## United Nations Sustainable Development Goals

### Priority strategic directions

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<td>Protect, restore and promote sustainable use of terrestrial ecosystems, sustainable manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss</td>
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### THE COMPANY’S OPERATING CONTEXT

The average price of Urals-grade oil as per the 2018 year-end results was slightly more than 70.2 USD/bbl. Apart from the extension of the OPEC+ deal, price stabilization and growth in 2018 were worsened by the political situation in a number of oil-exporting countries and the strengthening of the sanctions pressure. Due to the measures taken by OPEC, the Brent grade oil price remained at the level of above 70 USD/bbl for most of the year. In Q4, it exceeded 84 USD/bbl. In 2018, the oil supply surplus on the world market was partially mitigated owing to the collective efforts of the countries participating in the OPEC+ production restriction deal. However, significant growth of oil price caused production intensification and resulted in price...
compensation to the October 2017 level. Year-end 2018 was characterized by conservative forecasts based on expected overproduction of liquid hydrocarbons.

The established tax environment in the Russian Federation, along with the actual couple of “oil price – USD exchange rate” partially mitigated the growth of the average Urals-grade oil price per ton after taxes. Despite the significant growth of the global price, the price in rubles after taxes increased only by 16% due to the absence of the price change compensation effect and due to fluctuations in the currency exchange rates. At this, the tax burden per 1 ton of oil increased by 50% compared to 2017.

The oil products market dynamics in the Mediterranean region where the Downstream assets of Zarubezhneft JSC are operating allowed to maintain a high level of the assets’ operating efficiency up to Q4.

Changes in the environmental legislation in 2018
A major reform of environmental legislation continued in 2018. A number of new laws and amendments to current regulations previously adopted towards the end of 2017 have introduced significant changes in the environmental assessment and waste handling processes. The Russian federal law dated December 28, 2017 N 422-FZ introduced changes to Article 14 of the Russian Federal Law – Concerning Environmental Assessment and Art. 12 of the Federal Law – Concerning Changes in the Federal Law – Concerning Environment Protection. The Russian federal law dated December 30, 2017 N 503-FZ – Concerning Changes in the Federal Law – Concerning Production and Consumption Waste, as well as individual statutory acts of the Russian Federation, have changed the rules regulating waste handling at enterprises and the handling of solid household waste. The procedure for the calculation of the environmental payments made by the enterprise to the budget as compensation of the negative environmental impact has also been changed.

Changes to production technology
The Company is integrating modern technologies intensively to increase the development efficiency of the existing fields. This includes adaptation of front-end EOR methods for fractured carbonate reservoir conditions. The possibility of applying tertiary enhanced oil recovery methods is being analyzed: gas bank injection, smart water application, thermal and gas treatment, surfactant-polymer flooding. These technologies contribute to the increase of the displacement factor and, therefore, the increase of the ultimate oil recovery factor, and are therefore widely applied by the leading oil producing companies (BP, Shell, Equinor (ex. Statoil), Total). In 2016-2018, Zarubezhneft carried out R&D for these technologies and in 2019, it plans to perform a number of pilot production tests at the fields to integrate the front-end scientific developments into production.

Digital transformation projects
The Company is currently implementing long-term projects aimed at improving controllability, increasing accuracy of information and enhancing production efficiency. Thus, in 2018, the in-house developed software – the integrated engineering system NestroWay, software complexes for managing the integrity of oil and gas equipment and planning of power infrastructure, production automation projects in the subsidiaries were tested. Apart from this, in 2018, the Company established and commissioned the corporate Knowledge Management System (KMS) which corresponds to the best international similar software and is a unified platform for obtaining information, sharing experience and providing opportunity for direct communications with the company’s experts specializing in various occupational knowledge areas.
Strategic priorities
In 2018, the Company continued the second stage of implementation of the Zarubezhneft JSC Corporate Development Strategy called “Readiness for Growth and First Successes” to be completed in 2020. The main focus of this stage is the development of the Upstream segment where Zarubezhneft JSC shall focus on fields where it is possible to expand its own competencies, particularly fields with out-of-balance development systems and fields with complex reservoirs similar to those being developed in the Company’s regions of presence. The third stage, which is estimated to last until 2030, is called “Intensive Growth” and envisions the launch of more than five new projects and achievement of the 15 MM TOE production level (5.2 MM TOE by year-end 2018).

Expansion of the area of activity
The basis for the Company’s long-term growth as per the Zarubezhneft JSC Corporate Strategy is its launch of new oil projects. During the reporting period, the Company implemented several measures to develop this business line that included the following:
- Zarubezhneft JSC’s policy in the field of business development in the UPSTREAM sector was developed and approved;
- a new version of the Business Process Standard “Search and Evaluation of New Assets” was prepared;
- The IT-system for monitoring the evaluation process and entering new projects was launched into pilot operation;
- The Benchmarking concept was developed; a comparative analysis of the activities of Russian and foreign companies on entering new projects is now underway.

In 2018, more than 30 projects were reviewed in the Russian Federation and abroad; Investment Committee meetings were held on 22 projects. Experts of the Corporate Center and its subsidiaries carried out four process audits of new fields. In addition to the countries of the Company’s traditional presence (Vietnam and Cuba), the Company began focusing its activities on searching, evaluating and developing projects in the following regions:
- Middle East and Africa (Iraq, Egypt, Gabon);
- South America (Ecuador, Colombia, Argentina);
- Southeast Asia (Indonesia, Brunei).

During the reporting period, a number of documents were signed with foreign partners that laid the legal foundation for future cooperation: Confidentiality agreements were signed with the Ministry of Oil and Ore Mining of Sudan, Sudapet Sudan National Oil and Gas Company, Stream Oil (Gabon) and Pura Vida (Australia) private companies, and a Memorandum of Understanding was signed with the Ministry of Oil of South Sudan.

LONG-TERM DEVELOPMENT PROGRAM
For the comprehensive evaluation of the Company’s assets under the Long-term Development Program, three main development scenarios for the existing entities with an outlook for 2030 and two prospective development options were contemplated: projects of geologic exploration works, in which Zarubezhneft JSC participates directly or indirectly, as well as potentially attractive major investment projects.

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1 Zarubezhneft JSC’s Long-term Development Program (LDP) was formed in pursuance of the instructions of the Government of the Russian Federation dated July 17, 2014, No. 4955n-П13. The Zarubezhneft JSC Board of Directors approved the LDP on November 20, 2014 (Minutes of Meeting #91).
The priority goal for the future development of the Company is not only intensive development of its current production assets (especially LLC “RUSVIETPETRO” and JV “Vietsovpetro”), but also the active search for and entry into prospective major oil and gas production investment projects.

The potential regions in which the Company has accumulated significant experience in integrated project implementation, particularly Vietnam, Russian Federation and the Middle East, are of top priority for consideration. The accumulated significant experience in increasing the current value of assets by incrementing the current assets' resource base and improving its development efficiency by raising the oil recovery factor for the fractured basement deposits as well as active engagement in the development of low-capacity terrigenous block structures allow outlining the strengths of the Company's existing competencies.

To improve performance in the major Upstream segment, Zarubezhneft JSC is making target-oriented efforts in several key areas:

1. Maximization the synergy of the Group of Companies' current assets with the new projects.

2. Competency development for the efficient development of complex reservoirs by expanding the scientific assets of the Company, VNIIneft JSC and Giprovostokneft JSC.

3. Development of full-range service package for fields at any development stage by establishing full-scale construction and drilling contractors on the service segment basis. Zarubezhneftestroyomontazh LLC continues its work as a full-scale construction contractor for the Group with expansion of its own capacities. RMNTK Nefteotdacha JSC launched projects for sidetracking service development and further replacement of third-party contractors for the performance of work and supervising at LLC “JC “RUSVIETPETRO” remote fields.

CSR PROGRAMS IMPLEMENTED AS PART OF THE STRATEGY AND PART OF THE LONG-TERM DEVELOPMENT PROGRAM

The Company’s KPI system includes the basic mechanism for motivating the management of the Company and its subsidiaries to perform the tasks assigned by the State as the 100% shareholder of the Company, the target indicators of Zarubezhneft’s Strategy, the LDP, Zarubezhneft’s Business Plan indicators and the investment projects being implemented by Zarubezhneft JSC. The benchmark list includes a number of CSR aspects reflected in the KPIs: labor capacity and OPEX decrease.

Labor capacity, thous. RUB/man-hour

The “Labor capacity” indicator is estimated as the revenue of Zarubezhneft JSC as per RAS, calculated in conditions comparable to 2017 and correlated with the number of man-hours worked by the Company’s employees. In 2018, the figure was 63.0 thousand RUB/man-hours, with the established target value of 48.6 thousand RUB/man-hours. The indicator growth rate to the previous year’s level was 111%. Thus, the target growth rate of 108.2% was fulfilled, which was fixed in the

Reduction of the operating expenditure reduction was approved with a target value of -2% (Directives No. 2303п-П13 dated April 16, 2015). As per the Cost Efficiency Improvement and Optimization Report for 2018, the actual Operating Expenditure Reduction value by year-end 2018 was 3.1% (Minutes of the Meeting of Zarubezhneft JSC Board of Directors No. 164 dated February 26, 2019), and exceeded the value established by the Directive of the Government of the Russian Federation.

Apart from the strategic KPI, the following indicators are controlled under the Long-term Development Program: Occupational Health, Industrial Safety, Environment Protection, Security and Zarubezhneft JSC Social Responsibility.

In 2018, 22 projects were implemented under the Zarubezhneft JSC Innovational Development Program for 2016-2020 (with an outlook for 2030). The expected results were achieved for all projects, the set milestones were passed.

In 2018, the Comprehensive Program for Replacement of Purchasing of Foreign Products, Works and Services with Equivalent Russian Products, Works and Services was updated.

In 2014, Zarubezhneft JSC joined the Anti-corruption Charter of Russian Business. An anti-corruption policy is in force within the company (Version 2.0, adopted by the Board of Directors in 2016). The policy highlights the unacceptability of corrupt actions that include conflicts of interests both towards the representatives of the state, public institutions, politicians and other third parties and the employees of the Company and subsidiaries through the abuse of official capacity for personal benefit. In 2017, an independent anti-corruption audit of the Company’s Internal Corruption Risk Control and Management System was performed. In the reporting year, adjustments were made in the following regulations: “Procurement management”, “Legal support”, “Finance and treasury operations management”, “Investment planning”, “Personnel management”, “Communications management”, “Charity and sponsorship”, “M&A deals making” and “Gifts and representative costs”.

Zarubezhneft JSC expressly declares its non-acceptance of corruption, and strictly follows the requirements of Russian laws and the laws of other countries where the Company is carrying out or plans to carry out its activities.

Anti-corruption clauses were included in the bodies of contracts and agreements with partners and counter-agents, labor contracts with Zarubezhneft JSC employees, contracts on material remuneration of Russian employees working abroad, as well as the numerous internal regulatory documents.
Being a participant of the Anti-corruption Charter of Russian Business, the Company regularly undergoes a procedure to confirm proper and full implementation of the anti-corruption measures.

One of the key tasks of the second stage of implementation of the Company’s Strategy in terms of organizational development in the context of planned inorganic growth in the number of assets is the transition to the STRATEGIC CONTROLLER management model, a management model in which the Corporate Center becomes a strategic system and methodological controller of subsidiaries, ensuring the creation of a unified methodological base and uniform rules of work on key processes in the corporate center and in subsidiaries.

To implement this task, the Company has implemented a system of business processes that operates effectively.

In 2018, the improvement project “Implementation of the Organizational Framework and the Updated Regulatory System” was successfully completed, under which:
- the principles and the matrix of functional distribution between the CC and SC was developed;
- the standard for a new business process, “Corporate Subsidiary Management”, was approved, including the Corporate Management Matrix and the Business Processes Decision-making Matrix;
- The Specific organizational framework for business processes was developed – a set of standard requirements for enterprises of the Group of Companies;
- a single database of existing internal regulatory documents (about 500 internal regulatory documents) was formed;
- an institute of expert methodologists was established, 51 expert methodologists were appointed on 66 business processes.

**INVESTMENT PROGRAM FOR THE MAIN PRODUCTION SEGMENTS**

As part of the investment projects portfolio management, regular work on the analysis, monitoring and adjustment is being carried out that allows establishing a significant safety buffer against all possible negative fluctuations of the macroeconomic environment to retain a high positive economic efficiency.

Projects funding is performed as per the investment decisions adopted and is aimed at ensuring the Company’s development as per the approved Long-term Development Program.
Here, the company provides funding in two directions:
- Search for new assets;
- Maximum development of the most efficient existing assets.

**Upstream segment projects**
The Upstream segment is the most efficient segment in terms of the implementation of investment projects. The efficiency of the segment’s investment portfolio has significantly grown and the project implementation risks at the geologic exploration and production stage are sustainably decreasing owing to the regular monitoring and control of asset development projects, NPV integration into the management motivation system, as well as efficient decision making by the Zarubezhneft JSC Investment Committee.

As part of costs optimization for the Block 12/11 project, the Company’s plans to account for the drilling and testing of the 4-th exploration well, as well as for development of a number of design documents for commissioning the Thien Nga – Hai Au structures. The option of using the infrastructure of the nearest Block 11-2 to optimize the cost of transporting products is being elaborated.

The period of pilot production development of the Boca de Jaruco project in the Republic of Cuba was extended for two years, and efforts to recover CUPET costs in this projects out of the Special Account’s funds were also arranged. The Company managed to mitigate significant geological risks by stopping further development of Reservoir E; at this, it plans on using the infrastructure developed for this reservoir to provide the project with its own gas. The main task for 2019 is the selection of the optimal cyclic steam treatment technology. The 2019 Work Program envisages drilling and developing three horizontal wells, as well as arranging a well production metering unit. A pilot production period of 5 years was adopted for the project.

Phased geologic exploration work, infrastructure construction and drilling of production wells are being performed under the Lutseyakshskoye Field Project to obtain first oil flow starting from 2020. At the same time, the main scenario for the development of a field is its movement to the taxation system using the Excess-Profits Tax.
Under the South-Pchelinskoye License Area Project, there are plans to drill prospecting and exploration and development wells in 2022-2023, as well as to develop the necessary infrastructure at the field. The field is expected to be commissioned in 2022.

**Downstream segment projects**
Under the 2019-2033 Investment Program, there are plans to implement investment projects for the maintenance of segment enterprises investments for which were postponed in connection with the Optimization Program and Brod Refinery’s operational downtime.

The new capital investments aimed at restoring the refinery’s operations in 2019 will be the first priority under the 2019-2023 Investment Program.

The second priority for implementation is the project for the refinery’s gasification to ensure compliance with the environmental standards, which will also allow additional increase of stock products.

The investment program of Modriča Motor Oil Plant includes measures mainly aimed at maintaining the plant’s operations. No investments for expanding and developing the capacities of the motor oil plant are planned.