude oil and natural gas produced in Russia (excluding V. Filanovsky field).

	3 months of	
	2017	**2016**
	(millions of rubles)	
Decrease in extraction taxes from application of reduced and zero rates for crude oil and gas production	18,891	10,905
	(thousands of tonnes)	
Volume of crude oil production subject to:		
zero rates	210	225
reduced rates (tax holidays for specific regions and high viscosity oil)	1,411	1,223
reduced rates (depleted fields)	3,612	3,655
reduced rates (other)	839	823
Total volume of production subject to reduced or zero rates	**6,072**	5,926

Excise and export tariffs

	3 months of	
	2017	**2016**
	(millions of rubles)	
In Russia		
Excise tax on refined products	25,906	16,591
Crude oil export tariffs	36,784	31,492
Refined products export tariffs	13,197	15,526
Total in Russia	**75,887**	**63,609**
International		
Excise tax and sales taxes on refined products	33,461	51,217
Crude oil export tariffs	18	9
Refined products export tariffs	81	114
Total internationally	**33,560**	**51,340**
Total	**109,447**	**114,949**

In the first quarter of 2017, export tariffs increased by 3 billion RUB, or by 6.2%. Compared to the first quarter of 2016, the volumes of crude oil export beyond the Customs Union increased by 11.4%, but the volumes of the refined products exports decreased by 2.8%. The increase in excise tax expenses in Russia was driven by increase in rates, while international excise expenses decreased due to the ruble appreciation and divestment of retail networks in Eastern Europe.

Foreign exchange loss

Foreign exchange loss mostly related to revaluation of US dollar and euro net monetary position of Russian entities that largely consists of accounts receivables and loans to our foreign subsidiaries.

In the first quarter of 2017, ruble to US dollar exchange rate decreased from 60.66 rubles per dollar to 56.38 rubles per dollar, or by 7.1%, that resulted in a 43 billion RUB foreign exchange loss. In the first quarter of 2016, ruble to US dollar exchange rate decreased from 72.88 rubles per dollar to 67.61 rubles per dollar, or by 7.2%, that resulted in a 45 billion RUB foreign exchange loss.

Income taxes

The maximum statutory income tax rate in Russia is 20%. Nevertheless, the actual effective income tax rate may be higher due to non-deductible expenses or lower due to certain non-taxable gains.

In the first quarter of 2017, our total income tax expense increased by 4 billion RUB, or by 34.0%, compared to the first quarter of 2016 and our profit before income tax increased by 24 billion RUB, or by 43.3%. Our effective income tax rate in the first quarter of 2017 was 20.1%, compared to 21.5% in the first quarter of 2016.

Non-GAAP items reconciliation

Reconciliation of profit for the period to EBITDA

EBITDA is not defined under IFRS. We define EBITDA as profit from operating activities before depreciation, depletion and amortization. We believe that EBITDA provides useful information to investors because it is an indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions and other investments and our ability to raise and service debt. EBITDA should not be considered in isolation as an alternative to profit or any other measure of performance under IFRS.

	3 months of	
	2017	**2016**
	(millions of rubles)	
Profit for the period	**62,684**	**42,970**
Add back		
Income tax expense	15,765	11,766
Financial income and costs	6,171	6,540
Foreign exchange loss	43,494	45,378
Equity share in income of affiliates	(3,730)	(2,353)
Other expenses	2,487	3,343
Depreciation, depletion and amortization	80,774	84,348
EBITDA	**207,645**	**191,992**
EBITDA by operating segments		
Exploration and production[1]	127,777	129,586
Refining, marketing and distribution segment	70,527	63,510
Corporate and other	3,883	2,001
Elimination	5,458	(3,105)
EBITDA	**207,645**	**191,992**

[1] Including EBITDA of the West Qurna-2 project in the amounts of 2,943 million RUB and 21,494 million RUB in the first quarter of 2017 and 2016, respectively.

Liquidity and capital resources

	3 months of 2017	2016
	(millions of rubles)	
Net cash provided by operating activities	131,603	164,396
including changes in working capital	(65,721)	(18,840)
Net cash used in investing activities	(127,948)	(138,393)
Net cash (used in) provided by financing activities	(52,260)	53,420

Operating activities

Our primary source of cash flow is funds generated from our operations. In the first quarter of 2017, cash generated from operations decreased by 33 billion RUB, or by 19.9%, compared to the first quarter of 2016, mainly as a result of the increase in working capital.

Investing activities

In the first quarter of 2017, the amount of cash used in investing activities decreased by 10 billion RUB, or by 7.5%.

In the first quarter of 2017, our capital expenditures increased by 4 billion RUB, or by 3.5%.

	3 months of 2017	2016
	(millions of rubles)	
Capital expenditures		
Exploration and production		
Western Siberia	37,113	32,004
Timan-Pechora	18,785	24,555
Ural region	6,705	5,816
Volga region	11,356	8,564
Other in Russia	2,699	1,970
Total in Russia	76,658	72,909
Iraq	2,491	9,296
Other outside Russia	31,524	22,681
Total outside Russia	34,015	31,977
Total exploration and production	**110,673**	**104,886**
Refining, marketing and distribution		
Russia	6,383	12,787
- refining	4,509	9,941
- retail	316	592
- other	1,558	2,254
International	3,045	4,391
- refining	1,929	2,343
- retail	860	1,950
- other	256	98
Total refining, marketing and distribution	**9,428**	**17,178**
Corporate and other		
Russia	149	250
International	151	247
Total corporate and other	**300**	**497**
Non-cash transactions and effect of timing of payments	9,827	3,246
Total capital expenditures	**130,228**	**125,807**

In the first quarter of 2017, our capital expenditures in the exploration and production segment increased by 5.8 billion RUB, or by 5.5%.

The decrease in capital expenditures in the domestic refining, marketing and distribution segment was due to completion of upgrades at our refineries. The decrease in the international segment was a result of the ruble appreciation.

The table below presents our exploration and production capital expenditures in new promising oil regions.

	3 months of	
	2017	**2016**
	(millions of rubles)	
Western Siberia (Yamal)	4,444	9,257
Caspian region (Projects in Russia)	10,932	6,778
Timan-Pechora (Yaregkoye field)	1,816	5,624
Iraq (West Qurna-2 project)	2,034	9,083
Iraq (Block-10)	457	213
Uzbekistan	23,999	5,956
Total	**43,682**	**36,911**

Financing activities

In the first quarter of 2017, net movements of short-term and long-term debt generated an inflow of 8 billion RUB, compared to an inflow of 106 billion RUB in the first quarter of 2016.

Other information

Sectorial sanctions against the Russian companies

In July-September 2014, the United States ("US"), the European Union ("EU") and other countries imposed a set of economic sanctions on Russia, including certain sectoral sanctions which affect Russian oil and gas companies. Such sectoral sanctions prohibit US and the EU companies and individuals from providing, exporting, or re-exporting directly or indirectly, goods, services (except for financial services), or technology in support of exploration or production for deepwater, Arctic offshore, or shale projects on the territory of the Russian Federation.

The Company is not subject to any financial restrictions and is not currently involved in deepwater, Arctic offshore or shale projects in Russia. That is why we assess the impact of the sanctions on the Company's activities as immaterial.

Operations in Iraq

The Group is exposed to various risks due to its operations in Iraq. Management monitors the risks associated with the projects in Iraq and believes that there is no adverse effect on the Group's financial position that can be reasonably estimated at present.