Management's discussion and analysis of financial condition and results of operations

The following report represents management's discussion and analysis of the financial condition and results of operations of OAO LUKOIL as of December 31, 2008, and each of the years ended December 31, 2008, 2007 and 2006, and significant trends that may affect its future performance. It should be read in conjunction with our US GAAP consolidated financial statements and notes and supplemental oil and gas disclosure.

References to "LUKOIL," "the Company," "the Group," "we" or "us" are references to OAO LUKOIL and its subsidiaries and equity affiliates. All dollar amounts are in millions of US dollars, unless otherwise indicated. Tonnes of crude oil produced are translated into barrels using conversion rates characterizing the density of oil from each of our oilfields. Tonnes of crude oil purchased as well as 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 into BOE 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. Please see "Forward-looking statement" on page 39 for a discussion of some of the factors that could cause actual results to differ materially.

Key financial and operational results

	2008	Change to 2007, %	2007	Change to 2006, %	2006
Sales (millions of US dollars)	107,680	31.5	81,891	21.0	67,684
Net income (millions of US dollars)	9,144	(3.9)	9,511	27.1	7,484
EBITDA (millions of US dollars)	15,552	1.1	15,388	25.1	12,299
Taxes, other than income tax (including excises and export tariffs)	(34,804)	42.6	(24,400)	12.7	(21,645)
Basic earnings per share of common stock (US dollars)	10.88	(5.2)	11.48	26.7	9.06
Diluted earnings per share of common stock (US dollars)	10.88	(5.2)	11.48	27.0	9.04
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	803,109	1.0	795,099	1.5	783,194
Crude oil production by the Group including our share in equity affiliates (thousands of tonnes)	95,240	(1.5)	96,645	1.5	95,235
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	17,020	22.0	13,955	2.5	13,612
Refined products produced by our subsidiaries (thousands of tonnes)	52,455	7.4	48,819	6.9	45,670
Hydrocarbon proved reserves including our share in equity affiliates (millions of BOE)	19,334	(5.1)	20,369	–	20,360

During 2008, our net income was $9,144 million, which is $367 million, or 3.9%, less than in 2007.

In 2008, the main driver of our performance was international hydrocarbon prices. In the nine months of 2008, high level of hydrocarbon prices and high refining margins resulted in our outstanding financial results despite effect of growing tax and transportation expenses and the real ruble appreciation. However, a slump in hydrocarbon prices in the fourth quarter of 2008 along with a loss resulting from the ruble devaluation, and high level of export duties rates in the beginning of the quarter led to a quarterly loss amounted to $1.6 billion. Nevertheless, we secured Company cash inflows from operating activities and gained noticeable free cash flow in 2008. These and other drivers impacting the results of our operations are considered below in detail.

Segment information

Our operations are divided into three main business segments:

- **Exploration and Production** – which includes our exploration, development and production operations relating to crude oil and natural gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, Uzbekistan, the Middle East, South America, and Northern and Western Africa.

- **Refining, Marketing and Distribution** – which includes refining and transport operations, marketing and trading of crude oil, natural gas and refined products.

- **Chemicals** – which includes processing and trading of petrochemical products.

Other businesses include a power generation business, banking, finance and other activities. Each of our three main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the "Domestic crude oil and refined products prices" section on page 9, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of refining crude oil and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 23 "Segment information" to our consolidated financial statements.

Executive overview

Recent developments and outlook

The following has been achieved in 2008:

Exploration and production

- 11 new oil and gas fields were brought on line (2007: 13 oil and gas fields).
- In August, we began commercial production on the first stage of the Yuzhnoye Khylchuyu oil field. In December, the Company completed the construction of the second stage of the field. We produced 1,527 thousand tonnes from this field to December 31, 2008.

Refining

- We acquired 49% interest in the ISAB refinery complex in Priolo, Italy. The ISAB has an annual refining capacity of 16 million tonnes.
- In April, the Odessa refinery was put back into operation after the completion of the wide-scale upgrade started in August 2005. Annual capacity of the Odessa refinery was extended up to 2.8 million tonnes per year.

Marketing

- The Company acquired 689 petrol stations and various downstream infrastructure in Turkey, 75 petrol stations and storage facilities in Bulgaria.
- In the Russian Federation we acquired petrol stations networks of companies ZAO Association Grand, OOO Mega Oil M, and we increased from 41.81% to 85.32% our share in OAO Udmurtnefteproduct. Therefore, we increased our network by 272 stations.

Other

- We entered power generation and distribution business by acquiring OAO UGK TGK-8 ("TGK-8"), which increases synergy and efficiency of the Group business.

Other achievements in 2008 are described in detail in other parts of this report.

Changes in the Group structure, acquisition and disposition of assets

In the fourth quarter of 2008, the Group acquired a 100% interest in ZAO Association Grand and OOO Mega Oil M for $493 million. ZAO Association Grand and OOO Mega Oil M are holding companies, owning 181 petrol stations in Moscow, the Moscow region and other regions of central European Russia. This acquisition was made in order to expand the Group's presence on the most advantageous retail markets in the Russian Federation.

In July 2008, a Group company signed an agreement to acquire a 100% interest in the Akpet group for $555 million. The transaction was finalized in November 2008. The amended agreement provided for three payments of purchase consideration: the first payment in amount of $250 million was paid at the date of finalization; second and third deferred payments should be paid by the end of April 2009 and October 2009, respectively. The Akpet group operates 689 petrol filling stations on the basis of dealer agreements and owns eight refined product terminals, five LNG storage tanks, three jet fuel terminals and a lubricant production plant in Turkey.

In June 2008, a Group company signed an agreement with ERG S.p.A. to establish a joint venture to operate the ISAB refinery complex in Priolo, Italy. In December 2008, the Group completed the acquisition of a 49% stake in the joint venture for €1.45 billion (approximately $1.83 billion). In December 2008, the Group company paid €600 million (approximately $762 million). The remaining amount was paid in February 2009. The seller has a put option, the effect of which would be to increase the Group's stake in the company operating the ISAB refinery complex up to 100%. The agreement states that each partner will be responsible for procuring crude oil and marketing refined products in line with its equity stake in the joint venture. The ISAB refinery complex has the flexibility to process Urals blend crude oil, and the Group intends to fully integrate its share of the ISAB refinery complex capacity into its crude oil supply and refined products marketing operations. The ISAB refinery complex has an annual refining capacity of 16 million tonnes. The ISAB refinery complex also includes three jetties and storage tanks totaling 3,700 thousand cubic meters.

In December 2005, the Company made a decision to sell ten tankers. A Group company finalized the sale of eight tankers in May 2006, for a price that approximated their carrying value of $190 million. The sale of the remaining two tankers was finalized in April 2008, for a price that approximated their carrying value of $70 million.

In March 2008, a Group company entered into an agreement to acquire 75 petrol stations and storage facilities in Bulgaria for approximately $367 million. The transaction was finalized in the second quarter of 2008.

In March 2008, a Group company acquired 100% of the share capital of the SNG Holdings Ltd. group for $578 million. The purchase agreement provided for two additional components of contingent purchase consideration in amount of $100 million each. During 2008, all conditions for contingent purchase consideration were met and a Group company completely settled its obligation under the purchase agreement. The SNG Holdings Ltd. group holds a 100% interest in a production sharing agreement in oil and gas condensate fields located in the South-Western Gissar and Ustyurt regions of Uzbekistan. The purpose of the acquisition was to increase the Group's presence in the Uzbekistan oil and gas sector.

In March 2008, a Group company entered into an agreement with a related party, whose management and directors include members of the Group's management and Board of Directors, to acquire a 64.31% interest in TGK-8 for approximately $2,117 million. The purchase consideration partly consists of 23.55 million shares of common stock of the Company (at a market value of approximately $1,620 million). The transaction was finalized in May 2008. From May to December 2008, a Group company acquired additional interests in TGK-8 for a total of $1,075 million. These acquisitions increased the Group's ownership to 95.53%. TGK-8 is one of the major gas consumers in the Southern Federal District with an annual consumption of 6 billion cubic meters per year. Its power plants are located in Astrakhan, Volgograd and Rostov regions, Krasnodar and Stavropol Districts, and the Republic of Dagestan of the Russian Federation with total productive capacity of 3.6 GW. By purchasing TGK-8 LUKOIL expects significant synergies through natural gas supplies from the Company's gas fields located in the Northern Caspian and in Astrakhan region, which will allow the Company to reach efficient gas price. This acquisition is made in accordance with the Company's plans to develop its electric power business.

During 2007, the Group acquired 7.65% of the share capital of OAO "LUKOIL-Nizhegorodnefteorgsintez" ("Nizhegorodnefteorgsintez") from minority shareholders for $154 million. During 2008, the Group additionally acquired 3.09% of the share capital of Nizhegorodnefteorgsintez for $64 million. As of December 31, 2008, the Group's ownership in Nizhegorodnefteorgsintez was 100%. Nizhegorodnefteorgsintez is a refinery plant located in European Russia.

In December 2007, a Group company acquired a distribution network of 55 petrol stations and storage facilities in the Rostov region, for $56 million. The acquisition of this distribution network will enable the Company to double petroleum products marketing output in the region. We expect our refined products sales in this region to increase up to 200 thousand tonnes per year, which represents 12% of the local retail market as a result of this acquisition.

In June 2007, the Group finalized the acquisition of a 100% interest in companies owning 376 petrol stations in Europe, including 156 in Belgium and Luxembourg, 49 in Finland, 44 in the Czech Republic, 30 in Hungary, 83 in Poland and 14 in Slovakia, for $444 million from ConocoPhillips, its related party. The stations located in Finland were re-branded as Teboil stations in 2007. The most part of the petrol stations in other European countries were re-branded as LUKOIL stations during 2008.

In November 2006, a Group company entered into an agreement with Mittal Investments S.A.R.L. to sell 50% of its interest in Caspian Investment Resources Ltd. ("Caspian", formerly Nelson Resources Limited), which has exploration and production operations in western Kazakhstan, for $980 million. This transaction was completed on April 20, 2007. In addition, Mittal Investments S.A.R.L. paid a liability in the amount of $175 million, which represented 50% of Caspian's outstanding debt to Group companies.

In January 2007, a Group company acquired the remaining 34% of the share capital of OOO Geoilbent for $300 million. The acquisition increased the Group's ownership to 100%. Prior to this acquisition the Group accounted for its investment using the equity method of accounting due to the fact that the minority shareholder held substantive participating rights. OOO Geoilbent was an exploration and production company operating in the West Siberian region of the Russian Federation.

Resource base

The table below summarizes the net oil-equivalent proved reserves of consolidated subsidiaries and our share in equity affiliates:

(millions of BOE)	December 31, 2008	Changes in 2008			December 31, 2007
		Production*	Extensions, discoveries and changes in structure	Revision of previous estimates	
Western Siberia	10,494	(486)	454	(861)	11,387
Timan-Pechora	3,017	(126)	69	(391)	3,465
Ural region	2,165	(90)	15	10	2,230
Volga region	1,670	(28)	8	(9)	1,699
Other in Russia	234	(16)	21	(20)	249
Outside Russia	1,754	(71)	308	178	1,339
Proved oil and gas reserves	**19,334**	**(817)**	**875**	**(1,093)**	**20,369**
Probable oil and gas reserves	**11,767**				**12,187**
Possible oil and gas reserves	**5,282**				**6,301**

* Gas production shown before own consumption.

The Company's proved reserves as of January 1, 2009 amount to 19.3 billion BOE and comprise of 14.5 billion BOE of crude oil and 29.3 trillion cubic feet of gas.

In 2008, the increase in Company's proved reserves due to geological exploration and production drilling amounted to 601 million BOE.

Acquisitions increased our proved reserves by 274 million BOE, mainly due to the acquisition of 100% share of the PSA project in South-Western Gissar and Ustyurt region in Uzbekistan.

However, the Company's reserves estimation was affected by the global economic crisis and respective decrease in commodities and raw materials prices. The Urals blend oil price as of the estimation date was nearly three times lower as compared to the level of previous year estimation. This decrease affected the economic feasibility of the Company's reserves development and resulted in a transfer of 1.1 billion BOE from the proved reserves category into the category of inexpedient resources.

These reserves are not to be developed in the near future, and their transfer to a lower category will not affect the Company's present plans.

The Company expects transfer of the most of the resources dismissed due to economic reasons to the proved reserves category in case of oil price growth.

Operational highlights

Hydrocarbon production

	2008	2007	2006
Daily production of hydrocarbons, including Company's share in equity affiliates (thousand BOE per day)	2,194	2,178	2,145
- crude oil	1,921	1,953	1,926
- natural and petroleum gas*	273	225	219
Hydrocarbon extraction expenses (US dollar per BOE)	4.12	3.58	3.08

* Gas available for sale (excluding gas produced for our own consumption).

Crude oil production. In 2008, our total daily crude oil production decreased by 1.6%, compared to 2007. We produced (including the Company's share in equity affiliates) 702.9 million barrels, or 95.2 million tonnes.

The following table represents our production in 2008 and 2007 by major regions.

		Change to 2007			
(thousands of tonnes)	2008	Total, %	Change in structure	Organic change	2007
Western Siberia	56,187	(6.1)	105	(3,767)	59,849
Timan-Pechora	16,685	14.5	–	2,109	14,576
Ural region	11,548	3.3	–	365	11,183
Volga region	3,041	0.8	–	24	3,017
Other in Russia	2,185	3.6	–	75	2,110
Crude oil production in Russia	89,646	(1.2)	105	(1,194)	90,735
Crude oil produced internationally	3,200	(6.2)	(360)	148	3,412
Total crude oil produced by consolidated subsidiaries	**92,846**	**(1.4)**	**(255)**	**(1,046)**	**94,147**
Our share in crude oil production of equity affiliates:					
in Russia	299	(18.1)	(69)	3	365
outside Russia	2,095	(1.8)	–	(38)	2,133
Total crude oil production	**95,240**	**(1.5)**	**(324)**	**(1,081)**	**96,645**

The main oil producing region of the Company is Western Siberia. In the oil fields of Western Siberia the Company produced 60.5% of its crude oil in 2008 (63.6% in 2007 and 63.8% in 2006). In 2008, the Western Siberian producing assets continued to mature resulting in a production decline and water cut increase. A significant impact on our production in the period was caused by a lack of sufficient power generating capacities to meet the growing demand for extra power from a wide range of oil producers in Western Siberia as they faced the need to scale up pumping operations supporting crude oil production operations. In order to compensate for the decrease in crude oil production the Company is opening up oil fields in the Timan-Pechora and Caspian regions. In August 2008, we began commercial production on the first stage of the Yuzhnoye Khylchuyu oil field, located in the Timan-Pechora region. We produced 1.5 million tonnes from this field to December 31, 2008. In 2009, we expect to reach annual production of 7.5 million tonnes on the Yuzhnoye Khylchuyu oil field. This oil field is developed within our strategic partnership with ConocoPhillips.

The structural decrease in overseas crude oil production reflects the changes in ownership of Caspian, where the Group reduced its interest from 100% to 50% at the end of April 2007.

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, including vertically integrated oil companies that lack refining capacity or are unable to export their crude oil. Then we either refine or export this purchased crude oil. Crude oil purchased on international markets is used for trading activities, for supplying our overseas refineries or for processing at third party refineries.

	2008		2007		2006	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	1,730	236	345	47	13,561	1,850
Crude oil purchases internationally.....	76,078	10,379	32,802	4,475	37,390	5,101
Total crude oil purchased................	**77,808**	**10,615**	**33,147**	**4,522**	**50,951**	**6,951**

The increase in volumes of crude oil purchased internationally resulted from increased refining and trading. In 2008, we purchased 5,029 thousand tonnes in order to process at our and at third party refineries (including 416 thousand tonnes at the ISAB refinery complex) compared to 1,534 thousand tonnes in 2007.

Gas production. In 2008, we produced 17,020 million cubic meters of gas available for sale (including our share in equity affiliates), an increase of 22.0%, compared to 2007.

Our major gas production field is the Nakhodkinskoe gas field, where we produced 8,313 million cubic meters of natural gas in 2008, compared to 7,719 million cubic meters in 2007. In mid-2007, we began production from the Shakh-Deniz field in Azerbaijan where our share in gas production totaled 552 million cubic meters in 2008. At the end of 2007, we began production from the Khauzak gas field in Uzbekistan, where we produced 2,340 million cubic meters of natural gas in 2008.

Refining, marketing and trading

We operate four refineries located in European Russia and three refineries located overseas – in Bulgaria, Ukraine and Romania. In August 2005, we closed the Odessa refinery to commence a wide-scale upgrade. In April 2008, we put it back into operation after the completion of the upgrade. Annual capacity of the Odessa refinery amounts to 2.8 million tonnes. In 2008, we acquired 49% interest in the ISAB refinery in Priolo, Italy.

Compared to 2007, production at our refineries increased by 7.4%. Russian refineries increased production by 4.2%. In the second quarter of 2008, the production of our Ukhta refinery was lower than the average quarterly level by approximately 0.4 million tonnes due to a planned overhaul. In 2007, our refinery throughput in Russia was lower than planned by approximately 0.2 million tonnes due to a fire at the Volgograd refinery in March 2007. We recovered crude oil throughput at the refinery by the end of April 2007. The production of our overseas refineries increased by 23.1% in 2008, compared to 2007, primarily due to putting into operation the Odessa refinery. Besides, our share of refined products produced on the ISAB refinery amounted to 578 thousand tonnes.

The Group is constantly improving the refined products mix at our refineries in order to produce more profitable products of higher quality. At our Russian refineries we produced 7,224, 7,218 and 6,542 thousand tonnes of Euro 4 and Euro 5 diesel fuel in 2008, 2007 and 2006, respectively. In 2008, 2007 and 2006, our production of Euro 3 gasoline amounted to 4,191, 852 and 548 thousand tonnes, respectively.

Along with our own production of refined products we refined crude oil at third party refineries. In Russia we refined crude oil at third party refineries primarily to supply our network in the Ural region and for export sales. To supply our retail networks in Eastern Europe we refined crude oil at third party refineries in Belarus and Serbia. In early 2007, we decreased processing of our crude oil at Belarussian refineries due to a reduction in profitability of these operations resulting from changes in legislation. However, the growth in refining margins at the end of 2007 and beginning of 2008 resulted in increased volumes of refining in Belarus. Refined products processed in Belarus are used for supplying our local retail network and for wholesale export.

Our marketing and trading activities mainly include wholesale and bunkering operations in Western Europe, South-East Asia, Central America and retail operations in the USA, Central and Eastern Europe, the Baltic States and other regions. In 2008, the total volume of refined products purchased from third parties for wholesale and retail network supply was 38,687 thousand tonnes, or $29,741 million (compared to 38,694 thousand tonnes, or $23,883 million, in 2007, and 35,928 thousand tonnes, or $19,413 million, in 2006).

In Russia we purchase refined products on occasion, primarily to manage supply chain bottlenecks.

The following table represents volumes of refinery throughput, refined products produced and purchased.

	2008	2007	2006
	(thousand barrels per day)		
Own refinery throughput	1,113	1,044	978
Refinery throughput at the affiliated and the third parties refineries	120	93	100
Total refinery throughput	**1,233**	**1,137**	**1,078**
	(thousand of tonnes)		
Refined products produced at the Group refineries in Russia*	42,067	40,381	37,459
Refined products produced at the Group refineries outside Russia	10,388	8,438	8,211
Total refined products produced at the Group refineries	**52,455**	**48,819**	**45,670**
Refined products produced at the third party refineries in Russia	2,881	3,270	3,002
Refined products produced at affiliated and third party refineries outside Russia	2,701	945	1,586
Total refined products produced at affiliated and third party refineries	**5,582**	**4,215**	**4,588**
Refined products purchased in Russia	1,635	1,543	919
Refined products purchased internationally	38,743	38,745	36,034
Total refined products purchased	**40,378**	**40,288**	**36,953**

* Excluding mini refineries.

Exports of crude oil and refined products from Russia

In 2008, our export of crude oil from Russia was 6.8% less than in 2007. In 2008, we exported 43.8% of our total domestic crude oil production (46.5% in 2007, and 50.2% in 2006). The decrease of export was due to growth of crude oil refining volumes in Russia and a decrease in crude oil production.

The volumes of crude oil exported from Russia by our subsidiaries are summarized as follows:

	2008		2007		2006	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Exports of crude oil using Transneft export routes	264,393	36,070	293,163	39,995	304,034	41,478
Exports of crude oil bypassing Transneft	23,639	3,225	15,818	2,158	19,461	2,655
Total crude oil exports	**288,032**	**39,295**	**308,981**	**42,153**	**323,495**	**44,133**

In 2008, the crude oil exported through our own export infrastructure was 2,824 thousand tonnes, or 52.1% more than in 2007.

In June 2008, we finalized construction of the offshore ice-resistant terminal in Varandey, with an annual capacity of 12 million tonnes. The Varandey oil export terminal will be used to export crude oil produced by the Group in Timan-Pechora, including our joint-venture with ConocoPhillips.

In 2008, we exported from Russia 25.8 million tonnes of refined products, an increase of 2.6%, compared to 2007. We export from Russia primarily diesel fuel, fuel oil and gasoil. These products account for approximately 93% of our refined products export volumes.

Main macroeconomic factors affecting our results of operations

Changes in the price of crude oil and refined products

The price at which we sell crude oil and refined products is the primary driver of our revenues. During 2008, the Brent crude oil price fluctuated between $33 and $144 per barrel, reached its peak of $144.2 at the beginning of July and minimum of $33.6 at the end of December.

In the first half of 2008, the price growth was driven by an escalation in geopolitical tensions, which was strengthened by financial market speculation. The continued US dollar fluctuations and supply concerns due to a storm threat in the Gulf of Mexico also boosted prices. In the third quarter of 2008, the spread of crude oil price was significant. The financial crisis sent the crude oil price to a nine-month minimum. However this decline was followed by short-term price growth. The downward trend became settled and in the fourth quarter of 2008, crude oil price dropped to four year minimum. Crude oil prices are now below the level at which development of many oilfields becomes profitable. If the trend lasts, a concern over a shortage of hydrocarbon supply may appear. Considerable amounts of crude oil are sold on futures market with the delivery scheduled at the end of 2009 and stored in supertankers rather than sold on spot markets. This indicates that crude oil is seriously underpriced.

Substantially all the crude oil we export is Urals blend. The following table shows the average crude oil and refined product prices for 2008, 2007 and 2006.

	2008	Change to 2007, %	2007	Change to 2006, %	2006
	(in US dollars per barrel, except for figures in percent)				
Brent crude	97.26	34.4	72.39	11.1	65.16
Urals crude (CIF Mediterranean)*	94.76	36.6	69.38	13.1	61.37
Urals crude (CIF Rotterdam)*	94.83	37.1	69.16	12.9	61.23
	(in US dollars per metric tonne, except for figures in percent)				
Fuel oil 3.5% (FOB Rotterdam)	459.74	35.6	339.00	18.2	286.91
Diesel fuel (FOB Rotterdam)	901.53	42.2	634.09	9.7	577.92
High-octane gasoline (FOB Rotterdam)	836.79	20.2	695.97	12.4	619.29

Source: Platts.

* The Company sells crude oil on foreign markets on various delivery terms. Thus, our average realized sale price of oil on international markets differs from the average prices of Urals blend on Mediterranean and Northern Europe markets.

Domestic crude oil and refined products prices

Substantially all crude oil produced in Russia is produced by vertically integrated oil companies such as ours. As a result, most transactions are between affiliated entities within vertically integrated groups. Thus, there is no concept of a benchmark domestic market price for crude oil. The price of crude oil that is produced but not refined or exported by one of the vertically integrated oil companies is generally determined on a transaction-by-transaction basis against a background of world market prices, but with no direct reference or correlation. At any time there may exist significant price differences between regions for similar quality crude oil as a result of the competition and economic conditions in those regions. At the same time it should be noted that in 2007 and 2008, our domestic crude oil sales prices were nearly at the level of our export net back price.

Domestic prices for refined products are determined to some extent by world market prices, but they are also directly affected by local demand and competition.

The table below represents average domestic wholesale prices of refined products in 2008, 2007 and 2006.

	2008	Change from 2007, %	2007	Change from 2006, %	2006
	(in US dollars per metric tonne, except for figures in percent)				
Fuel oil	255.55	31.6	194.19	10.9	175.07
Diesel fuel	710.56	41.0	503.84	6.4	473.44
High-octane gasoline (Regular)	740.11	17.1	631.93	13.0	559.11
High-octane gasoline (Premium)	807.77	13.3	712.81	15.5	617.41

Source: Kortes (excluding VAT).

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenues is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, ruble inflation and movements of exchange rates can significantly affect the results of our operations. In particular, the real appreciation of the ruble against the US dollar generally causes our costs to increase in US dollar terms. The devaluation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 17.4% in 2008, compared to 2007. However, as a result of global economic crisis the exchange rate of the ruble to the US dollar decreased in the second half of 2008. In the fourth quarter of 2008, the appreciation of the purchasing power of the US dollar in Russia was 7.4%, compared to the third quarter of 2008. The year-end ruble-dollar exchange rate exceeded the opening by 19.7% that resulted in considerable currency translation loss.

The following table gives data on inflation in Russia and the change in the ruble-dollar exchange rate.

	2008	2007	2006
Ruble inflation (CPI), %	13.3	11.9	9.1
Change of the ruble-dollar exchange rate, %	(19.7)	6.8	8.5
Average exchange rate for the period (ruble to US dollar)	24.86	25.58	27.19
Exchange rate at the end of the period (ruble to US dollar)	29.38	24.55	26.33

Tax burden

Given the relative size of our activities in Russia, our tax profile is largely determined by the taxes payable in Russia (based on records maintained under Russian legislation – not US GAAP). In 2008, 2007 and 2006, the tax charge on the operations in Russia was approximately 86% of our total tax charge.

In addition to income taxes, we are subject to a number of other taxes in Russia, many of which are based on revenue or volumetric measures. Other taxes to which we are subject include:

- mineral extraction tax
- excise and export tariffs
- property tax
- social taxes
- VAT
- other local and regional taxes

The effective rates of total taxes and tariffs (total taxes, including income taxes, taxes other than on income and excise and export tariffs, divided by income before taxes and tariffs) for 2008, 2007 and 2006, respectively, were 81%, 75% and 77%. In 2008, tax expenses in Russia were about 56% of the domestic and export sales revenue of Russian companies of the Group.

The measures that we use for tax planning and management strategies have been based on our understanding of tax legislation existing at the time of implementation of these measures. We are subject to tax authority audits on an ongoing basis, as is normal in the Russian environment, and, at times, the authorities have attempted to impose significant additional taxes on us. We believe that we have adequately met and provided for tax liabilities based on our interpretation of existing tax legislation. However, the relevant authorities may have differing interpretations and the effects could be significant.

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

		2008*	Change to 2007, %	2007*	Change to 2006, %	2006*
Export tariffs on crude oil	$/tonne	355.08	71.8	206.70	4.9	197.01
Export tariffs on refined products						
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	251.53	65.9	151.59	5.7	143.40
Liquid fuels (fuel oil)	$/tonne	135.51	66.0	81.64	5.7	77.27
Excise on refined products						
Straight-run gasoline	RUR/tonne	2,657.00	–	2,657.00	–	2,657.00
High-octane gasoline	RUR/tonne	3,629.00	–	3,629.00	–	3,629.00
Low-octane gasoline	RUR/tonne	2,657.00	–	2,657.00	–	2,657.00
Diesel fuel	RUR/tonne	1,080.00	–	1,080.00	–	1,080.00
Motor oils	RUR/tonne	2,951.00	–	2,951.00	–	2,951.00
Mineral extraction tax						
Crude oil	RUR/tonne	3,328.35	34.6	2,472.67	9.1	2,265.69
Natural gas	RUR/1,000 m^3	147.00	–	147.00	–	147.00

* Average values.

Tax rates set in rubles and translated at the average exchange rates are as follows:

		2008*	Change to 2007, %	2007*	Change to 2006, %	2006*
Excise on refined products						
Straight-run gasoline	$/tonne	106.90	2.9	103.88	6.3	97.74
High-octane gasoline	$/tonne	146.01	2.9	141.89	6.3	133.49
Low-octane gasoline	$/tonne	106.90	2.9	103.88	6.3	97.74
Diesel fuel	$/tonne	43.45	2.9	42.23	6.3	39.73
Motor oils	$/tonne	118.73	2.9	115.38	6.3	108.55
Mineral extraction tax						
Crude oil	$/tonne	133.91	38.5	96.68	16.0	83.34
Natural gas	$/1,000 m^3	5.91	2.9	5.75	6.3	5.41

* Average values.

These 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. During 2005-2008, the base rate was 419 rubles per metric tonne extracted and it was adjusted depending on the international market price of Urals blend and the ruble exchange rate. The tax rate was zero when the average Urals blend international market price for a tax period is less than or equal to $9.00 per barrel. Each $1.00 per barrel increase in the international Urals blend price over the threshold ($9.00 per barrel) resulted in an increase of the tax rate by $1.61 per tonne extracted (or $0.22 per barrel extracted using a conversion factor of 7.33).

Effective from January 1, 2009, the tax rate calculation was changed. The base rate remained the same, while the threshold crude oil price up to which the tax rate is zero was raised from $9.00 to $15.00 per barrel. This leads to a $1.3 per barrel decrease in crude oil extraction tax expenses in Russia. Also, the list of regions where, depending on the period and volume of production, zero crude oil extraction tax rate applies was extended. In particular, it now includes Caspian offshore and the Nenetsky Autonomous District, where the Group explores and produces hydrocarbons.

Effective from January 1, 2007, the crude oil extraction tax rate varies depending on the development and depletion of a particular oilfield. The tax rate is zero for extra-heavy crude oil and for crude oil produced in certain regions of Eastern Siberia, depending on the period and volume of production. For crude oil produced in other regions the tax rate calculation described above should be multiplied by a coefficient characterizing the depletion of a particular oilfield. The coefficient is equal to 1.0 for oilfields with depletion below 80%. Each 1% increase of depletion of a particular oilfield above 80% results in a decrease of the coefficient by 0.035. The minimum value of the coefficient is 0.3. The depletion level assessment is based on crude oil production and reserves information reported to the Russian government.

Natural gas extraction tax rate. The mineral extraction tax on natural gas production is calculated using a flat rate. The current rate of 147 rubles per thousand cubic meters of natural gas extracted is effective since January 1, 2006.

Crude oil export duty rate is calculated on a progressive scale. The rate is zero when the average Urals blend international market price is less than or equal to approximately $15.00 per barrel ($109.50 per metric tonne). If the Urals blend price is between $15.00 and $20.00 per barrel ($146.00 per metric tonne), each $1.00 per barrel increase in the Urals blend price over $15.00 results in an increase of the crude oil export duty rate by $0.35 per barrel exported. If the Urals blend price is between $20.00 and $25.00 per barrel ($182.50 per metric tonne), each $1.00 per barrel increase in the Urals blend price over $20.00 results in an increase of the crude oil export duty rate by $0.45 per barrel exported. Each $1.00 per barrel increase in the Urals blend price over $25.00 per barrel results in an increase of the crude oil export duty rate by $0.65 per barrel exported.

Prior to October 1, 2008, the Russian government set export tariff rates for two-month periods. The rates in a specific two-month period were based on Urals blend international market prices in the preceding two months. Thus, the calculation method that the Russian government employed to determine export tariff rates resulted in a two-month gap between movements in crude oil prices and the revision of the export duty rate based on those crude oil prices.

This method of calculation was amended in September 2008. The Russian government set the specific crude oil export duty rate for October, November and December 2008 at $372.20, $287.30 and $192.10 per tonne, respectively, in order to compensate oil companies the negative effect of sharply decreased crude oil prices. Effective from December 2008, the crude oil export duty rate is revised monthly on the basis of the immediately preceding one-month period of crude oil price monitoring.

Export duty rates on refined products are set by the Russian government. The rate of export duty depends on internal demand for refined products and international crude oil market conditions.

Crude oil and refined products exported to CIS countries, other than Ukraine, are not subject to export duties. Crude oil exported from Russia to Belarus is subject to export duties calculated with an application of a coefficient 0.335 in 2008 (0.293 in 2007) to the regular export duty rate set by the Government of the Russian Federation. Starting on January 1, 2009, this coefficient was increased to 0.356.

Income tax. Before 2009, operations in the Russian Federation were subject to an income tax rate of 24%. The Federal income tax rate was 6.5% and a regional income tax rate varied from 13.5% to 17.5% at the discretion of the individual regional administrations. Starting on January 1, 2009, the Federal income tax rate was decreased to 2.0% and the regional income tax rate varies between 13.5% and 18.0%. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

Transportation of crude oil and refined products in Russia

The main Russian crude oil production regions are remote from the main crude oil and refined products markets. Therefore, access of crude oil production companies to the markets is dependent on the extent of diversification of transport infrastructure and access to it. As a result, transportation cost is an important macroeconomic factor affecting our net income.

Transportation of crude oil produced in Russia to refineries and export destinations is performed primarily through the trunk oil pipeline system of state-owned Transneft. Access to the Transneft crude oil export pipeline network is allocated quarterly, based on recent volumes produced and delivered through the pipeline and proposed export destinations. The crude oil transported by Transneft is Urals blend – a mix of crude oils of various qualities. Therefore Russian companies that produce crude oil of a higher quality, can not obtain benefits from selling it using Transneft's pipeline. Alternative access to international markets bypassing Transneft export routes can be obtained through railroad transport, by tankers, and by the own export infrastructure of oil producing companies. Our own export infrastructure includes the Vysotsk terminal in the Leningrad region, the Varandey terminal in the Nenetsky Autonomous District and the Svetly terminal in the Kaliningrad region. We use the Varandey terminal to export crude oil produced by our joint venture with ConocoPhillips located in Northern Timan-Pechora. The Svetly terminal exports crude oil primarily produced by OOO LUKOIL-Kaliningradmorneft, our subsidiary operating in the Kaliningrad region, and refined products. We use the Vysotsk terminal to export refined products. In the future we expect to use the terminal to export both crude oil and refined products, depending on market conditions. Currently it has capacity of 12 million tonnes per year and it can be expanded up to 15 million tonnes per year.

Transportation of refined products in Russia is performed by railway transport and the pipeline system of OAO AK Transnefteproduct. Russian railway infrastructure is owned and operated by OAO Russian Railways. Both these companies are state-owned. Besides transportation of refined products, OAO Russian Railways provides oil companies with crude oil transportation services. We transport the major part of our refined products by railway transport.

As the activities of the above mentioned companies fall under the scope of natural monopolies, the fundamentals of their tariff policies are defined by the state authorities to ensure the balance of interests of the state and all participants in the transportation process. Transportation tariffs of natural monopolies are set by the Federal Service for Tariffs of the Russian Federation ("FST"). The tariffs are dependent on transport destination, delivery volume, distance of transportation, and several other factors. Changes in the tariffs depend on inflation forecasts by the Ministry of Economic Development of the Russian Federation, the investment needs of owners of transport infrastructure, other macroeconomic factors, and compensation of economically reasonable expenses, incurred by entities of natural monopolies. Tariffs are to be revised by FST at least annually.

Year ended December 31, 2008, compared to years ended December 31, 2007 and December 31, 2006

The table below details certain income and expense items from our consolidated statements of income for the periods indicated.

	2008	2007	2006
	(millions of US dollars)		
Revenues			
Sales (including excise and export tariffs)	107,680	81,891	67,684
Costs and other deductions			
Operating expenses	(8,126)	(6,172)	(4,652)
Cost of purchased crude oil, gas and products	(37,851)	(27,982)	(22,642)
Transportation expenses	(5,460)	(4,457)	(3,600)
Selling, general and administrative expenses	(3,860)	(3,207)	(2,885)
Depreciation, depletion and amortization	(2,958)	(2,172)	(1,851)
Taxes other than income taxes	(13,464)	(9,367)	(8,075)
Excise and export tariffs	(21,340)	(15,033)	(13,570)
Exploration expense	(487)	(307)	(209)
Loss on disposals and impairments of assets	(425)	(123)	(148)
Income from operating activities	**13,709**	**13,071**	**10,052**
Interest expense	(391)	(333)	(302)
Interest and dividend income	163	135	111
Equity share in income of affiliates	375	347	425
Currency translation (loss) gain	(1,163)	93	169
Other non-operating expense	(244)	(240)	(118)
Minority interest	(83)	(55)	(80)
Income before income taxes	**12,366**	**13,018**	**10,257**
Current income taxes	(4,167)	(3,410)	(2,906)
Deferred income taxes	945	(97)	133
Total income tax expense	**(3,222)**	**(3,507)**	**(2,773)**
Net income	**9,144**	**9,511**	**7,484**
Basic earnings per share of common stock (in US dollars)	10.88	11.48	9.06
Diluted earnings per share of common stock (in US dollars)	10.88	11.48	9.04

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

Sales revenues

Sales breakdown	2008	2007	2006
	(millions of US dollars)		
Crude oil			
Export and sales on international markets other than CIS	22,382	18,346	16,859
Export and sales to CIS	1,625	912	790
Domestic sales	600	440	376
	24,607	**19,698**	**18,025**
Refined products			
Export and sales on international markets			
Wholesale	50,553	37,971	30,302
Retail	11,989	9,183	7,157
Domestic sales			
Wholesale	8,049	5,862	5,431
Retail	5,823	3,721	2,720
	76,414	**56,737**	**45,610**
Petrochemicals			
Export and sales on international markets	1,232	1,569	1,260
Domestic sales	880	733	569
	2,112	**2,302**	**1,829**
Gas and gas products			
Export and sales on international markets	926	562	432
Domestic sales	985	831	533
	1,911	**1,393**	**965**
Other	**2,636**	**1,761**	**1,255**
Total sales	**107,680**	**81,891**	**67,684**

Sales volumes	2008	2007	2006
Crude oil	(thousands of barrels)		
Export and sales on international markets other than CIS	242,784	268,974	278,972
Export and sales to CIS	31,629	19,879	21,682
Domestic sales	15,408	11,757	13,363
Crude oil	(thousands of tonnes)		
Export and sales on international markets other than CIS	33,122	36,695	38,059
Export and sales to CIS	4,315	2,712	2,958
Domestic sales	2,102	1,604	1,823
	39,539	**41,011**	**42,840**
Refined products	(thousands of tonnes)		
Export and sales on international markets			
Wholesale	67,669	64,394	57,558
Retail	8,200	7,910	7,171
Domestic sales			
Wholesale	13,314	13,704	15,155
Retail	5,964	4,853	3,995
	95,147	**90,861**	**83,879**
Total sales volume of crude oil and refined products	**134,686**	**131,872**	**126,719**

Realized average sales prices

	2008		2007		2006	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international						
Oil (excluding CIS)	92.19	675.76	68.21	499.96	60.43	442.96
Oil (CIS)	51.38	376.58	45.86	336.15	36.46	267.22
Refined products						
Wholesale		747.06		589.66		526.46
Retail		1,462.14		1,160.90		998.05
Average realized price within Russia						
Oil	38.97	285.66	37.43	274.37	28.16	206.43
Refined products						
Wholesale		604.55		427.74		358.38
Retail		976.40		766.67		680.79

During 2008, our revenues increased by $25,789 million, or by 31.5%, compared to 2007 (in 2007 by $14,207 million, or by 21.0%, compared to 2006).

The total volume of crude oil and refined products sold was 134.7 million tonnes, which represents a slight increase compared to 2007. Our revenues from crude oil sales increased by $4,909 million, or by 24.9%, compared to 2007 (in 2007 by $1,673 million, or by 9.3%, compared to 2006). Our revenue from sales of refined products increased by $19,677 million, or by 34.7% (in 2007 by $11,127 million, or by 24.4%, compared to 2006).

Sales of crude oil and refined products on international markets, including the CIS, accounted for 84.1% of the total sales volume in 2008 (in 2007 – 84.7%, and in 2006 – 83.4%).

The increase in sales was principally due to the following:

- increase in hydrocarbon prices in the first half of 2008
- increase in crude oil refining, resulting from high refining margins in the first half of 2008

In the fourth quarter of 2008, our revenue was seriously affected by the slump in hydrocarbon prices resulted from the global economic crisis. As a result, the total revenue in the fourth quarter was nearly $14 billion less than in the third quarter. This comprised of $3.8 billion decrease in crude oil revenue and $9.7 billion decrease in refined product revenue.

Sales of crude oil

2008 vs. 2007

The 24.9% increase in our total crude oil sales from 2007 to 2008 was attributable primarily to an increase in our international crude oil sales revenues (excluding CIS). This sales revenue, which accounted for approximately 91.0% of our total crude oil sales revenue in 2008 and 93.1% in 2007, increased by 22.0% primarily due to an increase in sales prices by 35.2%. At the same time the volume of international crude oil sales decreased by 9.7%, compared to 2007 as a result of decreased crude oil production and increased crude oil refining in Russia.

2007 vs. 2006

The 9.3% increase in our total crude oil sales from 2006 to 2007 was attributable primarily to an increase in our international crude oil sales revenues (excluding CIS). This sales revenue, which accounted for approximately 93.1% of our total crude oil sales revenue in 2007 and 93.5% in 2006, increased by 8.8% primarily due to an increase in sales prices by 12.9%. At the same time the total volume of crude oil sales decreased by 3.6%, compared to 2006 as a result of increased crude oil refining in Russia.

Sales of refined products

2008 vs. 2007

In 2008, our revenue from the wholesale of refined products outside Russia increased by $12,582 million, or by 33.1%, compared to 2007, mainly due to an increase in the average realized price.

In 2008, our revenue from international retail sales increased by $2,806 million, or by 30.6%, compared to 2007, mainly due to an increase in average retail prices by 25.9%. The increase of retail sales volumes outside Russia amounted to 290 thousand tonnes, or 3.7%. This increase was attributable to the expansion of our retail network. In 2008, we acquired petrol stations in Turkey, petrol stations and storage facilities in Bulgaria, besides, in the second quarter of 2007, we acquired petrol stations in seven European countries. Our international retail sales include supplies of refined products to third party retail networks under long-term contracts with pricing similar to retail pricing.

In 2008, our revenue from the wholesale of refined products on the domestic market increased by $2,187 million, or by 37.3%, compared to the previous year, due to an increase in the average realized price by 41.3%.

In 2008, our revenue from retail sales in Russia increased by $2,102 million, or by 56.5%, compared to 2007, due to an increase both in sales volumes and prices. Revenue from retail sales was 42.0% of total refined products sales in Russia in 2008 (in 2007 – 38.8%).

2007 vs. 2006

The average realized wholesale price of refined products outside Russia increased by $63.20 per tonne, or by 12.0%, compared to 2006. Wholesale volumes of refined products sold outside Russia increased by 6,836 thousand tonnes, or by 11.9%, primarily due to increased volumes of export from Russia. As a result, our revenue from the wholesale sales of refined products outside Russia increased by $7,669 million, or by 25.3%.

During 2007, retail sales of refined products outside Russia increased by 739 thousand tonnes, or by 10.3%, compared to 2006. This increase is attributable to additional sales volumes generated by the 376 petrol stations acquired from ConocoPhillips in the second quarter of 2007. Refined products sales at those stations were 769 thousand tonnes in the period June-December 2007. Average retail prices increased to $1,160.90 per tonne, or by 16.3%. As a result, our revenue from retail sales increased by $2,026 million, or by 28.3%, compared to 2006. In 2007, revenue from retail sales was 19.5% (in 2006 – 19.1%) of total refined products sales outside Russia. Our international retail sales include supplies of refined products to third party retail networks under long-term contracts with pricing similar to retail pricing.

In 2007, the average domestic wholesale realized price on refined products increased by $69.36 per tonne, or by 19.4%, compared to 2006. In 2007, the wholesale of refined products within Russia decreased by 1,451 thousand tonnes, or by 9.6%, compared to 2006. As a result, our revenue from the wholesale of refined products on the domestic market increased by 7.9%. Volumes of refined products, which were not utilized in the domestic wholesale market were directed to a retail segment or exported from Russia.

In 2007, retail sales within Russia increased by 858 thousand tonnes, or by 21.5%, compared to 2006. Average retail prices increased to $766.67 per tonne, or by 12.6%. As a result, our revenue from retail sales increased by $1,001 million in 2007, or by 36.8%, compared to 2006. Revenue from retail sales was 38.8% of total refined products sales in Russia in 2007 (in 2006 – 33.4%).

Sales of petrochemical products

2008 vs. 2007

In 2008, our revenue from sales of petrochemical products decreased by $190 million, or by 8.3%, compared to 2007. This resulted from the decrease in sales volumes by 15.5%. At the same time the prices increased by 8.6%. The decrease in volumes resulted from a temporary shutdown of our petrochemical plant Karpatnaftochim Ltd., Ukraine. In May 2008, this plant was stopped for modernization and construction of chlorine and caustic production line. Moreover, overall negative situation on the world petrochemical markets led to decrease of the sales volumes.

2007 vs. 2006

Revenue from sales of petrochemical products increased in 2007 by $473 million, or by 25.9%, compared to 2006. This increase in revenue resulted from both price and volume factors.

Sales of gas and gas products

2008 vs. 2007

In 2008, sales of gas and gas refined products amounted to $1,911 million, which is 37.2% more than in 2007. This was due to an increase in gas products and natural gas sales revenues. Gas products sales revenue increased by $215 million, or by 21.9%, compared to 2007, mainly as a result of an increase in prices for gas products both in Russia and abroad. Natural gas sales revenue amounted to $690 million (an increase of 77.4%, compared to 2007). This increase was a result of the commencement of natural gas production in Uzbekistan and Azerbaijan, and an increase in average realized prices in Russia.

Our major purchaser of natural gas produced in the Russian Federation is OAO Gazprom. In 2008, we sold 7,856 million cubic meters of natural gas to OAO Gazprom (7.2 billion cubic meters in 2007), and the average realized price increased by 2.9% to $42.6 per 1,000 cubic meters.

2007 vs. 2006

In 2007, sales of natural gas amounted to $389 million (an increase by 69.1%, compared to 2006). In 2007, we sold 7.2 billion cubic meters of natural gas to OAO Gazprom at $41.4 per 1,000 cubic meters.

Sales of other products

Other sales include sales through our retail network, other services provided and goods not related to our primary activities (such as electricity, heat, transportation, etc.) sold by our production and marketing companies and revenue of our electric power generating companies.

2008 vs. 2007

In 2008, other sales increased by $875 million, or by 49.7%.

During 2008, sales of goods and other products from our retail outlets amounted to $613 million, an increase of $188 million above the level of 2007. This was mainly attributable to the expansion of our retail network.

The Group develops its electric power business. Related sales increased by $528 million, compared to 2007, mainly as a result of the acquisition of TGK-8.

2007 vs. 2006

Other sales increased by $934 million, or by 42.1%, mainly as a result of the growth in other sales and services provided to third parties.

Operating expenses

Operating expenses include the following:

	2008	2007	2006
	(millions of US dollars)		
Hydrocarbon extraction expenses	3,208	2,757	2,312
Own refining expenses	1,115	880	730
Refining expenses at third parties and affiliated refineries	439	242	230
Excise included in processing fee paid to third parties refineries*	116	158	–
Petrochemical expenses	235	272	247
Expenses on crude oil transportation to refineries	1,072	848	686
Other operating expenses	1,691	1,271	861
	7,876	**6,428**	**5,066**
Change in operating expenses in crude oil and refined products inventory originated within the Group**	250	(256)	(414)
Total operating expenses	**8,126**	**6,172**	**4,652**
Cost of purchased crude oil, petroleum and chemical products	**37,851**	**27,982**	**22,642**

*As a result of amendments to the Russian tax legislation, effective from January 1, 2007, the responsibility to pay excises on refined products (except for straight-run gasoline) was transferred from traders and retailers to refineries. Therefore excises are included in processing fees.

** The change in operating expenses in crude oil and refined products inventory originating within the Group includes extraction and refining expenses related to crude oil and refined products produced by the Group during the reporting period, but not sold to third parties.

Compared to 2007, operating expenses increased by $1,954 million, or by 31.7%, which is mainly explained by the growth of other operating expenses, hydrocarbon extraction expenses, processing and refining costs. Real appreciation of the ruble against the US dollar is a significant factor affecting our operating expenses in Russia. The devaluation of the purchasing power of the US dollar in the Russian Federation in 2008 was 17.4%, compared to 2007.

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, property insurance of extraction equipment and other similar costs.

2008 vs. 2007

In 2008, our extraction expenses increased by $451 million, or by 16.4%, compared to 2007. The increase resulted from the effect of the real ruble appreciation against the US dollar, increased expenses for energy supply, materials, artificial stimulation of reservoirs and labor. Our average hydrocarbon extraction cost per barrel of oil equivalent increased from $3.58 to $4.12, or by 15.1%, compared to 2007. At the same time in the forth quarter of 2008 our extraction cost decreased to $4.01 per barrel, compared to $4.29 per barrel in the third quarter of 2008 due to the ruble devaluation.

2007 vs. 2006

In 2007, our extraction expenses rose by $445 million, or by 19.2%, compared to 2006. The increase resulted from an increase in hydrocarbon production by our subsidiaries to 774.6 million BOE, which is an increase of 2.8%, compared to 2006, the effect of the real ruble appreciation, increased expenses for energy supply, materials and labor. In 2007, extraction expenses included approximately $45 million of expenses related to changes in the Group structure. Our average hydrocarbon extraction cost per barrel of oil equivalent increased from $3.08 to $3.58, or by 16.1%, compared to 2006.

Own refining expenses

2008 vs. 2007

In 2008, refining expenses increased by $235 million, or by 26.7%, compared to 2007.

Refining expenses at our domestic refineries increased by 19.8%, or by $129 million, mainly as a result of increased expenses for power supply, real ruble appreciation against the US dollar and increased production volumes.

Refining expenses at our international refineries increased by 46.5%, or by $106 million. This resulted mainly from increased expenses for power supply, the effect of appreciation of the exchange rates of the Romanian and Bulgarian currencies to the US dollar, and an increase in production volumes mainly as a result of commencement of operations of Odessa refinery after a wide-scale upgrade.

2007 vs. 2006

In 2007, refining expenses increased by $150 million, or by 20.5%, compared to 2006.

Refining expenses at our domestic refineries increased by 25.4%, or by $132 million, as a result of increased production volume, the effect of the real ruble appreciation, and due to large-scale overhauls at the Perm refinery in the second quarter of 2007.

Refining expenses at our international refineries increased by 8.6%, or by $18 million. This resulted mainly from a general increase in refining costs including an effect of an appreciation of the exchange rates of Romanian and Bulgarian currencies, which are tied to Euro, to the US dollar.

Refining expenses at third party and affiliated refineries

Along with our own production of refined products we refined crude oil at third party refineries both in Russia and overseas.

2008 vs. 2007

In 2008, refining expenses at third party and affiliated refineries increased by 81.4%, compared to 2007, as a result of increased refining costs in Russia that are linked to crude oil prices. Also, we increased refining volumes in Belarus, and, in December 2008, we commenced crude oil refining at the ISAB refinery complex.

2007 vs. 2006

In 2007, refining expenses at third party refineries increased by 5.2%, compared to 2006, as a result of increased refining costs in Russia, which was partially offset by decreased refining volumes in Belarus.

Petrochemical operating expenses

2008 vs. 2007

In 2008, operating expenses of our petrochemical companies decreased by $37 million, or by 13.6%, compared to 2007, due to decrease of production volumes. The decrease resulted from a temporary shutdown of our petrochemical plant Karpatnaftochim Ltd., Ukraine. In May 2008, this plant was stopped for modernization and construction of chlorine and caustic production line.

2007 vs. 2006

In 2007, operating expenses of our petrochemical companies increased by $25 million, or by 10.1%, compared to 2006. This was mainly due to increase of expenses at our Stavrolen petrochemical plant as a result of putting in operation of polypropylene production facilities.

Expenses on crude oil transportation to refineries

2008 vs. 2007

Expenses on crude oil transportation to refineries increased in 2008 by $224 million, or by 26.4%, compared to 2007, due to an increase in transportation tariffs and volumes transported.

2007 vs. 2006

Expenses on crude oil transportation to refineries increased in 2007 by $162 million, or by 23.6%, compared to 2006, due to an increase in transportation tariffs and volumes transported.

Other operating expenses

Other operating expenses include expenses of the Group's upstream and downstream enterprises that do not relate to their core activities, namely sales of electricity, heat, transportation services, other goods, etc., operating expenses of our gas processing plants, the costs of other services provided and goods sold by our marketing companies, and operating expenses of our power generating companies and of other non-core businesses of the Group.

2008 vs. 2007

In 2008, our other operating expenses increased by $420 million, or by 33.0%, compared to 2007. This was due to a general increase in other sales including growth of transportation and other services provided by the Group in the international segment. Half of the increase of other operating expenses was attributable to changes in Group structure, mainly to the acquisition of TGK-8 in May 2008.

2007 vs. 2006

In 2007, other operating expenses increased by $410 million, or by 47.6%, compared to 2006. This was due to a general increase in other sales including growth of transportation and other services provided by the Group in the international segment.

Cost of purchased crude oil, gas and products

2008 vs. 2007

Cost of purchased crude oil, gas and products increased by $9,869 million in 2008, or by 35.3%, compared to 2007, due to increases in international crude oil and refined products prices and an increase in volumes of crude oil purchases.

Cost of purchased crude oil, gas and products includes the result of hedging of international crude oil and refined products sales. In 2008, we recognized a $902 million gain from hedging, compared to an expense of $575 million in 2007.

Cost of purchased crude oil, gas and products in 2008 included purchases of natural gas and fuel oil to supply TGK-8.

2007 vs. 2006

Cost of purchased crude oil, gas and products increased by $5,340 million in 2007, or by 23.6%, compared to 2006, primarily due to an increase in international refined products trading volumes and prices.

In 2007, we recognized a $575 million expense on hedging of international crude oil and refined products sales, compared to a gain of $183 million in 2006.

Transportation expenses

2008 vs. 2007

In 2008, our transportation expenses increased by $1,003 million, or by 22.5%, compared to 2007. This was due to an increase in transportation tariffs and an overall increase in refined products sales volumes in Russia and internationally.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed in 2008, compared to the previous year, as follows: crude oil and refined products freight rates increased by 15.7% and 20.4%, respectively; crude oil pipeline tariffs increased by 15.9%; railway tariffs for refined products transportation increased by 13.6%.

2007 vs. 2006

In 2007, our transportation expenses increased by $857 million, or by 23.8%, compared to 2006. This was due to an increase in transportation tariffs, the increased volumes of refined products export from Russia, changes in exports destinations and an overall increase in sales volumes.

Average transportation tariffs weighted by volumes of the Group’s crude oil and refined products export deliveries to different locations changed in 2007, compared to the previous year as follows: crude oil sea shipping tariffs increased by 11.6%; crude oil pipeline tariffs increased by 13.8%; railway tariffs for refined products transportation increased by 35.1%.

Selling, general and administrative expenses

Selling, general and administrative expenses include general business expenses, payroll costs (excluding extraction entities’ and refineries’ production staff costs), insurance costs (except for property insurance related to extraction and refinery equipment), costs of maintenance of social infrastructure, movement in bad debt provision and other expenses.

2008 vs. 2007

In 2008, our selling, general and administrative expenses increased by $653 million, or by 20.4%, compared to 2007.

The growth was mainly due to real ruble appreciation, expansion of our activities both in Russia and internationally, and an overall increase in selling expenses.

2007 vs. 2006

In 2007, our selling, general and administrative expenses increased by $322 million, or by 11.2%, compared to 2006.

The growth was mainly due to real ruble appreciation, expansion of our activities both in Russia and internationally, indexation of salaries and increase in information technology expenses.

This was partially offset by the decrease in the cost related to our share-based management compensation plan. In 2007, such expenses amounted to $125 million, compared to $280 million in 2006.

Selling, general and administrative expenses in 2007 also included approximately $69 million of expenses related to the changes in the Group structure.

Depreciation, depletion and amortization

Depreciation, depletion and amortization expenses include depletion of assets fundamental to production, depreciation of other productive and non-productive assets and certain intangible assets.

2008 vs. 2007

Our depreciation, depletion and amortization expenses increased by $786 million, or by 36.2%, compared to 2007. The increase was a result of the Company's capital expenditures and the corresponding increase in depreciable assets, in particular due to putting in production the Yuzhnoe Khylchuyu oil field. Besides, the decrease of our proved reserves resulted in an increase in depreciation of our oil and gas producing assets.

2007 vs. 2006

Our depreciation, depletion and amortization expenses increased by $321 million, or by 17.3%, compared to 2006. The increase was a result of the Company's capital expenditures and the corresponding increase in depreciable assets. This increase included approximately $36 million related to the changes in the Group structure.

Exploration expenses

2008 vs. 2007

During 2008, exploration expense increased by $180 million, or by 58.6%, compared to 2007. Dry hole costs increased by $174 million to $317 million.

In 2008, we charged to expense the costs of three dry wells in Saudi Arabia totaling $122 million. The amount of $93 million was charged to expense in the fourth quarter of 2008 in regard of our project Yalama in Azerbaijan. Also, we expensed dry hole costs related to our projects in Kazakhstan and Columbia in amount of $20 million and $45 million, respectively.

2007 vs. 2006

During 2007, the amount charged to exploration expense increased by $98 million, or by 46.9%, compared to 2006. Dry hole costs increased by $52 million up to $143 million.

In the first half of 2007, we completed assessment of two exploratory wells drilled in Saudi Arabia. One of the wells was dry, and its cost of $51 million was charged to expense in 2007. The second well discovered a natural gas reservoir. Also, in beginning of 2008, we finalized geological evaluation of another exploratory well drilled in Saudi Arabia, which was found to be dry. Its cost of $21 million was charged to expense in 2007. Other overseas dry hole costs amounted to $20 million.

The dry hole costs in Russia amounted to $51 million and primarily related to Volga, Timan-Pechora and Western Siberia regions.

Loss on disposals and impairments of assets

2008 vs. 2007

In 2008, loss on disposals and impairments of assets amounted to $425 million, compared to $123 million in 2007.

In 2008, the loss included $156 million related to impairment of certain oil and gas assets located in the Timan-Pechora region. The impairment resulted from a decrease in crude oil reserves due to revision of geological models. The loss also included $171 million related to impairment of goodwill and certain retail assets in the United States and Serbia due to the change in the economic environment.

The losses include the financial result from disposals of a number of non-core assets and individually insignificant impairments of non-performing business units.

2007 vs. 2006

Loss on disposals and impairments of assets in 2007 amounted to $123 million, compared to $148 million in 2006.

Interest expense

2008 vs. 2007

In 2008, interest expense amounted to $391 million, which is $58 million, or 17.4%, more than in previous year. In 2008, interest expense was affected by termination of interest capitalization related to certain assets in Timan-Pechora due to completion of their construction and general increase in our indebtedness.

2007 vs. 2006

In 2007, interest expense increased by $31 million, or by 10.3%, compared to 2006, resulting from an overall increase in our indebtedness. At the same time, the weighted-average interest rate on our long-term indebtedness decreased, compared to the level of 2006.

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 and refining operations in Europe.

2008 vs. 2007

Compared 2007, our share in income of affiliates increased by $28 million, or by 8.1%.

2007 vs. 2006

Compared to 2006, our share in income of affiliates decreased by $78 million, or by 18.4%, primarily due to the changes in affiliates' structure.

Currency translation (loss) gain

In 2008, currency translation loss amounted to $1,163 million, of which $876 million refer to the Russian segment of the Group, and $287 million – to the international segment. Those losses mostly refer to the fourth quarter results.

The main reasons for those losses were decrease in the US dollar value of the ruble-nominated accounts receivables, advances, VAT recoverable, other taxes prepaid (less value of ruble-nominated liabilities), and fluctuations of euro-dollar exchange rate, which affected results of some operations performed by the Group outside of Russia.

Taxes other than income taxes

	2008	2007	2006
		(millions of US dollars)	
In Russia			
Mineral extraction taxes	12,267	8,482	7,281
Social security taxes and contributions	435	385	309
Property tax	374	284	219
Other taxes	180	105	160
Total in Russia	**13,256**	**9,256**	**7,969**
International			
Social security taxes and contributions	77	57	47
Property tax	31	29	28
Other taxes	100	25	31
Total internationally	**208**	**111**	**106**
Total	**13,464**	**9,367**	**8,075**

2008 vs. 2007

In 2008, taxes other than income taxes increased by 43.7%, or by $4,097 million, compared to 2007, mainly due to an increase in mineral extraction tax resulting from an increase in the crude oil extraction tax rate.

2007 vs. 2006

In 2007, taxes other than income taxes increased by 16.0%, or by $1,292 million, compared to 2006, due to an increase in mineral extraction tax resulting from an increase of crude oil extraction tax rate by 16.0%.

Excise and export tariffs

Our excise and export tariffs include taxes on sales of refined products and export tariffs on the export of crude oil and refined products.

	2008	2007	2006
		(millions of US dollars)	
In Russia			
Excise tax and sales taxes on refined products	956	734	610
Crude oil export tariffs	11,911	8,160	7,833
Refined products export tariffs	4,119	2,654	2,281
Total in Russia	**16,986**	**11,548**	**10,724**
International			
Excise tax and sales taxes on refined products	3,984	3,468	2,835
Crude oil export tariffs	143	–	1
Refined products export tariffs	227	17	10
Total internationally	**4,354**	**3,485**	**2,846**
Total	**21,340**	**15,033**	**13,570**

2008 vs. 2007

In spite of a decrease in crude oil export volumes, export tariffs increased by $5,569 million, or by 51.4%, compared to 2007, due to the increase in tariff rates.

The growth in international excises was mainly due to the increase in volumes sold as a result of expansion of our retail network in Europe, the appreciation of the Euro against the US dollar, as the excise rates in most European countries we operate in are either denominated in Euro or tied to it.

2007 vs. 2006

Excise and export tariffs increased by $1,463 million, or by 10.8%, compared to 2006. The increase in export tariffs resulted mainly from the increase of tariff rates. The volume factor of the tariffs' increase due to expansion of refined products export from Russia was partially offset by reduction of crude oil export.

The growth in international excises was mainly due to the effect of acquisition of the European petrol stations from ConocoPhillips, an increase in 2007 of excise rates in Bulgaria, substantial increase of refined product sales in Romania, and implementation in May, 2006, of a new sales-tax on export of refined products in Romania.

Income taxes

2008 vs. 2007

In 2008, our total income tax expense decreased by $285 million, or by 8.1%, compared to 2007, due to decrease in income before income tax by $652 million, or 5.0%, and recalculation of deferred taxes in Russia and Kazakhstan.

In 2008, our effective income tax rate was 26.1%, compared to 26.9% in 2007, which is higher than the maximum statutory rate for the Russian Federation (24%).

Starting from January 1, 2009, the income tax rate in the Russian Federation was decreased from 24.0% to 20.0%. Moreover, starting from 2009, the tax burden is reduced in Kazakhstan. As a result of this amendment we recalculated the deferred tax assets and liabilities as of December 31, 2008 at reduced income tax rate, which resulted in $299 million of income tax benefit in 2008, that we recognized in the fourth quarter.

2007 vs. 2006

Our total income tax expense increased by $734 million, or by 26.5%, compared to 2006, due to an increase of income before income tax by $2,761 million, or by 26.9%.

Our effective income tax rate in 2007 was 26.9% (in 2006 it was 27.0%), which is higher than the maximum statutory rate for the Russian Federation (24%).

The Group's effective income tax rate for the periods presented differs from the statutory income tax rate primarily due to domestic and foreign rate differences and the incurrence of costs that are either not tax deductible or only deductible to a certain limit.

Reconciliation of net income to EBITDA (earnings before interest, income taxes, depreciation and amortization)

	2008	2007	2006
		(millions of US dollars)	
Net income	**9,144**	**9,511**	**7,484**
Add back:			
Income tax expense	3,222	3,507	2,773
Depreciation and amortization	2,958	2,172	1,851
Interest expense	391	333	302
Interest and dividend income	(163)	(135)	(111)
EBITDA	**15,552**	**15,388**	**12,299**

EBITDA is a non-US GAAP financial measure. EBITDA is defined as net income before interest, taxes and depreciation and amortization. The Company believes that EBITDA provides useful information to investors because it is an indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions and other investments and our ability to incur and service debt. While depreciation and amortization are considered as operating costs under US GAAP, these expenses primarily represent the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. The EBITDA calculation is commonly used as a basis for some investors, analysts and credit rating agencies to evaluate and compare the periodic and future operating performance and value of companies within the oil and gas industry. EBITDA should not be considered in isolation as an alternative to net income, operating income or any other measure of performance under US GAAP. EBITDA does not include our need to replace our capital equipment over time.

Liquidity and capital resources

	2008	2007	2006
	(millions of US dollars)		
Net cash provided by operating activities	14,312	10,881	7,766
Net cash used in investing activities	(13,559)	(9,715)	(7,515)
Net cash provided by (used in) financing activities	763	(1,098)	(1,186)

Operating activities

Our primary source of cash flow is funds generated from our operations. During 2008, cash generated by operating activities was $14,312 million, an increase of 31.5% compared to 2007. In 2008, our operating cash inflows were supported by a decrease of working capital by $2,699 million, compared to January 1, 2008. This was mainly caused by:

- a decrease in inventory of $963 million primarily resulted from a decrease in hydrocarbons prices
- a $1,595 million net decrease in trade accounts receivable and payable
- a $378 million net decrease in tax accounts receivable and payable

Positive effect of the above mentioned factors was partially eliminated by the net increase of other assets and liabilities of $237 million.

Investing activities

An increase in cash used in investing activities resulted from an increase in cash paid for acquisitions of subsidiaries and cash spent on capital expenditures.

In 2008, we made a final payment of $157 million and two contingent payments of $200 million for the acquisition of upstream assets in Uzbekistan (SNG Holdings Ltd.). During 2008, we paid $64 million for the increase in our share of the share capital of our refinery in Nizhny Novgorod and $1,222 million as the cash part of the consideration for the TGK-8 acquisition. As first installments for the acquisitions of the 49% stake in the ISAB refinery complex and petrol stations in Turkey we paid $762 million and $250 million respectively. We also paid $343 million and $221 million for acquisitions of petrol stations in Bulgaria and petrol station networks in Russia. The other payments were primarily advances related to acquisitions of marketing assets in Russia and abroad.

In 2007, cash flows from investing activities included $1,155 million of cash received from the sale of our 50% interest in Caspian.

In 2008, capital expenditures increased by $1,454 million, or by 16.0%, compared to 2007 (for a detailed analysis of capital expenditures see a later section).

During 2007, the Company paid $255 million for the acquisition of licenses for crude oil exploration and production on two oil fields in the Komi Republic. Payments for acquisition of licenses in 2008 were $12 million.

Financing activities

In 2008, net movements of short-term and long-term debt generated an inflow of $2,311 million, compared to an inflow of $616 million in 2007.

Net inflows in 2008 included long-term loans of $889 million received from ConocoPhillips as its part of financing of our joint venture in the Timan-Pechora region. In 2007, we received $672 million from ConocoPhillips as its part of financing the joint venture.

Cash inflows in 2008 included $235 million related to the sale of 7,449 LPG and oil tank-wagons, which were leased back by the Group under a capital lease agreement.

During 2007, as a result of the settlement of a stock-based compensation plan, employees purchased 8.8 million shares held by the Group as treasury stock at the grant price for $129 million and resold 1.5 million shares back to the Group for $134 million.

Credit rating

In 2008, Standard & Poor's Ratings Services affirmed its long-term corporate credit rating and all debt ratings on the Company at BBB-. Standard & Poor's changed our outlook from positive to stable.

In 2008, Moody's affirmed the Company's long-term corporate family rating and long-term issuer rating of Baa2 and stable outlook.

In 2008, Fitch Ratings affirmed the Company's long-term issuer default rating of BBB- and short-term issuer default rating of F3. Fitch Ratings changed our outlook from positive to stable in February 2009.

A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organization. Similar ratings on the Company and/or on different types of securities do not necessarily mean the same thing. The ratings do not address the marketability of any of our securities or their market price. Any change in the credit ratings of the Company or our securities could adversely affect the price that a subsequent purchaser will be willing to pay for our securities. We recommend that you analyze the significance of each rating independently from any other rating.

Analysis of capital expenditures

	2008	2007	2006
	(millions of US dollars)		
Capital expenditures*			
Exploration and production			
Russia	6,813	6,391	4,334
International	1,076	871	786
Total exploration and production	7,889	7,262	5,120
Refining, marketing and distribution			
Russia	1,377	1,177	916
International	773	645	559
Total refining, marketing and distribution	2,150	1,822	1,475
Chemicals			
Russia	23	73	121
International	98	98	51
Total chemicals	121	171	172
Other	429	117	119
Total capital expenditures	**10,589**	**9,372**	**6,886**
Acquisitions of subsidiaries and minority shareholding interest**			
Exploration and production			
Russia	4	77	1,469
International	357	357	91
Total exploration and production	361	434	1,560
Refining, marketing and distribution			
Russia	636	685	122
International	1,397	511	–
Total refining, marketing and distribution	2,033	1,196	122
Other	3,194***	38	32
Less cash acquired	**(190)**	**(102)**	**(26)**
Total acquisitions	**5,398**	**1,566**	**1,688**

* Including non-cash transactions and prepayments.

** Including prepayments related to acquisitions of subsidiaries and minority shareholding interest and non-cash transactions.

*** Including $1,969 million of non-cash part of consideration for acquisition of TGK-8.

During 2008, our capital expenditures, including non-cash transactions, amounted to $10,589 million, which is $13.0% more than in 2007. The growth mainly resulted from expenditures in our exploration and production segment, which increased by $627 million, or by 8.6%, compared to 2007. The exploration and production capital expenditures in new regions decreased by $414 million. The capital expenditures in the traditional exploration and production region of Western Siberia increased by $570 million mainly as a result of an increase in production drilling. The capital expenditures in European Russia increased by $292 million as a result of an increase in exploratory drilling and investments in pipelines and machinery. An increase in the capital expenditures in our overseas exploration projects (excluding the Caspian region) amounted to $179 million and was primarily related to our projects in Kazakhstan and Saudi Arabia. The increase in other segment was due to expenditures of TGK-8.

Due to unfavorable conditions on hydrocarbon markets the Company reduced the planned level of capital expenditures for 2009 from $11.2 billion down to $6.5 billion. In case of crude oil price decreases the Company is ready to further reduce capital expenditures in order to maintain positive cash flows. This decrease will not affect the Company's key projects.

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

	2008	2007	2006
	(millions of US dollars)		
Northern Timan-Pechora	1,878	2,357	1,526
Yamal	161	75	135
Caspian region*	420	441	212
Total	**2,459**	**2,873**	**1,873**

* Russian and international projects.

Contractual obligations, other contingencies and off balance sheet arrangements

Capital commitments and contractual obligations

The Group owns and operates refineries in Bulgaria (LUKOIL Neftochim Bourgas AD) and Romania (Petrotel-LUKOIL). As a result of Bulgaria and Romania joining the European Union in 2007, LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL are required to upgrade their refining plants to comply with the requirements of European Union legislation in relation to the quality of produced petroleum products and environmental protection. These requirements are stricter than existing Bulgarian and Romanian legislation. The Group estimates the amount of future capital commitment required to upgrade LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL to be approximately $357 million and $42 million, respectively.

Group companies have commitments under the terms of existing license agreements in the Russian Federation of $1,168 million over the next 5 years and of $231 million thereafter. Management believes that a significant portion of these commitments will be fulfiled by the services to be provided by Eurasia Drilling Company and ZAO Globalstroy-Engineering as discussed below.

In connection with the sale of LUKOIL-Burenie (now Eurasia Drilling Company) in 2004 the Group signed a five year contract for drilling services. Under the terms of the contract, drilling services of approximately $791 million will be provided by Eurasia Drilling Company during 2009.

The Company has signed a four-year agreement for the provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for 2009 to be approximately $549 million.

Group companies have commitments for capital expenditure contributions in the amount of $751 million related to various production sharing agreements over the next 29 years.

The Group has a commitment to purchase equipment for modernization of its petrochemical refinery Karpatnaftochim Ltd., located in Ukraine, during 2009 in the amount of $118 million.

The Group has a commitment to execute the capital construction program of TGK-8. Under the terms of this program, power plants with total capacity of 890 MW should be constructed by the end of 2012. As of December 31, 2008, the Group estimates the amount of this commitment to be approximately $1,225 million.

Group companies have investment commitments relating to oil deposits in Iraq of $495 million to be spent within 3 years from when exploitation becomes possible. Due to significant changes in the political and economic situation in Iraq the future of this contract is not clear, however, the Group is actively pursuing its legal right to this contract in Iraq in alliance with ConocoPhillips.

The following table displays our total contractual obligations and other commitments:

(millions of US dollars)	Total	2009	2010	2011	2012	2013	After
On balance sheet							
Short term debt	**2,301**	2,301	–	–	–	–	–
Long-term bank loans and borrowings	**3,333**	635	829	944	377	243	305
Long-term non-bank loans and borrowings	**51**	6	8	7	1	26	3
Long-term loans and borrowings from related parties	**2,165**	–	44	44	44	44	1,989
6.356% Non-convertible US dollar bonds, maturing 2017	**500**	–	–	–	–	–	500
6.656% Non-convertible US dollar bonds, maturing 2022	**500**	–	–	–	–	–	500
7.25% Russian ruble bonds, maturing 2009	**204**	204	–	–	–	–	–
7.10% Russian ruble bonds, maturing 2011	**272**	–	–	272	–	–	–
8.00% Russian ruble bonds, maturing 2012	**8**	–	–	–	8	–	–
7.40% Russian ruble bonds, maturing 2013	**204**	–	–	–	–	204	–
Capital lease obligations	**271**	86	58	25	25	25	52
TOTAL	**9,809**	**3,232**	**939**	**1,292**	**455**	**542**	**3,349**
Off balance sheet							
Capital commitments under oil and gas license agreements in Russia*	**1,399**	200	370	272	238	88	231
Operating lease obligations	**1,412**	489	268	170	139	109	237
Capital commitment in LUKOIL-Neftochim Bourgas AD	**357**	319	6	32	–	–	–
Capital commitment in LUKOIL-Petrotel	**42**	8	2	4	5	10	13
Commitment for modernization of the petrochemical refinery in Ukraine	**118**	93	25	–	–	–	–
Capital commitments in PSAs	**751**	462	122	104	26	1	36
Capital commitments in TGK-8	**1,225**	–	–	–	1,225	–	–
Obligation under contract with Eurasia Drilling Company	**791**	791	–	–	–	–	–
Obligation under contract with ZAO Globalstroy-Engineering	**549**	549	–	–	–	–	–

* Management believes that a significant portion of these commitments will be fulfiled by the services to be performed by Eurasia Drilling Company and ZAO Globalstroy-Engineering.

Off balance sheet arrangements

LUKARCO, an investee recorded under the equity method of accounting has a loan facility on which $178 million was drawn as of December 31, 2008. Borrowings under this loan bear interest at LIBOR plus 2.5% per annum, maturing by May 1, 2012. To enhance the credit standing of LUKARCO, the Company guarantees 54% of the interest payment as well as the repayment of 54% of the loan at maturity. The total amount of the Company's guarantees was $98 million and $348 million, which include $2 million and $19 million related to accrued interest on the outstanding amount, as of December 31, 2008 and 2007, respectively. Payments are due if the Company is notified that LUKARCO is not able to fulfil its obligations at maturity date. The Company's guarantee is secured by its 54% interest in LUKARCO with the carrying value of $586 million and $462 million as of December 31, 2008 and 2007, respectively. There are no material amounts being carried as liabilities for the Group's obligations under this guarantee.

		Commitment Expiration by Period					
(millions of US dollars)	Total	2009	2010	2011	2012	2013	After
Guarantees of equity affiliate's debt	**161**	136	25	–	–	–	–

Litigation and claims

On November 27, 2001, ADC, a Canadian diamond development company, filed a lawsuit in the District Court of Denver, Colorado against OAO Archangelskgeoldobycha ("AGD"), a Group company, and the Company (together the "Defendants"). ADC alleged that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. ADC claimed total damages of approximately $4.8 billion, including compensatory damages of $1.2 billion and punitive damages of $3.6 billion. On October 15, 2002, the District Court dismissed the lawsuit for lack of personal jurisdiction. This ruling was upheld by the Colorado Court of Appeals on March 25, 2004. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts' ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was dismissed from the lawsuit. The Supreme Court found, however, that the trial court made a procedural error by not holding an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company, which is whether the Company had systematic and continuous contacts in the State of Colorado at the time the lawsuit was filed. In a modified opinion dated December 19, 2005, the Colorado Supreme Court remanded the case to the Colorado Court of Appeals (instead of the District Court) to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). On June 29, 2006, the Colorado Court of Appeals declined to dismiss the case based on forum non conveniens. The Company filed a petition for certiorari on August 28, 2006, asking the Colorado Supreme Court to review this decision. This petition has been rejected. On March 5, 2007, the Colorado Supreme Court remanded the case to the District Court. On June 11, 2007, the District Court ruled it would conduct an evidentiary hearing on the issue of whether the Company is subject to general personal jurisdiction in the State of Colorado. Two pre-trial conferences were held with the Court in January 2009. The Court has allowed limited discovery to proceed. Discovery is limited to questions regarding jurisdiction. The Court has not set a hearing date for the termination of jurisdiction. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

On February 20, 2004, the Stockholm District Court overturned the decision of the Arbitral Tribunal of the Arbitration Institute of the Stockholm Chamber of Commerce ("Arbitration Tribunal"), made on June 25, 2001, dismissing ADC's action against AGD based on lack of jurisdiction. ADC's lawsuit against AGD was initially filed with the Arbitral Tribunal claiming alleged non-performance under an agreement between the parties and its obligation to transfer the diamond exploration license to Almazny Bereg. This lawsuit claimed compensation of damages amounting to $492 million. In March 2004, AGD filed an appeal against the Stockholm District Court decision with the Swedish Court of Appeals. On November 15, 2005, the Swedish Court of Appeals denied AGD's appeal and affirmed the Stockholm District Court decision. On December 13, 2005, AGD filed an appeal against the Swedish Court of Appeals decision with the Swedish Supreme Court. On April 13, 2006, the Swedish Supreme Court denied the application of AGD for appeal against the Swedish Court of Appeal's decision dated November 15, 2005. On May 6, 2006, a Notice of Arbitration was received on behalf of ADC. On December 20, 2006, the first session of the Arbitration Tribunal with participation of both parties took place in order to define procedural issues related to the tribunal. As a result of the hearing the Arbitration Tribunal issued a detailed procedural order setting out the rules and timetable for the conduct of the arbitration. In May 2007, ADC filed a statement of claim that requested the Tribunal to require AGD to transfer the diamond exploration license to Almazny Bereg. On October 22, 2007, AGD submitted a statement of defense. On February 5, 2009, the Arbitration Tribunal issued a procedural order setting out the rules and timetable for the conduct of the arbitration in 2009. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

In July 2008, the Federal Anti-monopoly Service of Russian Federation filled a suit against major Russian oil companies, including the Company, alleging that they violated anti-trust law by abusing their dominant position on the oil products market. A judgment was delivered which has been appealed in the Moscow Arbitration Court. The case was scheduled to be heard in late March 2009. During the second half of 2008 and the first quarter 2009, new suits were filed against the Company and some of the Group's companies alleging violation the anti-trust law. The alleged violations primarily involve fixing monopolistically high prices for oil products (gasoline, diesel and jet fuels, and fuel oil), and taking concerted action to fix and maintain prices for oil products. Overall, the claims may total between $79 million and $240 million. The indictments filed by anti-monopoly authorities have been appealed in the Court. Management believes that the Group's companies have followed all legal requirements and, consequently, does not believe that the ultimate resolution of such matters will have a material adverse impact on the Group's operating results or financial condition.

The Group is involved in various other claims and legal proceedings arising in the normal course of business. While these claims may seek substantial damages against the Group and are subject to uncertainty inherent in any litigation, management does not believe that the ultimate resolution of such matters will have a material adverse impact on the Group's operating results or financial condition.

Critical accounting policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to select appropriate accounting policies and to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. See Note 2 "Summary of significant accounting policies" to our consolidated financial statements for descriptions of the Company's major accounting policies. Certain of these accounting policies involve judgments and uncertainties to such an extent that there is a reasonable likelihood that materially different amounts would have been reported under different conditions, or if different assumptions had been used.

Business combinations

Purchase price allocation
Accounting for the acquisition of a business requires the allocation of the purchase price to the various assets and liabilities of the acquired business. For most assets and liabilities, purchase price allocation is accomplished by recording the asset or liability at its estimated fair value. The most difficult estimations of individual fair values are those involving property, plant and equipment and identifiable intangible assets. We use all available information to make these fair value determinations and, for major business acquisitions, typically engage an outside appraisal firm to assist in the fair value determination of the acquired long-lived assets. We have, if necessary, up to one year after the acquisition closing date to finish these fair value determinations and finalize the purchase price allocation.

Principles of consolidation
Our consolidated financial statements include the financial position and results of the Company, controlled subsidiaries of which the Company directly or indirectly owns more than 50% of the voting interest, unless minority interest shareholders have substantive participating rights, and variable interest entities where the Group is determined to be the primary beneficiary. Other significant investments in companies of which the Company directly or indirectly owns between 20% and 50% of the voting interest and over which it exercises significant influence but not control, are accounted for using the equity method of accounting. Investments in companies of which the Company directly or indirectly owns more than 50% of the voting interest but where minority interest shareholders have substantive participating rights are accounted for using the equity method of accounting. Undivided interests in oil and gas joint ventures are accounted for using the proportionate consolidation method. Investments in other companies are recorded at cost.

Revenue recognition

Revenues from the production and sale of crude oil and petroleum products are recognized when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed or determinable. Revenues include excise on petroleum products sales and duties on export sales of crude oil and petroleum products.

Revenues from non-cash sales are recognized at the fair market value of the crude oil and petroleum products sold.

Successful efforts accounting for oil and gas activities

Accounting for oil and gas activities is subject to special accounting rules that are unique to the oil and gas industry. Property acquisitions, successful exploratory wells, all development costs and support equipment and facilities are capitalized. Artificial stimulation and well work-over costs are included in operating expenses as incurred.

Property acquisition costs
For individually significant undeveloped properties, management periodically performs impairment test based on exploration and drilling efforts to date. For undeveloped properties that individually are relatively small, management exercises judgment and determines a periodic property impairment charge as required that is reported in loss on disposals and impairments of assets.

Exploratory costs
For exploratory wells, drilling costs are temporarily capitalized, or "suspended", on the balance sheet, pending a judgmental determination of whether potentially economic oil and gas reserves have been discovered by the drilling effort. If a judgment is made that the well did not encounter potentially economic oil and gas quantities, the well costs are expensed as a dry hole and are reported in exploration expense. Exploratory wells that are judged to have discovered potentially economic quantities of oil and gas and that are in areas where a major capital expenditure would be required before production could begin, remain capitalized on the balance sheet as long as additional exploratory appraisal work is under way or firmly planned. There is no periodic impairment assessment of suspended exploratory well costs. Management continuously monitors the results of the additional appraisal drilling and seismic work and expenses the suspended well costs as dry holes when it judges that the potential field does not warrant further exploratory efforts in the near term.

Other exploratory expenditures, including geological and geophysical costs are expensed as incurred.

Proved oil and gas reserves

Due to the inherent uncertainties and the necessarily limited nature of reservoir data, estimates of reserves are inherently imprecise, require the application of judgment and are subject to change as additional information becomes available. The estimates are made using all available geological and reservoir data as well as historical production data. Estimates are reviewed and revised as appropriate. Revisions occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Company's plans.

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas liquids including condensate and natural gas that geological and engineering data demonstrate with reasonable certainty can be recovered in future years from known reservoirs under existing economic and operating conditions. Reserves are considered proved if they can be produced economically as demonstrated by either actual production or conclusive formation tests. Proved reserves do not include additional quantities of oil and gas reserves that may result from applying secondary or tertiary recovery techniques not yet tested and determined to be economic. The proved reserves include volumes which are recoverable up to and after license expiry dates. Proved developed reserves are the quantities of proved reserves expected to be recovered through existing wells with existing equipment and operating methods.

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. Most part of these licenses expire between 2013 and 2014. Management believes the licenses will be extended to produce subsequent to their current expiry dates. The Group is in the process of extending all of its production licenses in the Russian Federation and has already extended a portion of these licenses. To date there have been no unsuccessful license renewal applications.

Impairment of long-lived assets

Long lived assets, such as oil and gas properties, other property, plant, and equipment, and purchased intangibles subject to amortization, are assessed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future cash flows expected to be generated by that group. If the carrying amount of an asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by writing down the carrying amount to the estimated fair value of the asset group, generally determined as discounted future net cash flows. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale are presented separately in the appropriate asset and liability sections of the balance sheet.

Deferred income taxes

Deferred income tax assets and liabilities are recognized in respect of future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purposes of the consolidated financial statements and their respective tax bases and in respect of operating loss and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse and the assets be recovered and liabilities settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of income in the reporting period which includes the enactment date.

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income in the reporting periods in which the originating expenditure becomes deductible. In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that the deferred income tax assets will be realized. In making this assessment, management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies.

Asset retirement obligations

Under various laws, contracts, permits and regulations, the Group has legal obligations to remove tangible equipment and restore the land or seabed at the end of operations at production sites. The largest asset retirement obligations of the Group relate to wells and oil and gas production facilities and pipelines. In accordance with SFAS No. 143, *"Accounting for Asset Retirement Obligations,"* the Group records the fair value of liabilities associated with such obligations when incurred. Estimating the future asset retirement obligations costs necessary for this accounting calculation involves significant estimates and judgments by management. Most of these obligations are many years in the future and the contracts and regulations often have vague descriptions of what removal practices and criteria will have to be met when the removal event actually occurs. Asset removal technologies and costs are constantly changing, as well as political, environmental, safety and public relations considerations.

Contingencies

Certain conditions may exist as of balance sheet dates that may result in losses, but the impact of which will only be resolved when one or more future events occur or fail to occur. The Group is required to both determine whether a loss is probable based on judgment and interpretation of laws and regulations and determine whether the loss can be reasonably estimated. If our assessment of a contingency indicates that it is probable that a material loss will arise, and the amount of the liability can be estimated, then the estimated liability is accrued and charged to the consolidated statement of income. If our assessment indicates that a potentially material loss is not probable, but is only reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability is disclosed in the notes to our consolidated financial statements. Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed. The Company's management continually monitor known and potential contingent matters and make appropriate charges to the consolidated statement of income when warranted by circumstance.

Use of derivative instruments

The Group's derivative activity is limited to certain petroleum products marketing and trading outside of its physical crude oil and petroleum products businesses and hedging of commodity price risks. Currently this activity involves the use of futures and swaps contracts together with purchase and sale contracts that qualify as derivative instruments. The Group accounts for these activities under the mark-to-market methodology in which the derivatives are revalued each accounting period. Resulting realized and unrealized gains or losses are presented in the consolidated statement of income on a net basis. Unrealized gains and losses are carried as assets or liabilities on the consolidated balance sheet.

Recent accounting pronouncements

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, *"Disclosures about Transfers of Financial Assets and Interest in Variable Interest Entities."* This FSP amends FASB Statement No. 140, *"Accounting for transfers and Servicing of Financial Assets and Extinguishments of Liabilities,"* and requires additional disclosures about transfers of financial assets. It also amends FASB Interpretation No. 46 (R), *"Consolidation of Variable Interest Entities,"* and requires public entities, including sponsors that have a variable interest in a variable interest entity, to provide additional disclosures about their involvement with variable interest entities. This FSP is effective for the first reporting period ending after December 15, 2008. The adoption of the provisions of FSP FAS 140-4 and FIN 46(R)-8 did not have any impact on the Group's results of operations, financial position or cash flows.

In March 2008, the FASB issued SFAS No. 161, *"Disclosures about Derivative Instruments and Hedging Activities."* This Statement improves financial reporting about derivative instruments and hedging activities by enhanced disclosures of their effects on an entity's financial position, financial performance and cash flows. The Group is required to adopt the provisions of SFAS No. 161 no later than in the first quarter of 2009 and does not expect any material impact on its results of operations, financial position or cash flows upon adoption.

In December 2007, the FASB issued SFAS No. 141 (Revised), *"Business combinations."* This Statement will apply to all transactions in which an entity obtains control of one or more businesses. SFAS No. 141 (Revised) requires an entity to recognize the fair value of assets acquired and liabilities assumed in a business combination; to recognize and measure the goodwill acquired in the business combination or gain from a bargain purchase and modifies the disclosure requirements. The Group is required to prospectively adopt the provisions of SFAS No. 141 (Revised) for business combinations for which the acquisition date is on or after January 1, 2009. Early adoption of SFAS No. 141 (Revised) is prohibited.

In December 2007, the FASB issued SFAS No. 160, *"Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51."* This Statement will apply to all entities that prepare consolidated financial statements (except not-for-profit organizations) and will affect those which have an outstanding noncontrolling interest (or minority interest) in their subsidiaries or which have to deconsolidate a subsidiary. This Statement changes the classification of a non-controlling interest; establishing a single method of accounting for changes in the parent company's ownership interest that does not result in deconsolidation and requires a parent company to recognize a gain or loss when a subsidiary is deconsolidated. The Group is required to prospectively adopt the provisions of SFAS No. 160 in the first quarter of 2009, except for the presentation and disclosure requirements which shall be applied retrospectively. Early adoption of SFAS No. 160 is prohibited.

In February 2007, the FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities."* This Statement expands the possibility of using fair value measurements and permits enterprises to choose to measure certain financial assets and financial liabilities at fair value. Enterprises shall report unrealized gains and losses on items for which the fair value option has been elected in earnings in each subsequent period. The Group adopted the provisions of SFAS No. 159 in the first quarter of 2008. The Group elected not to use the fair value option for its financial assets and financial liabilities not already carried at fair value in accordance with other standards. Therefore the adoption of SFAS No. 159 did not have any impact on the Group's results of operations, financial position or cash flows.

In September 2006, the FASB issued SFAS No. 157, *"Fair Value Measurements,"* which establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair value measurements. In February 2008, the FASB issued Staff Position FSP No. 157-2, "*Effective date of FASB Statement No. 157,"* which defers the effective date of SFAS No. 157 for certain nonfinancial assets and nonfinancial liabilities to the first quarter of 2009. The Group elected to adopt SFAS No. 157 with deferral permitted by FSP No. 157-2. The deferral applies to nonfinancial assets and liabilities measured in a business combination; long-lived assets, intangible assets and goodwill measured at fair value upon impairment and liabilities for asset retirement obligations. The Group does not expect any material impact on its results of operations, financial position or cash flows on adoption of SFAS No. 157 for these assets and liabilities. The initial adoption of SFAS No. 157 is limited to commodity derivative instruments.

The initial adoption of the provisions of SFAS No. 157 did not have a material impact on the Group's results of operations, financial position or cash flows.

In September 2006, the FASB issued SFAS No. 158, *"Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)."* This Statement requires an employer that sponsors one or more single-employer defined benefit plans to: (a) Recognize the funded status of a benefit plan in its statement of financial position; (b) Recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost; (c) Measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions); (d) Disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. The provisions of this Statement were effective December 31, 2006, except for the requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end, which is effective December 31, 2008. The adoption of the provisions of SFAS No. 158 did not have a material impact on the Group's results of operations, financial position or cash flows.

Forward-looking statements

Certain statements in this document are not historical facts and are “forward-looking.” We may from time to time make written or oral forward-looking statements in reports to shareholders and in other communications. Examples of such forward-looking statements include, but are not limited to:

- statements of our plans, objectives or goals, including those related to products or services
- statements of future economic performance
- statements of assumptions underlying such statements.

Forward looking statements that may be made by us from time to time (but that are not included in this document) may also include projections or expectations of revenues, income (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios. Words such as “believes,” “anticipates,” “expects,” “estimates,” “intends” and “plans” and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. You should be aware that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements.

These factors include:

- inflation, interest rate and exchange rate fluctuations
- the price of oil
- the effects of, and changes in, Russian government policy
- the effects of competition in the geographic and business areas in which we conduct operations
- the effects of changes in laws, regulations, taxation or accounting standards or practices
- our ability to increase market share for our products and control expenses
- acquisitions or divestitures
- technological changes
- our success at managing the risks of the aforementioned factors.

This list of important factors is not exhaustive. When relying on forward-looking statements, you should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as of the date on which they are made, and, subject to any continuing obligations under the Listing Rules of the U.K. Listing Authority, we do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.