



PJSC LUKOIL

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

**for the three-month periods ended
30 September and 30 June 2018
and nine-month periods ended
30 September 2018 and 2017**

The following report contains a discussion and analysis of the financial position of PJSC LUKOIL at 30 September 2018 and the results of its operations for the three-month periods ended 30 September and 30 June 2018 and nine-month periods ended 30 September 2018 and 2017, 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 for the respective periods.

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 hydrocarbon exploration, production, refining, marketing and distribution.

LUKOIL is one of the world's largest publicly traded vertically integrated energy companies. Our proved reserves under SEC standards amounted to 16.0 billion BOE at 1 January 2018 and comprised of 12.1 billion barrels of crude oil and 23.6 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 West 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 nine months of 2018 amounted to 2.3 million BOE, with liquid hydrocarbons representing approximately 77% 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 have 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 nine months of 2018 amounted to 1.4 million barrels per day, and we produced 1.0 million tonnes of petrochemicals.

We market our own and third-party crude oil and refined products through our sales 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 nine months of 2018 amounted to 11.2 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 nine months of 2018, our total output of electrical energy was 12.9 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

	Q3 2018	Q2 2018	Change, %	9 months of 2018	2017	Change, %
(millions of rubles, except for figures in percent)						
Sales.....	2,305,886	2,056,058	12.2	5,992,672	4,274,253	40.2
EBITDA ⁽¹⁾ , including	321,810	295,151	9.0	836,485	607,835	37.6
Exploration and production segment.....	268,631	239,699	12.1	680,248	396,456	71.6
Refining, marketing and distribution segment ..	82,189	71,620	14.8	200,658	214,376	(6.4)
EBITDA ⁽¹⁾ net of West Qurna-2 project	312,666	288,854	8.2	815,309	595,250	37.0
Profit for the period attributable to LUKOIL shareholders	183,767	167,322	9.8	460,147	298,295	54.3
Capital expenditures	111,426	105,777	5.3	338,260	373,770	(9.5)
Free cash flow ⁽²⁾	159,773	137,172	16.5	342,880	173,696	97.4
Free cash flow before changes in working capital.....	199,705	157,169	27.1	450,665	194,094	132.2
(thousand BOE per day, except for figures in percent)						
Production of hydrocarbons, including our share in equity affiliates.....	2,362	2,313	2.1	2,332	2,254	3.5
Crude oil and natural gas liquids.....	1,817	1,787	1.7	1,801	1,808	(0.4)
Gas.....	545	526	3.6	531	446	19.1
Refinery throughput at the Group refineries	1,392	1,348	3.3	1,351	1,341	0.7

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

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

In the third quarter and the nine months of 2018, our results were positively impacted by an increase in international hydrocarbon prices, bigger share of high-margin projects in crude oil production and the ruble devaluation, as well as growth in international gas production volumes.

Compared to the second quarter of 2018, our results were supported by an increase in domestic crude oil production volumes as a result of the change of external limitations within the OPEC+ agreement, higher refining margins, as well as a decrease in excise rates on motor fuels in Russia. The key constraining factors for the third quarter results were lower positive export duty lag effect, as well as lower positive inventory effect at our refineries in Europe and higher operating expenses.

Among the restraining factors for the nine months were domestic refined products prices lagging the export netbacks, as well as external limitations of our liquids production in Russia due to the OPEC+ agreement. At the same time, nine months results were supported by higher positive export duty lag effect.

In the third quarter of 2018, the Group recognized expenses of 23.5 billion RUB in relation to the new share-based compensation plan. These expenses were included in selling, general and administrative expenses and related to the period from 1 January to 30 September 2018.

As a result, our EBITDA amounted to 322 billion RUB in the third quarter of 2018, an increase of 9% to the second quarter of 2018, and to 836 billion RUB in the nine months of 2018, an increase of 37.6% to the nine months of 2017.

Our profit was positively impacted by a foreign exchange gain and negatively impacted by increased depreciation, depletion and amortization.

As a result, in the third quarter of 2018, profit attributable to LUKOIL shareholders amounted to 184 billion RUB, an increase of 9.8% to the second quarter of 2018 and in the nine months of 2018 it amounted to 460 billion RUB, an increase of 54.3% to the nine months of 2017. In the second quarter of 2017, we recognized a gain on sale of JSC “Arkhangelskgeoldobycha” in the after-tax amount of 38 billion RUB. Excluding this factor, our profit increased by 76% compared to the nine months of 2017.

Our free cash flow increased by 22.6 billion RUB, or by 16.5%, compared to the second quarter of 2018, and almost two-fold compared to the nine months of 2017, due to higher operating cash flow.

The Group’s average daily hydrocarbon production increased by 2.1% compared to the second quarter of 2018 and increased by 3.5% compared to the nine months of 2017, driven primarily by growth in gas production volumes in Uzbekistan. In Russia, the quarter-on-quarter growth of crude oil production was driven by the changes of external limitations within the OPEC+ agreement. Planned increase in production from V.Filanovsky and Pyakyakhinskoe fields continued, as well as growth at other high-margin projects.

Compared to the second quarter of 2018, throughput at our own refineries increased by 3.3%, due to maintenance works in the second quarter of 2018. Moreover, we achieved further improvement in refined product slate in the nine months of 2018 at our refineries in Russia due to better utilization of our newly built facilities and feedstock optimization.

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 in the amount of Russian ruble equivalent of \$1.45 billion was completed on 24 May 2017 after all necessary governmental approvals were received. As a result the Group recognized profit before income tax in the amount of 48 billion RUB that is included in “Other income (expenses)” in the consolidated statement of profit or loss and other comprehensive income (profit after income tax – 38 billion RUB).

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

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.

In the nine months of 2018, the price for Brent crude oil fluctuated between \$61 and \$83 per barrel, reached its maximum of \$83.6 in the end of September and its minimum of \$61.5 in early February. Average price expressed in US dollars increased by 1.4% compared to the second quarter of 2018 and by 39.1% compared to the nine months of 2017. Moreover, as a result of the ruble devaluation, the prices expressed in rubles increased even faster.

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

	Q3 2018	Q2 2018	Change, %	9 months of 2018	9 months of 2017	Change, %
(in US dollars per barrel, except for figures in percent)						
Brent crude.....	75.25	74.23	1.4	72.13	51.84	39.1
Urals crude (CIF Mediterranean)	74.42	72.62	2.5	70.79	50.83	39.3
Urals crude (CIF Rotterdam)	74.09	72.05	2.8	70.50	50.39	39.9
(in US dollars per metric tonne, except for figures in percent)						
Diesel fuel 10 ppm (FOB Rotterdam)	668.03	657.94	1.5	639.47	472.91	35.2
High-octane gasoline (FOB Rotterdam)	733.68	712.16	3.0	697.13	544.40	28.1
Naphtha (FOB Rotterdam).....	649.09	631.37	2.8	617.05	456.26	35.2
Jet fuel (FOB Rotterdam).....	707.38	706.06	0.2	686.99	502.49	36.7
Vacuum gas oil (FOB Rotterdam)	511.19	510.99	0.0	496.49	352.01	41.0
Fuel oil 3.5% (FOB Rotterdam).....	424.60	400.63	6.0	393.33	288.20	36.5

Source: Platts.

	Q3 2018	Q2 2018	Change, %	9 months of 2018	9 months of 2017	Change, %
(in rubles per barrel, except for figures in percent)						
Brent crude.....	4,931	4,588	7.5	4,431	3,024	46.5
Urals crude (CIF Mediterranean)	4,877	4,488	8.7	4,349	2,965	46.7
Urals crude (CIF Rotterdam)	4,855	4,453	9.0	4,331	2,940	47.3
(in rubles per metric tonne, except for figures in percent)						
Diesel fuel 10 ppm (FOB Rotterdam)	43,777	40,660	7.7	39,287	27,587	42.4
High-octane gasoline (FOB Rotterdam)	48,080	44,011	9.2	42,829	31,757	34.9
Naphtha (FOB Rotterdam).....	42,537	39,018	9.0	37,909	26,616	42.4
Jet fuel (FOB Rotterdam).....	46,356	43,634	6.2	42,206	29,312	44.0
Vacuum gas oil (FOB Rotterdam)	33,499	31,579	6.1	30,502	20,535	48.5
Fuel oil 3.5% (FOB Rotterdam).....	27,825	24,759	12.4	24,164	16,812	43.7

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 for refined products for the respective periods.

	Q3 2018	Q2 2018	Change, %	9 months of 2018	9 months of 2017	Change, %
(in rubles per metric tonne, except for figures in percent)						
Diesel fuel	42,888	41,476	3.4	40,395	32,111	25.8
High-octane gasoline (Regular)	40,572	42,768	(5.1)	39,668	36,021	10.1
High-octane gasoline (Premium)	42,260	43,778	(3.5)	40,743	36,763	10.8
Fuel oil	18,439	15,459	19.3	15,275	9,953	53.5

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 the ruble-euro exchange rates.

	Q3 2018	Q2 2018	9 months of 2018	9 months of 2017
Ruble inflation (CPI), %	0.4	1.3	2.5	1.7
Ruble to US dollar exchange rate				
Average for the period	65.5	61.8	61.4	58.3
At the beginning of the period	62.8	57.3	57.6	60.7
At the end of the period.....	65.6	62.8	65.6	58.0
Ruble to euro exchange rate				
Average for the period	76.2	73.8	73.3	64.9
At the beginning of the period	73.0	70.6	68.9	63.8
At the end of the period.....	76.2	73.0	76.2	68.4

Source: CBR, Federal State Statistics Service.

Taxation

Between 2015 and 2017, the Russian Government implemented the tax manoeuvre in the oil industry which involved reduction of export duty rate and increase in the crude oil extraction tax and excise tax rates. Changes that became 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. In 2018, there have been no material amendments to the export duty and crude oil mineral extraction tax rates calculation formulas.

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

	Q3 2018	Q2 2018	Change, %	9 months of 2018	9 months of 2017	Change, %
(in US dollars per tonne, except for figures in percent)						
Export duties on crude oil	134.89	120.54	12.0	124.17	83.47	48.8
Export duties on refined products						
Fuel oil	134.89	120.54	12.0	124.17	83.47	48.8
Motor gasoline	40.45	36.13	12.0	37.22	25.01	48.8
Straight-run gasoline	74.16	66.22	12.0	68.25	45.87	48.8
Diesel fuel and refined products.....	40.45	36.13	12.0	37.22	25.01	48.8
Mineral extraction tax ⁽¹⁾						
Crude oil	213.80	208.22	2.7	202.50	130.28	55.4
(in US dollars per thousand cubic meters, except for figures in percent)						
Natural gas (Nakhodkinskoe field).....	4.72	4.84	(2.5)	4.93	4.31	14.4
Natural gas (Pyakyakhinskoye field).....	8.50	8.83	(3.7)	8.76	8.10	8.2

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

	Q3 2018	Q2 2018	Change, %	9 months of		Change, %
	(in rubles per tonne, except for figures in percent)					
Export duties on crude oil ⁽¹⁾	8,840	7,449	18.7	7,628	4,869	56.7
Export duties on refined products ⁽¹⁾						
Fuel oil	8,840	7,449	18.7	7,628	4,869	56.7
Motor gasoline	2,651	2,233	18.7	2,287	1,459	56.7
Straight-run gasoline.....	4,860	4,092	18.7	4,193	2,676	56.7
Diesel fuel and refined products.....	2,651	2,233	18.7	2,287	1,459	56.7
Mineral extraction tax						
Crude oil	14,011	12,868	8.9	12,441	7,600	63.7
	(in rubles per thousand cubic meters, except for figures in percent)					
Natural gas (Nakhodkinskoe field).....	310	299	3.4	303	251	20.5
Natural gas (Pyakyakhinskoye field).....	557	546	2.1	538	472	13.9

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

The table below illustrates the impact of tax incentives on taxation of crude oil production from 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 2018 tax formulas				
Standard	17.7	11.5	29.2	58.4
Yaregskoye field	0.0	1.8	1.8	3.6
Yu. Korchagin field.....	7.4	0.0	7.4	14.9
V. Filanovsky field.....	7.5	0.0	7.5	15.0
Usinskoye (Permian layers)	7.4	11.5	18.9	37.9
Pyakyakhinskoye field	7.4	11.5	18.9	37.9
V. Vinogradov field	9.5	11.5	21.0	42.0
Fields with depletion above 80%	10.5–17.7	11.5	22.0–29.2	44.0–58.4
New fields with reserves below 5 million tonnes.....	11.3–17.7	11.5	22.8–29.2	45.6–58.4
Tyumen deposits	15.6	11.5	27.1	54.3

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:

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

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 Factors* (where applicable) are presented below:

	2017	2018	2019	2020	2021	2022 and further
	(rubles)					
Base Rate	919	919	919	919	919	919
Fixed Factor.....	306	357	428	428	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 Autonomous region of West 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 particular unconventional deposits.

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

The table on p. 9 illustrates the impact of crude oil extraction tax incentives on taxation of crude oil production from our different fields and deposits at \$50 per barrel Urals price.

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

Gas produced from our two major fields, Nakhodkinskoye and Pyakyakhinskoe, is taxed at the rates subject to application of reducing coefficients due to the fields' geographical location and the depth of reservoir.

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, \$146.0 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 crude oil price over \$15 per barrel)
Above \$146.0 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 \$146.0 per tonne (or \$1.75 plus \$0.45 per barrel per each \$1 increase in crude oil price over \$20 per barrel)
Above \$182.5 per tonne (\$25 per barrel)	\$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 crude oil price over \$25 per barrel)

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.

	Q3 2018	Q2 2018	Change, %	9 months of		Change, %
				2018	2017	
	(in US dollars per barrel, except for figures in percent)					
Urals price (Argus)	74.12	72.46	2.3	70.62	50.51	39.8
Export duty on crude oil	18.48	16.51	11.9	17.01	11.43	48.8
Mineral extraction tax on crude oil	29.29	28.52	2.7	27.74	17.85	55.4
Net Urals price ⁽¹⁾	26.35	27.43	(3.9)	25.87	21.23	21.9
Export duty lag effect	0.25	1.72	(85.5)	0.67	0.21	219.0
Net Urals price ⁽¹⁾ assuming no lag	26.10	25.71	1.5	25.20	21.02	19.9
	(in rubles per barrel, except for figures in percent) ⁽²⁾					
Urals price (Argus)	4,857	4,478	8.5	4,339	2,946	47.3
Export duty on crude oil	1,211	1,020	18.7	1,045	667	56.7
Mineral extraction tax on crude oil	1,919	1,763	8.9	1,704	1,041	63.7
Net Urals price ⁽¹⁾	1,727	1,695	1.9	1,590	1,238	28.4
Export duty lag effect	16	106	(84.9)	41	12	241.7
Net Urals price ⁽¹⁾ assuming no lag	1,711	1,589	7.7	1,549	1,226	26.4

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

⁽²⁾ Translated to rubles using average exchange rate for the period.

Crude oil produced at some of our fields is subject to special export duty rates calculated according to specified 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 p. 9 illustrates the impact of crude oil export duty incentives on taxation of export of crude oil produced from our different fields and deposits 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
Multiplier for:	
Light and middle distillates	0.30
Diesel fuel	0.30
Gasolines	0.30
Straight-run gasoline	0.55
Fuel oil	1.00

Crude oil and refined products exported 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 ruble-US dollar exchange rate at the date of the complete declaration (except for pipeline deliveries for which 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.

Changes in tax legislation. In July–August 2018, new laws were adopted introducing a number of changes in the taxation of the oil industry in Russia which will come into effect on 1 January 2019.

The changes relate to the continuation of a so called tax maneuver, the objective of which is the gradual reduction of crude oil export duty rate to zero with the equivalent increase in the extraction tax rate for crude oil. The rates for fields benefiting from tax incentives are adjusted accordingly. To eliminate the negative effect of export duty reduction on refining margins, a negative excise on refinery feedstock is introduced.

The export duty rate reduction will be implemented by applying an additional adjusting factor to the standard crude oil export duty rate calculated in accordance with the table on p. 10:

	2019	2020	2021	2022	2023	2024 and further
Adjusting factor.....	0.833	0.667	0.5	0.333	0.167	0

The Company expects that the above mentioned tax changes combined will not have a material impact on the Group's financial results.

Starting from 2019, a tax on additional income from the hydrocarbon production (hereinafter TAI) will be implemented for certain fields. The TAI rate is set at 50% and is applied to the estimated sales revenue less actual and estimated costs. For crude oil production subject to TAI, a special mineral extraction tax rate formula is applied.

The Company expects those changes to have significant positive impact on development plans for, and production profile of, its brownfields subject to TAI.

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 taxes 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, excise taxes are paid either by producers or retailers depending on the local legislation.

Excise rates on motor fuels in Russia are tied to the ecological class of fuel. Excise tax rates for the periods considered are listed below.

	Q3 2018	Q2 2018	Change, %	9 months of 2018	2017	Change, %
(in rubles per tonne, except for figures in percent)						
Gasoline						
Below Euro-5.....	13,100	13,100	–	13,100	13,100	–
Euro-5.....	8,213	10,224	(19.7)	9,872	10,130	(2.5)
Diesel fuel						
All ecological classes.....	5,665	7,006	(19.1)	6,771	6,800	(0.4)
Motor oils.....	5,400	5,400	–	5,400	5,400	–
Straight-run gasoline.....	13,100	13,100	–	13,100	13,100	–

From June to December 2018, excise rates on refined products are temporarily reduced by 3,000 rubles per tonne of motor gasoline (Euro-5) and by 2,000 rubles per tonne of diesel fuel (all ecological classes).

Established excise tax rates starting from 2018 are listed below.

	1 January to 31 May 2018	1 June to 31 December 2018	2019	2020	2021
(in rubles per tonne)					
Gasoline					
Below Euro-5.....	13,100	13,100	13,100	13,100	13,624
Euro-5.....	11,213	8,213	12,314	12,752	13,262
Diesel fuel					
All ecological classes.....	7,665	5,665	8,541	8,835	9,188
Motor oils.....	5,400	5,400	5,400	5,616	5,841
Straight-run gasoline.....	13,100	13,100	13,912	14,720	15,533

Income tax. The federal income tax rate in Russia 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 transported 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 through 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.

	3rd quarter of 2018 to 2nd quarter of 2018	9 months of 2018 to 9 months of 2017
Transneft		
Crude oil	0.0%	4.0%
Russian Railways		
Crude oil and refined products	0.0%	5.3%

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 operations of the Group companies), finance activities, and certain other activities, that are not primary to the Group.

Each of our segments is dependent on the others, with a portion of the revenues of one segment being a part of the costs of the others. 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. 7, benchmark 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 28 “Segment information” to our condensed interim consolidated financial statements.

Exploration and production

The following table summarizes key figures on our Exploration and production segment:

	Q3 2018	Q2 2018	9 months of 2018 2017	
			(millions of rubles)	
EBITDA	268,631	239,699	680,248	396,456
- in Russia	220,313	203,525	568,495	341,375
- outside Russia and Iraq.....	39,174	29,877	90,577	42,496
- in Iraq.....	9,144	6,297	21,176	12,585
Hydrocarbon extraction expenses	53,690	53,091	157,451	154,165
- in Russia.....	43,608	43,717	130,182	131,243
- outside Russia and Iraq	5,339	5,113	14,690	10,238
- in Iraq.....	4,743	4,261	12,579	12,684
			(ruble per BOE)	
Hydrocarbon extraction expenses (excluding Iraq).....	234	241	237	242
- in Russia	240	246	243	245
- outside Russia and Iraq	196	207	193	204
			(US dollar per BOE)	
Hydrocarbon extraction expenses (excluding Iraq)	3.58	3.90	3.87	4.14
- in Russia.....	3.67	3.98	3.97	4.20
- outside Russia and Iraq.....	3.00	3.35	3.14	3.50

Our upstream EBITDA increased by 12.1%, compared to the second quarter of 2018, and by 71.6%, compared to the nine months of 2017.

Compared both to the second quarter of 2018 and the nine months of 2017, our upstream EBITDA in Russia increased as a result of higher hydrocarbon prices, the ruble devaluation, as well as increase in production from our high-margin fields and lower per barrel lifting costs. The change in external limitations on our domestic crude oil production volumes within the OPEC+ agreement since July 2018 also contributed to the increase in our EBITDA. The quarter-on-quarter dynamics of EBITDA was negatively affected by lower positive export duty lag effect, while the year-on-year effect of the export duty lag was supportive for EBITDA dynamics.

Compared both to the second quarter of 2018 and the nine months of 2017, our upstream EBITDA outside Russia increased mainly due to higher hydrocarbon prices, growth in gas production in Uzbekistan, the effect of the ruble devaluation, as well as higher EBITDA of the West Qurna-2 project in Iraq and lower per barrel lifting costs.

The following table summarizes our hydrocarbon production by major regions.

	Q3	Q2	9 months of	
	2018	2018	2018	2017
	(thousand BOE per day)			
Crude oil and natural gas liquids				
Consolidated subsidiaries				
West Siberia	780	770	774	808
Timan-Pechora	318	314	317	312
Ural region	326	327	326	323
Volga region	235	225	225	194
Other in Russia	31	31	31	33
Total in Russia	1,690	1,667	1,673	1,670
Iraq ⁽¹⁾	35	24	31	36
Other outside Russia	45	46	47	44
Total outside Russia	80	70	78	80
Total consolidated subsidiaries	1,770	1,737	1,751	1,750
Our share in equity affiliates				
in Russia	13	13	13	20
outside Russia	34	37	37	38
Total share in equity affiliates	47	50	50	58
Total crude oil and natural gas liquids	1,817	1,787	1,801	1,808
Natural and petroleum gas⁽²⁾				
Consolidated subsidiaries				
West Siberia	206	212	212	218
Timan-Pechora	33	33	33	35
Ural region	16	14	15	16
Volga region	27	27	27	22
Other in Russia	1	1	–	1
Total in Russia	283	287	287	292
Total outside Russia	251	226	232	140
Total consolidated subsidiaries	534	513	519	432
Share in equity affiliates				
in Russia	2	1	2	2
outside Russia	9	12	10	12
Total share in production of equity affiliates	11	13	12	14
Total natural and petroleum gas	545	526	531	446
Total daily hydrocarbon production	2,362	2,313	2,332	2,254
Including natural gas liquids produced at the gas processing plants	36	46	42	35

⁽¹⁾ Compensation crude oil related to the Group.

⁽²⁾ Natural and petroleum gas production excluding flaring, reinjected gas and gas used in production of natural gas liquids.

Crude oil production by major regions is presented in the table below.

	Q3 2018	Q2 2018	9 months of 2018 2017	
	(thousands of tonnes)			
West Siberia.....	9,552	9,270	28,025	29,262
Timan-Pechora.....	4,063	3,976	12,005	11,804
Ural region.....	3,862	3,772	11,359	11,316
Volga region.....	2,829	2,681	8,066	6,983
Other in Russia.....	400	397	1,194	1,270
Crude oil produced in Russia.....	20,706	20,096	60,649	60,635
Iraq ⁽¹⁾	469	318	1,238	1,426
Other outside Russia.....	457	457	1,404	1,477
Crude oil produced outside Russia.....	926	775	2,642	2,903
Total crude oil produced by consolidated subsidiaries.....	21,632	20,871	63,291	63,538
Our share in crude oil produced by equity affiliates:				
in Russia.....	159	157	474	719
outside Russia.....	395	425	1,251	1,284
Total crude oil produced.....	22,186	21,453	65,016	65,541

⁽¹⁾ Compensation crude oil related to the Group.

Our main oil producing region is West Siberia where we produced 44.2% and 44.3% of our crude oil in the third quarter and the nine months of 2018 (44.4% in the second quarter of 2018, 46.1% in the nine months of 2017), respectively.

The dynamics of our crude oil production volumes was mainly driven by a temporary 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 (OPEC+ agreement). We limited production in our traditional regions (West Siberia, Timan-Pechora, Ural) by closing least-productive wells, wells with high water cut and high lifting costs. We also decreased a number of workover operations. In June 2018, the OPEC+ countries agreed to increase the crude oil production volumes from July 2018 that resulted in an increase in our domestic crude oil daily production by approximately 30 thousand BOE in the third quarter of 2018. As a result, daily liquids production in Russia increased by 1.4%, compared to the second quarter of 2018.

We continued increasing production at the V. Filanovsky (Caspian sea), Pyakyakhinskoye and other high-margin fields, which have a major positive impact on our financial results due to high quality reserve base and tax incentives. In the third quarter of 2018, the fourth well was launched at the second development stage of the V. Filanovsky field. In the nine months of 2018, we produced 4,433 thousand tonnes of crude oil at this field, an increase of 40%, compared to the nine months of 2017.

In the third quarter of 2018, oil production at Yu. Korchagin field increased by 6% quarter-on-quarter as a result of the launch of the first production well at the second development stage of this field in July 2018. Additional drilling program implemented at the first development stage of the field also supported the production growth.

We also produced 1,194 thousand tonnes of liquids at the Pyakyakhinskoye field, an increase of 5%, compared to the nine months of 2017.

Development of the Yaregskoye field and the Permian layers of our Usinskoye field in Timan-Pechora led to an increase in the high-viscous crude oil production to 3,117 thousand tonnes, or by 29%, compared to the nine months of 2017.

Gas production (excluding flaring, reinjected gas and gas used in production of natural gas liquids) by major regions is presented in the table below.

	Q3 2018	Q2 2018	9 months of 2018 (millions of cubic meters)	
West Siberia.....	3,221	3,282	9,821	10,123
Timan-Pechora.....	519	508	1,542	1,628
Ural region.....	250	212	691	738
Volga region.....	427	423	1,254	1,011
Other in Russia.....	6	6	19	24
Gas produced in Russia.....	4,423	4,431	13,327	13,524
Uzbekistan.....	3,516	3,131	9,568	5,205
Other outside Russia.....	403	362	1,187	1,267
Gas produced outside Russia.....	3,919	3,493	10,755	6,472
Total gas produced by consolidated subsidiaries.....	8,342	7,924	24,082	19,996
Our share in gas produced by equity affiliates:				
in Russia.....	24	25	72	71
outside Russia.....	146	178	484	601
Total gas produced.....	8,512	8,127	24,638	20,668

In Russia, our major gas production region is West Siberia (Bolshekhetskaya depression), where the major part of gas is produced from the Nakhodkinskoe field, which has been developed since 2005. In January 2017, we started gas production from our second field in Bolshekhetskaya depression, the Pyakyakhinskoye field. Gas production from Pyakyakhinskoye field amounted to 2,909 million cubic meters, an increase of 26% to the nine months of 2017. Our international gas production (including our share in affiliates' production) increased by 59%, compared to the nine months of 2017, as a result of commissioning of new gas treatment facilities within Gissar and Kandym projects in Uzbekistan. Kandym gas processing complex has reached its design capacity of 8 billion cubic meters in September 2018.

West Qurna-2 project

The West Qurna-2 field in Iraq is developed under the service contract, signed in January 2010. In May 2018, a Group company and Iraqi party signed a new development plan of the field, according to which, crude oil production is planned to increase to 800 thousand barrels per day by 2025.

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 for in the reporting period. Amount of the invoice depends on crude oil production volumes during the period and amount of costs claimed for reimbursement. Approved invoice amount for the reporting quarter is 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 costs incurred, compensation crude oil received, costs yet unrecovered and remuneration fee.

	Costs incurred⁽¹⁾	Remuneration fee (millions of US dollars)	Crude oil received	Crude oil to be received
Cumulative at 31 December 2017	8,072	303	7,842	533
Change in the nine months of 2018.....	406	89	680	(185)
Cumulative at 30 September 2018	8,478	392	8,522	348

⁽¹⁾ Including prepayments.

The West Qurna-2 project summary is presented below:

	Q3 2018		Q2 2018	
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production.....	35,614	5,207	34,869	5,098
Production related to cost compensation and remuneration	3,206	469	2,175	318
Shipment of compensation crude oil ⁽¹⁾	2,953	432	4,899	716
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)
Cost compensation	9,538	146	8,829	143
Remuneration fee	4,108	63	1,856	30
	13,646	209	10,685	173
Cost of compensation crude oil, received as liability settlement (included in <i>Cost of purchased crude oil, gas and products</i>) ⁽¹⁾	14,180	217	21,146	342
Extraction expenses	4,743	72	4,261	69
Depreciation, depletion and amortization.....	4,826	73	4,560	74
EBITDA.....	9,144	139	6,297	102

⁽¹⁾ This crude oil is sold to third party customers or delivered to our refineries. After realization of these products, respective sales revenues are recognized.

	9 months of			
	2018		2017	
	(thousand barrels)	(thousand tonnes)	(thousand barrels)	(thousand tonnes)
Total production.....	103,284	15,100	107,320	15,644
Production related to cost compensation and remuneration	8,469	1,238	9,784	1,426
Shipment of compensation crude oil ⁽¹⁾	9,840	1,439	8,942	1,303
	(millions of rubles)	(millions of US dollars)	(millions of rubles)	(millions of US dollars)
Cost compensation	26,116	425	22,274	382
Remuneration fee	7,574	121	3,529	60
	33,690	546	25,803	442
Cost of compensation crude oil, received as liability settlement (included in <i>Cost of purchased crude oil, gas and products</i>) ⁽¹⁾	42,215	680	24,142	412
Extraction expenses	12,579	204	12,684	218
Depreciation, depletion and amortization.....	13,637	222	9,826	169
EBITDA.....	21,176	342	12,585	216

⁽¹⁾ This crude oil is sold to third party customers or delivered to our refineries. After realization of these products, respective sales revenues are recognized.

In February-June 2017, due to a so-called performance factor that represents a ratio of actual production volumes to target production volumes according to the provisions of the service contract, our per barrel remuneration fee was approximately three times lower. The parties agreed not to apply the performance factor from the third quarter of 2017. In the third quarter of 2018, the Iraqi party reimbursed to the Group remuneration unpaid due to implementation of the performance factor in February-June 2017 in the amount of \$32 million.

Refining, marketing and distribution

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

	Q3 2018	Q2 2018	9 months of 2018	9 months of 2017
			(millions of rubles)	
EBITDA	82,189	71,620	200,658	214,376
- in Russia	59,318	52,695	154,312	156,212
- outside Russia	22,871	18,925	46,346	58,164
Refining expenses at the Group refineries	28,318	25,677	75,991	63,458
- in Russia	12,821	10,730	32,876	29,788
- outside Russia	15,497	14,947	43,115	33,670
			(ruble per tonne)	
Refining expenses at the Group refineries	1,621	1,534	1,510	1,271
- in Russia	1,172	1,006	1,019	932
- outside Russia	2,374	2,464	2,388	1,872
			(US dollar per tonne)	
Refining expenses at the Group refineries	24.74	24.83	24.53	21.77
- in Russia	17.89	16.28	16.53	15.97
- outside Russia	36.23	39.87	38.84	32.08

Our refining, marketing and distribution EBITDA was 14.8% higher than in the second quarter of 2018, and 6.4% lower than in the nine months of 2017.

In Russia, most of the refining, marketing and distribution EBITDA increase compared to the second quarter of 2018 was due to lower excise rates, higher refining margins and seasonal growth of sales volumes backed by higher refinery throughput. At the same time, an increase in operating expenses was a constraining factor for our EBITDA. The decrease of EBITDA in Russia as compared to the nine months of 2017 was mainly due to domestic prices lagging international netbacks and an increase in operating expenses.

Outside Russia, our refining, marketing and distribution EBITDA growth compared to the second quarter of 2018 was due to seasonally better performance of refining and retail, as well as the ruble devaluation. This growth was constrained by lower positive inventory effect at our refineries. The year-on-year dynamics of our EBITDA outside Russia was mainly defined by an increase in operating expenses and by accounting specifics of our trading operations that resulted in material gains in the first quarter of 2017, while significant positive inventory effect at our refineries was partially offset by lower refining margins.

Refining and petrochemicals

The following table summarizes key figures for our refining and petrochemical volumes.

	Q3 2018	Q2 2018	9 months of 2018	9 months of 2017
	(thousands of tonnes)			
Refinery throughput at the Group refineries	17,467	16,734	50,314	49,946
- in Russia	10,939	10,668	32,262	31,963
- outside Russia, including	6,528	6,066	18,052	17,983
- crude oil	5,837	5,340	15,726	16,301
- refined products	691	726	2,326	1,682
Refinery throughput at third party refineries	1,622	1,631	4,913	4,744
Total refinery throughput	19,089	18,365	55,227	54,690
Production of the Group refineries in Russia⁽¹⁾	10,435	10,045	30,546	30,239
- diesel fuel	3,952	3,986	12,069	11,648
- motor gasoline	2,075	2,022	6,127	6,077
- fuel oil	1,218	1,096	3,588	3,800
- jet fuel	722	738	2,076	2,021
- lubricants and components	223	188	692	872
- straight-run gasoline	418	570	1,545	1,590
- vacuum gas oil	377	135	574	575
- bitumen	273	227	635	711
- coke	245	289	821	749
- other products	932	794	2,419	2,196
Production of the Group refineries outside Russia	6,155	5,761	16,939	16,933
- diesel fuel	2,678	2,369	7,041	7,425
- motor gasoline	1,316	1,066	3,369	3,806
- fuel oil	626	740	2,075	2,178
- jet fuel	317	317	931	822
- straight-run gasoline	592	532	1,583	1,448
- coke	49	51	153	135
- other products	577	686	1,787	1,119
Refined products produced by the Group	16,590	15,806	47,485	47,172
Refined products produced at third party refineries	1,581	1,597	4,821	4,658
Total refined products produced	18,171	17,403	52,306	51,830
Reference: Net of cross-supplies of refined products between the Group refineries	311	485	1,267	1,321
Products produced at petrochemical plants and facilities	351	302	988	942
- in Russia	254	225	729	656
- outside Russia	97	77	259	286

⁽¹⁾ Net of cross-supplies of refined products among the Group.

The total volume of refined products produced by the Group increased by 5.0%, compared to the second quarter of 2018, and by 0.7%, compared to the nine months of 2017.

Compared to the second quarter of 2018, production at our refineries domestically and outside Russia increased by 3.9% and 6.8%, respectively, mainly due to the scheduled maintenance works at our refineries in Nizhny Novgorod and Bulgaria in the previous quarter. Growth in dark product output in Russia was due to maintenance works at the conversion units of the Nizhny Novgorod and Perm refineries in the third quarter 2018, while higher light product yield at our refineries outside Russia was due to maintenance at our refinery in Bulgaria in the second quarter 2018.

Compared to the nine months of 2017, production at our refineries in Russia increased by 1.0% due to higher utilization rates at our refineries in Perm and Volgograd. Outside Russia, a decrease in processing of crude oil by 3.5% and an increase in processing of refined products by 38.3% were mainly attributable to optimization of a feedstock at our refineries in Italy and the Netherlands.

In the periods considered, we processed our crude oil at third party refineries in Belarus, Kazakhstan and Canada. In 2016, a Group company entered into a tolling agreement valid through 2019 with a Canadian refinery. In the third quarter and the nine months of 2018, attributable refined products output amounted to 1.5 million tonnes and 4.7 million tonnes, respectively (1.6 million tonnes in the second quarter of 2018 and 4.5 million tonnes in the nine months of 2017).

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 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.

	Q3 2018	Q2 2018	9 months of 2018	2017
	(thousands of tonnes)			
Crude oil purchases				
in Russia	231	189	635	747
for trading internationally	12,758	12,245	35,058	25,096
for refining internationally	6,091	5,459	16,782	16,654
Shipment of the West Qurna-2 compensation crude oil.....	432	716	1,439	1,303
Total crude oil purchased.....	19,512	18,609	53,914	43,800

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

	Q3 2018	Q2 2018	9 months of 2018	2017
	(thousands of tonnes)			
Refined products retail sales	4,068	3,742	11,239	10,626
Refined products wholesale sales	27,916	26,244	81,589	86,384
Total refined products sales	31,984	29,986	92,828	97,010
Refined products purchased in Russia	318	223	898	1,335
Refined products purchased internationally	13,685	13,715	41,235	44,609
Total refined products purchased	14,003	13,938	42,133	45,944
Petrochemical products purchased in Russia	8	8	24	29
Petrochemical products purchased internationally.....	109	133	388	308
Total petrochemical products purchased.....	117	141	412	337

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

	Q3 2018	Q2 2018	9 months of 2018	2017
	(thousands of tonnes)			
Exports of crude oil to Customs Union	674	687	2,044	2,124
Exports of crude oil beyond Customs Union	8,919	8,295	25,206	25,585
Total crude oil exports.....	9,593	8,982	27,250	27,709
Exports of crude oil through Transneft and other third party infrastructure including:	7,287	7,017	20,770	20,733
- ESPO pipeline	300	300	900	840
- CPC pipeline	1,240	1,144	3,439	2,347
Exports of crude oil through the Group's transportation infrastructure.....	2,306	1,965	6,480	6,976
Total crude oil exports.....	9,593	8,982	27,250	27,709
	(millions of rubles)			
Exports of crude oil to Customs Union.....	17,437	17,074	48,150	34,310
Exports of crude oil beyond Customs Union	305,638	264,279	780,517	524,777
Total crude oil exports.....	323,075	281,353	828,667	559,087

	Q3 2018	Q2 2018	9 months of 2018 2017	
	(thousands of tonnes)			
Refined products exports				
- diesel fuel	2,382	2,388	7,581	7,531
- gasoline	3	46	226	146
- fuel oil	255	195	1,071	2,011
- jet fuel	10	12	46	76
- lubricants and components	153	128	458	476
- gas refinery products	256	244	801	871
- other products	728	625	1,907	1,996
Total refined products exports	3,787	3,638	12,090	13,107
Total petrochemical products exports	84	73	256	232
	(millions of rubles)			
Total refined products and petrochemicals exports	155,686	140,206	441,012	329,285

The volume of our crude oil exports from Russia increased by 6.8% compared to the second quarter of 2018, and decreased by 1.7% compared to the nine months of 2017. In the third quarter and the nine months of 2018, we exported 46.3% and 44.9% of our domestic crude oil production (44.7% in the second quarter of 2018 and 45.7% in the nine months of 2017) and 51 thousand tonnes and 142 thousand tonnes of crude oil purchased from our affiliates and third parties (48 thousand tonnes in the second quarter of 2018 and 311 thousand tonnes in the nine months of 2017), respectively. In the third quarter of 2018, an increase in export volumes was driven by the increase in crude oil production. In the nine months of 2018, the decrease in export volumes was primarily a result of higher refinery throughput.

The volume of our refined products exports increased by 4.1% compared to the second quarter of 2018 driven by higher refinery throughput volumes, and decreased by 7.8% compared to the nine months of 2017 driven by higher domestic demand for our products.

Substantially, we use the Transneft infrastructure to export our crude oil. Nevertheless, a sizeable amount of crude oil is exported through our own infrastructure which allows us to preserve the premium quality of crude oil and thus enables us to achieve higher netbacks. All the volume of crude oil exported that bypassed Transneft was routed beyond the Customs Union.

Besides our own infrastructure, we also export the 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 to achieve higher netbacks compared to traditional export routes.

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 third quarter and the nine months of 2018, we sold 3.0 million tonnes and 8.1 million tonnes of motor fuels via our domestic retail network, which was 9.8% more compared to the second quarter of 2018 and 7.7% more compared to the nine months of 2017), respectively. Outside Russia, retail sales increased by 5.9% compared to the second quarter of 2018 due to seasonality factor, and by 1.2%, compared to the nine months of 2017.

We also supply jet fuel to airports and bunker fuel to sea and river ports in and outside 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 third quarter and the nine months of 2018, our total output of commercial electrical energy was 3.8 billion kWh and 12.9 billion kWh, respectively (3.8 billion kWh in the second quarter of 2018 and 12.4 billion kWh in the nine months of 2017), and our total output of commercial heat energy was approximately 0.9 million Gcal and 7.4 million Gcal (1.4 million Gcal in the second quarter of 2018 and 7.2 million Gcal in the nine months of 2017), respectively.

Financial results

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

	Q3 2018	Q2 2018	9 months of 2018 (millions of rubles)	
Revenues				
Sales (including excise and export tariffs)	2,305,886	2,056,058	5,992,672	4,274,253
Costs and other deductions				
Operating expenses	(123,837)	(112,221)	(344,698)	(338,674)
Cost of purchased crude oil, gas and products	(1,323,504)	(1,187,883)	(3,402,816)	(2,226,683)
Transportation expenses.....	(70,624)	(68,207)	(204,886)	(204,210)
Selling, general and administrative expenses.....	(64,766)	(40,409)	(141,929)	(118,403)
Depreciation, depletion and amortization	(105,900)	(97,593)	(291,183)	(248,856)
Taxes other than income taxes	(248,539)	(213,970)	(649,176)	(434,588)
Excise and export tariffs	(151,765)	(137,402)	(410,358)	(341,595)
Exploration expenses	(1,041)	(815)	(2,324)	(2,265)
Profit from operating activities.....	215,910	197,558	545,302	358,979
Finance income.....	5,132	4,648	13,294	9,662
Finance costs.....	(9,955)	(8,279)	(25,556)	(22,162)
Equity share in income of affiliates.....	6,828	6,104	18,181	11,670
Foreign exchange gain (loss)	11,215	22,394	32,177	(25,149)
Other (expenses) income.....	(780)	(10,562)	(10,643)	44,604
Profit before income taxes.....	228,350	211,863	572,755	377,604
Current income taxes	(46,064)	(39,952)	(104,253)	(75,096)
Deferred income taxes	2,176	(3,916)	(6,620)	(3,245)
Total income tax expense.....	(43,888)	(43,868)	(110,873)	(78,341)
Profit for the period.....	184,462	167,995	461,882	299,263
Profit for the period attributable to non-controlling interests.....	(695)	(673)	(1,735)	(968)
Profit for the period attributable to PJSC LUKOIL shareholders	183,767	167,322	460,147	298,295
Earnings per share of common stock attributable to PJSC LUKOIL shareholders (in Russian rubles)				
Basic.....	259.02	235.79	648.48	419.37
Diluted.....	255.54	235.79	643.85	419.37

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

Sales revenues

Sales breakdown	Q3	Q2	9 months of	
	2018	2018	2018	2017
(millions of rubles)				
Crude oil				
Export and sales on international markets other than Customs Union	769,427	702,110	1,926,164	1,071,351
Export and sales to Customs Union	17,233	17,224	48,222	33,582
Domestic sales	14,423	10,626	38,667	27,942
	801,083	729,960	2,013,053	1,132,875
Cost compensation and remuneration at the West Qurna-2 project	13,646	10,685	33,690	25,803
	814,729	740,645	2,046,743	1,158,678
Refined products ⁽¹⁾				
Export and sales on international markets				
Wholesale	1,015,461	897,216	2,696,640	2,093,493
Retail	97,256	86,802	256,056	205,353
Domestic sales				
Wholesale	124,784	111,298	320,911	257,284
Retail	139,765	121,219	364,656	309,329
	1,377,266	1,216,535	3,638,263	2,865,459
Petrochemicals				
Export and sales on international markets	15,731	15,068	46,353	35,807
Domestic sales	12,224	11,189	33,993	28,552
	27,955	26,257	80,346	64,359
Gas				
Sales on international markets	36,267	26,266	82,513	36,649
Domestic sales	8,122	8,420	24,872	22,719
	44,389	34,686	107,385	59,368
Sales of energy and related services				
Sales on international markets	5,743	3,413	11,778	9,149
Domestic sales	10,432	10,545	38,735	44,913
	16,175	13,958	50,513	54,062
Other				
Export and sales on international markets	13,125	11,893	34,912	38,096
Domestic sales	12,247	12,084	34,510	34,231
	25,372	23,977	69,422	72,327
Total sales	2,305,886	2,056,058	5,992,672	4,274,253

⁽¹⁾ Including revenue from gas refined products sales.

Sales volumes	Q3	Q2	9 months of	
	2018	2018	2018	2017
	(thousands of tonnes)			
Crude oil				
Export and sales on international markets other than Customs Union	21,651	21,424	59,626	49,216
Export and sales to Customs Union	680	693	2,062	2,083
Domestic sales	551	443	1,707	1,802
	22,882	22,560	63,395	53,101
Crude oil volumes related to cost compensation and remuneration at the West Qurna-2 project	469	318	1,238	1,426
	23,351	22,878	64,633	54,527
Refined products ⁽¹⁾				
Export and sales on international markets				
Wholesale	23,937	22,445	70,553	75,722
Retail	1,114	1,052	3,140	3,103
Domestic sales				
Wholesale	3,979	3,799	11,036	10,662
Retail	2,954	2,690	8,099	7,523
	31,984	29,986	92,828	97,010
Petrochemicals				
Export and sales on international markets	217	234	712	697
Domestic sales	192	195	580	583
	409	429	1,292	1,280
	(millions of cubic meters)			
Gas				
Sales on international markets	3,674	3,309	10,121	6,037
Domestic sales	3,344	3,509	10,336	10,225
	7,018	6,818	20,457	16,262

⁽¹⁾ Including volumes of gas refined products sales.

Realized average sales prices

		Q3	Q2	9 months of	
		2018	2018	2018	2017
Average realized price on international markets					
Crude oil (beyond Customs Union) ⁽¹⁾	(RUB/barrel)	4,848	4,471	4,407	2,970
Crude oil (Customs Union)	(RUB/barrel)	3,458	3,391	3,191	2,199
Refined products					
Wholesale	(RUB/tonne)	42,422	39,974	38,221	27,647
Retail	(RUB/tonne)	87,303	82,511	81,546	66,179
Petrochemicals	(RUB/tonne)	72,493	64,393	65,103	51,373
Gas (excluding royalty)	(RUB/1,000 m ³)	9,871	7,938	8,153	6,071
Crude oil (beyond Customs Union) ⁽¹⁾	(\$/barrel)	73.98	72.34	71.74	50.91
Crude oil (Customs Union)	(\$/barrel)	52.77	54.87	51.94	37.70
Refined products					
Wholesale	(\$/tonne)	647	647	622	474
Retail	(\$/tonne)	1,332	1,335	1,327	1,134
Petrochemicals	(\$/tonne)	1,106	1,042	1,060	881
Gas (excluding royalty)	(\$/1,000 m ³)	151	128	133	104
Average realized price within Russia					
Crude oil	(RUB/barrel)	3,571	3,272	3,090	2,115
Refined products					
Wholesale	(RUB/tonne)	31,361	29,297	29,079	24,131
Retail	(RUB/tonne)	47,314	45,063	45,025	41,118
Petrochemicals	(RUB/tonne)	63,667	57,379	58,609	48,974
Gas ⁽²⁾	(RUB/1,000 m ³)	2,429	2,400	2,406	2,222

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

⁽²⁾ As most of our gas production in Russia is sold ex-field, the price does not include cost of transportation by Unified Gas Supply System of Gazprom.

In the third quarter of 2018, our revenues increased by 250 billion RUB, or by 12.2%, compared to the second quarter of 2018. Our revenues from crude oil sales increased by 74 billion RUB, or by 10.0%, and our revenues from sales of refined products increased by 161 billion RUB, or by 13.2%, while our revenues from gas sales increased by 10 billion RUB, or by 27.9%. This was mainly driven by an increase in hydrocarbon prices and production volumes, as well as crude oil trading volumes and the effect of the ruble devaluation on our revenues denominated in the US dollars and euro.

Compared to the nine months of 2017, our revenues increased by 1,718 billion RUB, or by 40.2%. Our revenues from crude oil sales increased by 888 billion RUB, or by 76.6%, our revenues from sales of refined products increased by 773 billion RUB, or by 27%, and our gas sales increased by 48 billion rubles, or by 80.9%, largely, as a result of an increase in hydrocarbon prices, gas production volumes, crude oil trading volumes and the effect of the ruble devaluation on our revenues denominated in the US dollars and euro.

Sales of crude oil

Compared to the second quarter of 2018, our international crude oil sales revenue increased by 9.6%, or by 67 billion RUB. Our international sales volumes (beyond the Customs Union) increased by 227 thousand tonnes, or by 1.1%. At the same time, our average international ruble realized prices increased by 8.4%. Our sales volumes in Russia increased by 108 thousand tonnes, or by 24.4%, as a result of an increase in crude oil production and higher domestic demand. In the third quarter of 2018, our realized domestic crude oil sales price increased by 9.1%. As a consequence, our domestic sales revenue increased by 35.7%, or by 4 billion RUB.

Compared to the nine months of 2017, our international crude oil sales revenue increased by 79.8%, or by 855 billion RUB. In the nine months of 2018, our international sales volumes (beyond the Customs Union) increased by 10,410 thousand tonnes, or by 21.2%, as a result of an increase in trading volumes. Our average international ruble realized prices increased by 48.4%. At the same time, our domestic sales volumes decreased by 95 thousand tonnes, or by 5.3%, as a result of higher utilization rates at our refineries. Our realized sales price increased by 46.1%. As a consequence, in the nine months of 2018, our domestic sales revenue increased by 38.4%, or by 11 billion RUB.

Sales of refined products

Compared to the second quarter of 2018, our revenue from the wholesale of refined products outside Russia increased by 118 billion RUB, or by 13.2%, as a result of an increase in our realized ruble prices by 6.1% and sales volumes by 6.6% due to the increase in production volumes.

In the third quarter of 2018, our international retail revenue increased by 10 billion RUB, or by 12.0%. Our international retail realized ruble prices increased by 5.8% largely as a result of devaluation of the ruble against euro, while our sales volumes increased by 62 thousand tonnes, or by 5.9%, due to a seasonality factor.

Compared to the second quarter of 2018, our revenue from the wholesale of refined products on the domestic market increased by 13 billion RUB, or by 12.1%, as a result of an increase in our realized ruble prices and sales volumes by 7.0% and 4.7%, respectively.

In the third quarter of 2018, our revenue from refined products retail sales in Russia increased by 19 billion RUB, or by 15.3%, compared to the second quarter of 2018. Our average domestic retail prices increased by 5.0% and volumes – by 9.8% due to a seasonality factor.

Compared to the nine months of 2017, our revenue from the wholesale of refined products outside Russia increased by 603 billion RUB, or by 28.8%, that was price driven. Our dollar and ruble realized prices increased by 31.3% and by 38.2%, respectively. Our sales volumes decreased by 6.8% as a result of the decrease in trading volumes.

Compared to the nine months of 2017, our dollar and ruble realized retail prices outside Russia increased by 17.0% and by 23.2%, respectively. Our sales volumes increased by 1.2%. As a result, our international retail revenue increased by 51 billion RUB, or by 24.7%.

In the nine months of 2018, our revenue from the wholesale of refined products on the domestic market increased by 64 billion RUB, or by 24.7%, compared to the nine months of 2017. Our realized prices and sales volumes increased by 20.5% and by 3.5%, respectively. The increase in sales volumes was a result of higher domestic demand.

Our revenue from refined products retail sales in Russia increased by 55 billion RUB, or by 17.9%, compared to the nine months of 2017. Our average domestic retail prices and volumes increased by 9.5% and by 7.7%, respectively. The increase in retail sales volumes was a result of higher demand for our products.

Sales of petrochemical products

Compared to the second quarter of 2018 and the nine months of 2017, our revenue from sales of petrochemical products increased by 2 billion RUB, or by 6.5%, and by 16 billion RUB, or by 24.8%, respectively, largely as a result of growth in realized prices.

Sales of gas

Sales of gas increased by 10 billion RUB, or by 28.0%, compared to the second quarter of 2018, and by 48 billion RUB, or by 80.9%, compared to the nine months of 2017.

This increase mostly related to our operations outside Russia and was a result of production growth within Gissar and Kandym projects in Uzbekistan. Higher gas prices also contributed to the increase in our gas sales revenue.

Sales of energy and related services

Compared to the second quarter of 2018, our revenue from sales of energy and related services increased by 2 billion RUB, or by 15.9%, due to a seasonality factor in our international sales.

Compared to the nine months of 2017, our revenue from sales of energy and related services decreased by 4 billion RUB, or by 6.6%, mainly due to a sale of energy distribution subsidiary in Russia in the fourth quarter of 2017.

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 third quarter of 2018, revenue from other sales increased by 1 billion RUB, or by 5.8%, compared to the second quarter of 2018, largely as a result of a seasonal increase in non-petrol revenue of our retail network and the effect of the ruble devaluation on our revenue denominated in other currencies.

Compared to the nine months of 2017, revenue from other sales decreased by 3 billion RUB, or by 4.0%, largely due to the sale of our diamond business in June 2017 that was partially compensated by the effect of the ruble devaluation.

Operating expenses

Operating expenses include the following:

	Q3 2018	Q2 2018	9 months of 2018		2017
	(millions of rubles)				
Hydrocarbon extraction expenses ⁽¹⁾	48,947	48,830	144,872	141,481	
Extraction expenses at the West Qurna-2 field	4,743	4,261	12,579	12,684	
Own refining expenses	28,318	25,677	75,991	63,458	
Refining expenses at third-party refineries	4,712	1,374	8,742	10,235	
Expenses for crude oil transportation to refineries	13,324	12,856	37,889	36,281	
Power generation and distribution expenses	6,826	6,871	21,324	23,259	
Petrochemical expenses	2,987	2,780	8,633	8,901	
Other operating expenses	13,980	9,572	34,668	42,375	
Total operating expenses	123,837	112,221	344,698	338,674	

⁽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 data for Note 28 “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 and do not include adjustments related to elimination of intra-group service margin. Operating expenses for the purposes of this analysis are grouped based on the nature of the costs incurred.

Our operating expenses increased by 12 billion RUB, or by 10.4%, compared to the second quarter of 2018 and by 6 billion RUB, or by 1.8%, compared to the nine months of 2017.

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.

	Q3 2018	Q2 2018	9 months of 2018 2017	
			(millions of rubles)	
Hydrocarbon extraction expenses ⁽¹⁾	48,947	48,830	144,872	141,481
- in Russia	43,608	43,717	130,182	131,243
- outside Russia ⁽¹⁾	5,339	5,113	14,690	10,238
			(ruble per BOE)	
Hydrocarbon extraction expenses ⁽¹⁾	234	241	237	242
- in Russia	240	246	243	245
- outside Russia ⁽¹⁾	196	207	193	204

⁽¹⁾ Excluding expenses at the West Qurna-2 field.

Compared to the second quarter of 2018, our extraction expenses didn't change significantly.

In the third quarter of 2018, extraction expenses in Russia didn't change significantly, despite the growth of crude oil production as a result of the changes of external limitations due to the OPEC+ agreement. Our average hydrocarbon extraction expenses decreased by 2.4% in the third quarter of 2018 compared to the previous quarter as a result of cost efficiency measures implemented by our production entities.

Outside Russia, extraction expenses increased by 4.4%, compared to the second quarter of 2018, largely as a result of the ruble depreciation to the US dollar. At the same time, the average hydrocarbon extraction expenses decreased by 5.3% due to an increase in gas share in the overall hydrocarbon output.

In the nine months of 2018, our extraction expenses increased by 3 billion RUB, or by 2.4%, compared to the nine months of 2017.

In Russia, our total and average extraction expenses decreased by 0.8% due to cost efficiency measures implemented by our production entities.

Outside Russia, our hydrocarbon extraction expenses increased by 43.5% as a result of an increase in expenses on gas production that was a result of substantial production volumes growth within Gissar and Kandym projects in Uzbekistan, as well as of the ruble devaluation. As a result of higher share of gas in our international hydrocarbon production, our average hydrocarbon extraction expenses outside Russia decreased by 5.4%. This positive dynamics was constrained by a decrease in our share in profit crude oil at the Karachaganak project.

Own refining expense

	Q3 2018	Q2 2018	9 months of 2018 2017	
			(millions of rubles)	
Refining expenses at the Group refineries	28,318	25,677	75,991	63,458
- in Russia	12,821	10,730	32,876	29,788
- outside Russia	15,497	14,947	43,115	33,670
			(ruble per tonne)	
Refining expenses at the Group refineries	1,621	1,534	1,510	1,271
- in Russia	1,172	1,006	1,019	932
- outside Russia	2,374	2,464	2,388	1,872

Our own refining expenses increased by 3 billion RUB, or by 10.3%, compared to the second quarter of 2018, and by 13 billion RUB, or by 19.8%, compared to the nine months of 2017.

Compared to the second quarter of 2018, the increase in expenses at our domestic refineries was driven by an increase in consumption of purchased additives and higher maintenance expenses, and compared to the nine months of 2017, expenses increased due to higher utilization rates at our refineries in Perm and Volgograd.

Compared to both the second quarter of 2018 and the nine months of 2017, our refining expenses outside Russia increased largely as a result of an increase in fuel cost and the ruble depreciation to euro. Moreover, dynamics of the expenses were impacted by costs of scheduled maintenance at Burgas refinery in the first half of 2018 and increased production at our refinery in Italy.

Refining expenses at third-party refineries

Along with our own production of refined products we process crude oil at third-party refineries.

At the end of 2016, as part of our trading business development, a Group company entered into a 3-year tolling agreement with a Canadian refinery. Related refining expenses represent variable toll that is mostly the difference between the price of feedstocks supplied, including various related costs, and the selling price of the refined products taken. When the refined products are sold, this toll is naturally offset by the respective refined products sales revenue. The agreed compensation is received by the Group company for execution of this agreement.

In the third quarter of 2018, this tolling fee increased to 4.5 billion RUB from 1.3 billion RUB in the second quarter of 2018 as a result of higher refining margin.

In the nine months of 2018, this tolling fee amounted to 8.3 billion RUB, compared to 9.8 billion RUB in the nine months of 2017.

Expenses for crude oil transportation to refineries

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

Compared to the second quarter of 2018 and the nine months of 2017, our expenses for crude oil transportation to refineries increased by 0.5 billion RUB, or by 3.6%, and by 1.6 billion RUB, or by 4.4%, respectively, as a result of an increase in transportation tariffs and change in terms of crude oil supplies to our refineries outside Russia.

Petrochemical expenses

Our petrochemical expenses increased by 7.4% compared to the second quarter of 2018 and decreased by 3.0% compared to the nine months of 2017.

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.

Compared to the second quarter of 2018, other operating expenses increased by 4 billion RUB, or by 46.1%. Compared to the nine months of 2017, they decreased by 8 billion RUB, or by 18.2%, mostly as a result of the sale of our diamond business in the middle of 2017.

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.

	Q3 2018	Q2 2018	9 months of 2018	
			(millions of rubles)	
Cost of purchased crude oil in Russia	6,242	4,909	15,772	12,450
Cost of purchased crude oil outside Russia	669,158	583,337	1,664,778	882,669
Compensation crude oil related to West Qurna-2 project	14,180	21,146	42,215	24,142
Cost of purchased crude oil	689,580	609,392	1,722,765	919,261
Cost of purchased refined products in Russia	13,686	9,559	35,426	40,053
Cost of purchased refined products outside Russia	561,950	528,126	1,536,081	1,217,495
Cost of purchased refined products	575,636	537,685	1,571,507	1,257,548
Other purchases	12,437	12,559	39,422	27,035
Net loss (gain) from hedging of trading operations	10,021	28,452	45,112	(13,880)
Change in crude oil and petroleum products inventory	35,830	(205)	24,010	36,719
Total cost of purchased crude oil, gas and products	1,323,504	1,187,883	3,402,816	2,226,683

Compared to the second quarter of 2018 and the nine months of 2017, the cost of purchased crude oil, gas and products increased by 136 billion RUB, or by 11.4%, and by 1,176 billion RUB, or by 52.8%, respectively, largely as a result of an increase in hydrocarbon prices, volumes of crude oil trading and ruble devaluation to the US dollar. In the nine months of 2018, these factors were partially offset by a decrease in volumes of refined product trading.

Transportation expenses

	Q3 2018	Q2 2018	9 months of 2018	
			(millions of rubles)	
Crude oil transportation expenses	22,822	23,298	66,455	66,364
Refined products transportation expenses	41,153	40,207	123,506	123,296
Other transportation expenses	6,649	4,702	14,925	14,550
Total transportation expenses	70,624	68,207	204,886	204,210

Our transportation expenses increased by 2 billion RUB, or by 3.5%, compared to the second quarter of 2018 and didn't change significantly compared to the nine months of 2017.

Compared to the second quarter of 2018, our expenses for transportation of crude oil decreased by 0.5 billion RUB, or by 2.0%. Outside Russia, transportation expenses decreased as a result of changes in delivery terms and directions, despite the sales volumes growth. At the same time, in Russia, transportation expenses increased due to higher volumes of crude oil exports.

Compared to the nine months of 2017, our expenses for transportation of crude oil didn't change both in Russia and abroad. Outside Russia, a decrease due to the decline in average freight rates and changes in delivery terms was offset by the sales volumes growth and the ruble devaluation to the US dollar. In Russia, a decrease in crude oil export volumes was offset by an increase in tariffs.

Compared to the second quarter of 2018, our expenses for transportation of refined products increased by 1 billion RUB, or by 2.4%, as a result of an increase in international sales volumes and the effect of the ruble devaluation to the US dollar.

Compared to the nine months of 2017, our expenses for transportation of refined products remained at the same level. In Russia, expenses for transportation of refined products increased due to an increase in sales volumes and transportation tariffs. Outside Russia, transportation expenses slightly decreased as a result of the decline in sales volume, despite the ruble devaluation to the US dollar.

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, refinery and power generation 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.

	Q3 2018	Q2 2018	9 months of 2018	
			2018	2017
	(millions of rubles)			
Labor costs included in selling, general and administrative expenses.....	16,287	16,396	46,755	45,328
Other selling, general and administrative expenses	24,540	24,451	70,535	70,126
Share-based compensation.....	23,269	–	23,459	325
Expenses on provision for doubtful debts.....	670	(438)	1,180	2,624
Total selling, general and administrative expenses	64,766	40,409	141,929	118,403

Compared to the second quarter of 2018 and the nine months of 2017, our selling, general and administrative expenses increased by 24 billion RUB, or by 60.3%, and by 24 billion RUB, or by 19.9%, respectively.

In late December 2017, the Company announced a new compensation plan based on approximately 40 million shares available to certain members of management and key employees for the period from 2018 to 2022, which was implemented in July 2018 and recognized as equity-settled share-based compensation plan. In the third quarter of 2018, the Group recognized non-cash expenses of 23.5 billion RUB under this plan, related to the nine months of 2018.

In the second quarter of 2018, our selling, general and administrative expenses were positively impacted by a reversal of bad debt allowance related to one of our international upstream projects as a result of a repayment of the debt.

Depreciation, depletion and amortization

Compared to the second quarter of 2018, our depreciation, depletion and amortization expenses increased by 8 billion RUB, or by 8.5%, due to launching a new gas refinery plant at Kandym project in Uzbekistan, the ruble devaluation and an increase in crude oil production in Russia.

Compared to the nine months of 2017, depreciation, depletion and amortization expenses increased by 42 billion RUB, or by 17%, due to the completion of commissioning of the first stage of the V. Filanovsky field in 2017, and commencement of related assets depreciation, and an increase in gas production volumes as a result of launching new production facilities as part of the Gissar and Kandym project in Uzbekistan.

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, an exploration and production company, operating in Kazakhstan, Bashneft-Polus, an exploration and production company that develops the Trebs and Titov oilfields 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 0.7 billion RUB, or by 11.9%, compared to the second quarter of 2018, and by 7 billion RUB, or by 55.8%, compared to the nine months of 2017, largely as a result of an increase in income of Tengizchevroil.

Taxes other than income taxes

	Q3 2018	Q2 2018	9 months of 2018		2017
	(millions of rubles)				
In Russia					
Mineral extraction taxes.....	232,845	197,634	601,651	392,123	
Social security taxes and contributions.....	6,711	7,080	20,557	19,709	
Property tax.....	6,269	6,182	18,715	14,491	
Other taxes.....	264	648	1,146	1,877	
Total in Russia.....	246,089	211,544	642,069	428,200	
International					
Social security taxes and contributions.....	1,468	1,498	4,431	3,964	
Property tax.....	229	227	650	615	
Other taxes.....	753	701	2,026	1,809	
Total internationally.....	2,450	2,426	7,107	6,388	
Total taxes other than income taxes.....	248,539	213,970	649,176	434,588	

Our taxes other than income taxes increased by 35 billion RUB, or by 16.2%, compared to the second quarter of 2018, and by 215 billion RUB, or by 49.4%, compared to the nine months of 2017. This was largely driven by an increase in the mineral extraction tax rate in Russia resulting from an increase in crude oil prices and fixed factor in the tax calculation formula starting from 2018.

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 special tax regimes).

	Q3 2018	Q2 2018	9 months of 2018		2017
	(millions of rubles)				
Decrease in extraction taxes from application of reduced and zero rates for crude oil and gas production.....	37,235	32,561	95,856	54,828	
	(thousands of tonnes)				
Volume of crude oil production subject to:					
zero rates (ultra-high viscosity).....	420	385	1,182	737	
reduced rates (tax holidays for specific regions and high viscosity oil).....	1,432	1,383	4,169	4,064	
reduced rates (low permeability deposits).....	129	119	364	232	
reduced rates (Tyumen deposits).....	211	179	580	430	
reduced rates (depleted fields).....	3,971	3,859	11,735	10,813	
reduced rates (other).....	592	561	1,709	1,781	
Total volume of production subject to reduced or zero rates.....	6,755	6,486	19,739	18,057	

Besides, the Group applies special tax regimes for crude oil production at certain fields and deposits. In the third quarter and the nine months of 2018, volumes of production subject to such regimes amounted to 1,573 thousand tonnes and 4,433 thousand tonnes (compared to 1,495 thousand tonnes in the second quarter of 2018 and 3,171 thousand tonnes in the nine months of 2017), respectively.

Excise and export tariffs

	Q3 2018	Q2 2018	9 months of 2018		2017
	(millions of rubles)				
In Russia					
Excise tax on refined products	28,358	31,330	91,029	88,476	
Crude oil export tariffs	59,525	48,127	144,417	101,985	
Refined products export tariffs.....	14,619	9,818	37,971	30,751	
Total in Russia.....	102,502	89,275	273,417	221,212	
International					
Excise tax and sales taxes on refined products.....	49,158	48,073	136,704	120,015	
Crude oil export tariffs	22	(14)	22	118	
Refined products export tariffs.....	83	68	215	250	
Total internationally	49,263	48,127	136,941	120,383	
Total excise and export tariffs.....	151,765	137,402	410,358	341,595	

Compared to the second quarter of 2018, export tariffs increased by 16 billion RUB, or by 28.0%, as a result of higher volumes of crude oil and refined products export and higher export duty rates. The volumes of crude oil export beyond the Customs Union increased by 7.5% and the volumes of refined products exports increased by 4.1%. A decrease in excise tax expenses in Russia was due to a decrease in rates for gasoline and diesel fuel from 1 June 2018, partially offset by higher sales volumes. Outside Russia, excise tax expenses increased largely due to the ruble devaluation to euro.

Compared to the nine months of 2017, export tariffs increased by 50 billion RUB, or by 37.2%. An increase in export duty rates was offset by a decrease in the volumes of crude oil and refined product export beyond the Customs Union. The volumes of export of crude oil and refined products decreased by 1.5% and by 7.8%, respectively. An increase in excise tax expenses in Russia was driven by increase in domestic sales volumes, while outside Russia the excise tax expenses increased as a result of ruble devaluation to euro, an increase in sales volumes subject to excise taxes, and growth of excise tax rates in certain countries.

Foreign exchange gain (loss)

Foreign exchange gains or losses are mostly related to revaluation of US dollar and euro net monetary position of Russian entities that largely consists of accounts receivables, loans to our foreign subsidiaries and loans received in other currencies, and it's current structure results in exchange gains when the ruble devaluates and losses when it appreciates to those currencies. Nevertheless, in late 2017, the Company's net monetary position in foreign currencies significantly decreased as a result of change in the structure of intra-group financing.

As a result of the ruble devaluation in 2018, foreign exchange gains amounted to 11 billion RUB in the third quarter of 2018 and to 32 billion RUB in the nine months of 2018, compared to a foreign exchange gain of 22 billion RUB in the second quarter of 2018 and a foreign exchange loss of 25 billion RUB in the nine months of 2017.

Other (expenses) income

Other (expenses) income include the financial effects of disposals of assets, impairment losses, extraordinary gains and losses, revisions of estimates and other non-operating gains and losses.

In the third quarter of 2018, we received a legal case compensation of \$60 million (approximately 4 billion RUB) related to our international downstream project.

In the second quarter of 2018, the Group recognized an impairment loss for its exploration and production assets in Russia in the amount of 5 billion RUB following the decision to stop exploration works at the East Taimyr block.

In the nine months of 2017, we recognized a profit before income tax from sale of our diamond business in the amount of 48 billion RUB (38 billion RUB after income tax). Moreover, in the second quarter of 2017, we received \$74 million (approximately 4.3 billion RUB) as a repayment of previously impaired receivable related to our international upstream project.

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 and application of reduced regional income tax rates in Russia.

Compared to the second quarter of 2018, our total income tax expense didn't change. At the same time, our profit before income tax increased by 16 billion RUB, or by 7.8%. In the third quarter of 2018, our effective income tax rate was 19.2%, compared to 20.7% in the second quarter of 2018.

Compared to the nine months of 2017, our total income tax expense increased by 33 billion RUB, or by 41.5%. Our profit before income tax increased by 195 billion RUB, or by 51.7%. In the nine months of 2018, our effective income tax rate was 19.4%, compared to 20.7% in the nine months of 2017.

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 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.

	Q3 2018	Q2 2018	9 months of 2018 2017	
	(millions of rubles)			
Profit for the period	184,462	167,995	461,882	299,263
Add back				
Income tax expense.....	43,888	43,868	110,873	78,341
Financial income.....	(5,132)	(4,648)	(13,294)	(9,662)
Financial costs	9,955	8,279	25,556	22,162
Foreign exchange (gain) loss	(11,215)	(22,394)	(32,177)	25,149
Equity share in income of affiliates	(6,828)	(6,104)	(18,181)	(11,670)
Other expenses (income).....	780	10,562	10,643	(44,604)
Depreciation, depletion and amortization	105,900	97,593	291,183	248,856
EBITDA	321,810	295,151	836,485	607,835
EBITDA by operating segments				
Exploration and production.....	268,631	239,699	680,248	396,456
- in Russia	220,313	203,525	568,495	341,375
- outside Russia and Iraq.....	39,174	29,877	90,577	42,496
- in Iraq	9,144	6,297	21,176	12,585
Refining, marketing and distribution segment	82,189	71,620	200,658	214,376
- in Russia	59,318	52,695	154,312	156,212
- outside Russia.....	22,871	18,925	46,346	58,164
Corporate and other.....	(23,404)	(3,724)	(26,609)	(4,668)
Elimination.....	(5,606)	(12,444)	(17,812)	1,671
EBITDA	321,810	295,151	836,485	607,835

Reconciliation of Cash provided by operating activities to Free cash flow

	Q3 2018	Q2 2018	9 months of 2018 2017	
	(millions of rubles)			
Net cash provided by operating activities	271,199	242,949	681,140	547,466
Capital expenditures.....	(111,426)	(105,777)	(338,260)	(373,770)
Free cash flow	159,773	137,172	342,880	173,696

Liquidity and capital resources

	Q3	Q2	9 months of	
	2018	2018	2018	2017
	(millions of rubles)			
Net cash provided by operating activities	271,199	242,949	681,140	547,466
including increase in working capital	(39,932)	(19,997)	(107,785)	(20,398)
Net cash used in investing activities	(115,147)	(85,912)	(329,459)	(291,316)
Net cash used in financing activities.....	(130,606)	(136,809)	(337,816)	(216,185)

Changes in operating assets and liabilities:

	Q3	Q2	9 months of	
	2018	2018	2018	2017
	(millions of rubles)			
Increase in trade accounts receivable.....	(97,171)	(76,796)	(140,397)	(19,157)
Decrease (increase) in inventories	28,789	(15,880)	(12,037)	35,910
Increase (decrease) in accounts payable	25,600	51,778	39,464	(54,354)
Increase in net taxes other than on income payable.....	5,655	20,765	31,563	30,726
Change in other current assets and liabilities.....	(2,805)	136	(26,378)	(13,523)
Total increase in working capital	(39,932)	(19,997)	(107,785)	(20,398)

Operating activities

Our primary source of cash flow is funds generated from our operations. Compared to the second quarter of 2018 and the nine months of 2017, our cash generated from operations increased by 28 billion RUB, or by 11.6%, and by 134 billion RUB, or by 24.4%, respectively, as a result of an increase in profit. In the periods considered, our operating cash flow was adversely affected by an increase in working capital.

In the nine months of 2018, the increase in working capital was driven by following factors. Trade accounts receivable increased due to higher volumes of crude oil trading operations, as well as an increase in realized prices. Our accounts payable increased in line with the growth of crude oil trading and an increase in prices. In these periods, the physical volumes of inventories decreased, however in the second quarter of 2018 and in the nine months of 2018 this factor was offset by an increase in the cost of inventory. The increase in net tax accounts payable was a result of an increase in mineral extraction taxes.

Investing activities

In the third quarter of 2018, cash used in investing activities increased by 29 billion RUB, or by 34.0%, compared to previous quarter, as a result of dynamics of loans to affiliates and increase in capital expenditures. Compared to the nine months of 2017, it increased by 38 billion RUB, or by 13.1%. This increase was a result of proceeds from sale of our diamond business in the amount of 81 billion RUB in the second quarter of 2017 that was partially offset by a decrease in capital expenditures.

Our capital expenditures increased by 6 billion RUB, or by 5.3%, compared to the second quarter of 2018 and decreased by 36 billion RUB, or by 9.5%, compared to the nine months of 2017.

	Q3 2018	Q2 2018	9 months of 2018	
	(millions of rubles)			
Capital expenditures				
Exploration and production				
West Siberia	27,831	32,724	98,744	99,836
Timan-Pechora	15,605	17,689	55,031	58,031
Ural region	8,825	8,673	26,982	21,468
Volga region.....	16,445	12,341	37,177	43,734
Other in Russia.....	2,390	1,998	6,616	9,253
Total in Russia	71,096	73,425	224,550	232,322
Iraq	6,017	4,365	15,328	10,729
Other outside Russia	9,137	13,152	36,721	90,977
Total outside Russia	15,154	17,517	52,049	101,706
Total exploration and production	86,250	90,942	276,599	334,028
Refining, marketing and distribution				
Russia.....	21,267	9,252	45,786	28,030
- refining	16,282	5,776	31,646	15,198
- retail	2,061	1,150	5,227	4,096
- other	2,924	2,326	8,913	8,736
International	3,457	4,461	13,703	10,760
- refining	2,007	3,115	9,659	7,112
- retail	670	938	2,532	3,592
- other	780	408	1,512	56
Total refining, marketing and distribution	24,724	13,713	59,489	38,790
Corporate and other	452	1,122	2,172	952
Total capital expenditures	111,426	105,777	338,260	373,770

Compared to the previous quarter, our upstream capital expenditures decreased by 5 billion RUB, or by 5.2%. An increase in expenditures in Volga region was due to further development of the Yu. Korchagin and V. Filanovsky fields in the Caspian Sea. A decrease in West Siberia and Timan-Pechora was primarily due to a seasonality factor. A decrease outside Russia was due to completion of construction works at the Gissar and Kandym projects in Uzbekistan.

In Russian downstream, capital expenditures compared to the previous quarter increased due to the commencement of construction of the delayed coker complex at Nizhny Novgorod refinery and upgrade of petrol stations in Russia.

Compared to the nine months of 2017, our capital expenditures in the exploration and production segment decreased by 57 billion RUB, or by 17.2%, mainly due to lower spending in Uzbekistan after completion of main construction works as part of the Gissar and Kandym projects.

The increase in capital expenditures in our refining, marketing and distribution segment compared to the nine months of 2017 was primarily due to commencement of construction works at Nizhny Novgorod refinery.

The dynamics of our international capital expenditures was also affected by the ruble devaluation.

The table below presents our exploration and production capital expenditures at our growth projects.

	Q3 2018	Q2 2018	9 months of 2018	
	(millions of rubles)			
West Siberia (Yamal).....	4,398	7,198	17,286	11,303
Caspian region (Projects in Russia).....	15,244	11,211	33,826	41,277
Timan-Pechora (Yaregskoye field).....	1,687	3,030	7,421	9,901
Iraq (West Qurna-2 project)	5,200	4,002	14,018	9,754
Iraq (Block-10).....	817	363	1,310	975
Uzbekistan	2,928	6,450	18,911	69,674
Total	30,274	32,254	92,772	142,884

Financing activities

In the third quarter of 2018, net movements of short-term and long-term debt generated an outflow of 22 billion RUB, compared to an outflow of 121 billion RUB in the second quarter of 2018. In the nine months of 2018, net movements of short-term and long-term debt generated an outflow of 148 billion RUB, compared to an outflow of 41 billion RUB in the nine months of 2017.

Other information

Sectoral sanctions against the Russian companies

In July-September 2014, the United States (“US”), the European Union (“EU”) and several other countries imposed a set of sanctions on Russia, including sectoral sanctions which affect several Russian oil and gas companies. The US has placed the Company onto the Sectoral Sanctions Identifications List subject to Directive 4. Directive 4 prohibits US 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 that have the potential to produce oil in the Russian Federation, or in maritime area claimed by the Russian Federation and extending from its territory.

In August-October 2017, the US expanded abovementioned sanctions to include international oil projects initiated on or after 29 January 2018 that have the potential to produce oil in any location, and in which companies placed on the Sectoral Sanctions Identifications List (subject to Directive 4) have an ownership interest of 33% or more, or ownership of a majority of the voting interests.

The management believes that current sanctions do not have a material adverse effect on the Group’s oil projects. At the same time, the Company continues to monitor and evaluate potential risks for its operations in connection with sanctions.

Operations in Iraq

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