

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

The following report contains a discussion and analysis of the financial condition of OAO LUKOIL as of June 30, 2011 and the results of its operations for the three and six month periods ended June 30, 2011 and 2010, and significant factors that may affect its future performance. It should be read in conjunction with our interim US GAAP consolidated financial statements and notes thereto.

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.*

### Key financial and operational results

	2 <sup>nd</sup> quarter of		Change, %	1 <sup>st</sup> half of		Change, %
	2011	2010		2011	2010	
Sales (millions of US dollars).....	34,912	25,853	35.0	64,538	49,755	29.7
Net income attributable to OAO LUKOIL (millions of US dollars).....	3,251	1,949	66.8	6,768	4,002	69.1
EBITDA (millions of US dollars).....	5,345	3,704	44.3	10,688	7,433	43.8
Taxes other than income taxes, excise and export tariffs (millions of US dollars).....	(9,324)	(7,031)	32.6	(16,760)	(13,689)	22.4
Earning per share of common stock attributable to OAO LUKOIL (US dollars):						
Basic .....	4.16	2.30	80.9	8.66	4.72	83.4
Diluted .....	4.08	2.30	77.2	8.48	4.72	79.6
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE) ..	194,522	204,182	(4.7)	391,268	409,373	(4.4)
Crude oil production by the Group including our share in equity affiliates (thousands of tonnes) .....	22,735	24,085	(5.6)	45,571	48,140	(5.3)
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters).....	4,533	4,521	0.3	9,318	9,242	0.8
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes).....	16,273	16,430	(1.0)	30,845	31,177	(1.1)

During the first half of 2011, our net income was \$6,768 million, which is \$2,766 million, or 69.1%, more than in the same period of 2010. At the same time, our net income for the second quarter of 2011 amounted to \$3,251 million, which is \$1,302 million, or 66.8%, higher than in the second quarter of 2010.

The increase in our net income was mainly due to a sharp increase in hydrocarbon prices in the first half of 2011, compared to the respective period of 2010. At the same time, our results were affected by an increasing tax burden and the appreciation of the Russian ruble.

## Business overview

The primary activities of OAO LUKOIL and its subsidiaries are oil exploration, production, refining, marketing and distribution. The Company is the ultimate parent entity of a vertically integrated group of companies.

OAO LUKOIL was established in accordance with Presidential Decree 1403, issued on November 17, 1992. Under this decree, on April 5, 1993, the Government of the Russian Federation transferred to the Company 51% of the voting shares of fifteen enterprises. Under Government Resolution 861 issued on September 1, 1995, a further nine enterprises were transferred to the Group during 1995. Since 1995, the Group has carried out a share exchange program to increase its shareholding in each of 24 founding subsidiaries to 100%. From formation, the Group has expanded substantially through consolidation of interests, acquisition of new companies and establishment of new businesses. Now LUKOIL is a global energy company operating through its subsidiaries in 37 countries on four continents.

LUKOIL is one of the world's largest energy companies in terms of hydrocarbon reserves that amounted to 17.3 billion BOE as of January 1, 2011 and comprised of 13.3 billion BOE of crude oil and 23.6 trillion cubic feet of gas.

Our operations are divided into four 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.
- **Power generation** – which includes generation, transportation and sales of electricity, heat and related services.

Each of our four 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 8, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of crude oil refining and other factors. 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 19 “Segment information” to the interim consolidated financial statements.

## Changes in the Group structure

In April 2011, LUKOIL and OAO ANK Bashneft (“Bashneft”) signed an agreement to establish a joint venture and to stipulate conditions for the development of two fields named after R. Trebs and A. Titov. According to the agreement, OAO LUKOIL will purchase 25.1% of a Bashneft subsidiary for approximately \$169 million, while the license and subsoil use rights for R.Trebs and A.Titov fields will be re-issued in favor of this subsidiary. In its turn, the joint venture will purchase from the Group 29 exploration wells located in the license area. The agreement also envisages the exploitation of the Group’s infrastructure, including the oil export terminal in Varandey and the energy centre of the Yuzhnoye Khylochuyu field. The total recoverable oil reserves located within the license areas of R.Trebs and A.Titov fields are 140.1 million tonnes. The agreement is subject to endorsement by the respective regulatory authorities of the Russian Federation.

In April 2011, the Group acquired an 11% stake in the joint venture operating the ISAB refining complex (“ISAB”) for €241 million (approximately \$342 million) and thus increased the Group’s ownership in it from 49% to 60%. This was a partial exercise of ERG S.p.A. (“ERG”) option to sell its stake in the joint venture, established in 2008. According to the agreement ERG has a put option to sell its stake in full.

In July 2010, a Group company signed an agreement to purchase from a ConocoPhillips' subsidiary 64.6 million of the Company's ordinary shares at \$53.25 per share for the total amount of \$3,442 million. This transaction was finalized in August 2010. Under this agreement the Group had a 60-day option to purchase any or all of the remaining 98.7 million of the Company's ordinary shares held by the ConocoPhillips' subsidiary for the price of \$56 per share. In September 2010, this option was exercised in respect of 42.5 million LUKOIL ADRs, each representing one ordinary share of the Company. The Group company sold these ADRs to UniCredit Bank AG and the latter paid the purchase price of \$2.38 billion to the ConocoPhillips' subsidiary. Simultaneously, UniCredit Bank AG issued a series of equity-linked notes to the Group company that are redeemable for 17,500,000 LUKOIL ADRs on or before September 29, 2011. ConocoPhillips realized the remainder of its holding in LUKOIL in the open market and thereby fully quit LUKOIL share capital.

In January 2010, the Company signed an agreement to develop the West Qurna-2 field located in the south of Iraq. The parties to the agreement are the Iraqi state-owned South Oil Company and the contracting consortium formed by the Iraqi state-owned North Oil Company, the Company and Norway's Statoil ASA. The Company's share in the project is 56.25%. The West Qurna-2 field has recoverable crude oil reserves of about 12.9 billion barrels.

As a part of the expansion of its presence in Kazakhstan, in December 2009, the Group acquired the remaining 46.0% interest in its equity affiliate LUKARCO B.V. ("LUKARCO") for \$1.6 billion, thereby increasing the ownership stake to 100%. LUKARCO is a holding company, which owns a 5.0% share in Tengizchevroil, a joint venture which develops the Tengiz and Korolevskoe fields in Kazakhstan, and a 12.5% share in Caspian Pipeline Consortium ("CPC"), which carries Kazakhstani and Russian oil to Novorossiysk marine terminal. Therefore, the Group increased the ownership in Tengizchevroil from 2.7% to 5.0% and the ownership in CPC from 6.75% to 12.5%. The first installment in the amount of \$300 million was paid in December 2009. \$800 million were paid in December 2010 and the remaining amount should be paid no later than December 2011.

## Operational highlights

### Hydrocarbon production

We undertake exploration for, and production of, crude oil and natural gas in Russia and internationally. In Russia our major oil producing subsidiaries are OOO LUKOIL-Western Siberia, OOO LUKOIL-Komi and OOO LUKOIL-Perm. Also we have a consolidated joint venture with ConocoPhillips, OOO Narianmarneftegaz, in the Northern Timan-Pechora region. Exploration and production outside of Russia is performed by our 100% subsidiary LUKOIL-Overseas, that has stakes in PSA's and other projects in Kazakhstan, Azerbaijan, Uzbekistan, Iraq, Saudi Arabia, Columbia, Ghana and Cote d'Ivoire.

The table below summarizes the results of our exploration and production activities.

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
	(thousand BOE per day)			
Daily production of hydrocarbons, including the Company's share in equity affiliates, including: .....	2,137	2,243	2,162	2,262
- crude oil .....	1,844	1,951	1,859	1,962
- natural and petroleum gas <sup>(1)</sup> .....	293	292	303	300
	(US dollar per BOE)			
Hydrocarbon extraction expenses.....	4.93	4.07	4.72	4.02
- in Russia .....	4.96	4.10	4.75	4.05
- outside Russia .....	4.60	3.66	4.41	3.61
	(millions of US dollars)			
Hydrocarbon extraction expenses.....	924	800	1,777	1,584
- in Russia .....	868	753	1,667	1,491
- outside Russia .....	56	47	110	93
Exploration expenses.....	85	29	113	146
- in Russia .....	43	14	55	50
- outside Russia .....	42	15	58	96
Mineral extraction tax .....	3,192	1,991	5,657	3,757
- in Russia .....	3,171	1,973	5,612	3,723
- outside Russia .....	21	18	45	34

<sup>(1)</sup> Gas available for sale (excluding gas produced for our own consumption).

**Crude oil production.** In the first half of 2011, our daily crude oil production decreased to 1,859 thousand BOE, or by 5.2%, compared to the same period of 2010. We produced (including the Company's share in equity affiliates) 336.4 million barrels, or 45.6 million tonnes.

The following table represents our crude oil production in the first half of 2011 and 2010 by major regions.

(thousands of tonnes)	Change to 2010				
	1 <sup>st</sup> half of 2011	Total, %	Change in structure	Organic change	1 <sup>st</sup> half of 2010
Western Siberia.....	24,397	(4.1)	–	(1,037)	25,434
Timan-Pechora.....	9,208	(15.3)	–	(1,663)	10,871
Ural region .....	6,273	2.7	–	167	6,106
Volga region .....	1,536	7.3	–	104	1,432
Other in Russia.....	972	(4.8)	–	(49)	1,021
Crude oil produced in Russia .....	42,386	(5.5)	–	(2,478)	44,864
Crude oil produced internationally.....	1,723	(1.5)	–	(26)	1,749
<b>Total crude oil produced by consolidated subsidiaries .....</b>	<b>44,109</b>	<b>(5.4)</b>	<b>–</b>	<b>(2,504)</b>	<b>46,613</b>
<b>Our share in crude oil produced by equity affiliates:</b>					
in Russia .....	175	6.7	–	11	164
outside Russia .....	1,287	(5.6)	–	(76)	1,363
<b>Total crude oil produced .....</b>	<b>45,571</b>	<b>(5.3)</b>	<b>–</b>	<b>(2,569)</b>	<b>48,140</b>

The main oil producing region for the Company is Western Siberia where we produced 55.3% of our crude oil in the first half of 2011 (54.6% in the first half of 2010). In 2011, the Western Siberian producing assets continued to mature resulting in a production decline and water cut increase. The Company undertakes efforts to stabilize production in the region.

The main reason for the production decrease in Timan-Pechora was a decrease in average flow rates per well as a result of the water cut growth and the decrease of recoverable reserves related to revision of parameters of the geological model of the Yuzhnoye Khylychuyu oilfield.

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

	<b>2<sup>nd</sup> quarter of</b>			
	<b>2011</b>		<b>2010</b>	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia .....	176	24	234	32
Crude oil purchases internationally .....	35,155	4,796	43,394	5,920
<b>Total crude oil purchased .....</b>	<b>35,331</b>	<b>4,820</b>	<b>43,628</b>	<b>5,952</b>

	<b>1<sup>st</sup> half of</b>			
	<b>2011</b>		<b>2010</b>	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia .....	894	122	381	52
Crude oil purchases internationally .....	63,573	8,673	77,610	10,588
<b>Total crude oil purchased .....</b>	<b>64,467</b>	<b>8,795</b>	<b>77,991</b>	<b>10,640</b>

Significant part of our crude oil purchases is for processing. In the first half of 2011, we purchased 6,325 thousand tonnes of crude oil to process at our and at third party refineries (including 2,027 thousand tonnes at ISAB and 753 thousand tonnes at TRN), compared to 5,385 thousand tonnes in the first half of 2010 (including 2,109 thousand tonnes at ISAB and 1,103 thousand tonnes at TRN). Purchases for trading decreased significantly, compared to the first half of 2010.

**Gas production.** In the first half of 2011, we produced 9,318 million cubic meters of gas available for sale (including our share in equity affiliates). The increase of production compared to the respective period of 2010 amounted to 0.8%.

Our major gas production field is the Nakhodkinskoe gas field, where we produced 4,204 million cubic meters of natural gas in the first half of 2011 (4,110 million cubic meters in the first half of 2010). Our international gas production also did not change significantly.

### **Refining, marketing and trading**

**Refining.** We own and operate four refineries located in European Russia and three refineries located outside of Russia – in Bulgaria, Ukraine and Romania. Moreover, we have a 60% stake in the ISAB refinery complex in Italy (49% before April 1, 2011) and a 45% interest in the TRN refinery in the Netherlands.

Compared to the first half of 2010, production at our consolidated refineries decreased by 1.7%. Russian refineries increased their production by 0.9%, while international refineries' production decreased by 14.3% as a result of the shutdown of the Odessa refinery. The production of our affiliated refineries ISAB and TRN increased by 2.1% resulting from the increase of Group's share in the ISAB refinery.

We invested, and continue to invest, significant resources in our refineries aiming at taking the leading position in Russia in producing ecological fuel of high quality standards. Thus, in December 2010, we launched a catalytic cracking complex at our refinery in Nizhny Novgorod that enabled us to start production of gasoline fully compliant to the Euro-4 quality standard. Related investments amounted to approximately \$1 billion.

In Russia, LUKOIL holds the leading position in production and sales of European standards motor fuel being ahead of the official terms of their obligatory implementation in the country. At our Russian refineries we produced 4,579 and 4,304 thousand tonnes of Euro-4 and Euro-5 diesel fuel and 2,910 and 2,716 thousand tonnes of Euro-3 and Euro-4 gasoline in the first half of 2011 and 2010, respectively. We commenced production of Euro-4 gasoline in the end of 2010. The share of gasoline compliant to Euro-3 and Euro-4 exceeds 90% and the share of diesel compliant to Euro-4 and Euro-5 exceeds 70% of our total domestic production. Technically, we are able to produce all our gasoline in compliance with the Euro-4 standards. Production of lower quality gasoline is due to the supplies to the federal customers. Along with the launch of the new fuel hydrorefining unit at our refinery in Volgograd scheduled for the second half of 2012, we will be able to increase the share of Euro-4 and -5 diesel to 97% of our total domestic diesel production.

Along with our own production of refined products we can refine crude oil at third party refineries depending on market conditions and other factors. In the first half of 2011, we only processed our crude oil at a third party refinery in Kazakhstan.

The following table summarizes key figures for our refining activities.

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
	(millions of US dollars)			
Refining expenses at the Group refineries.....	344	259	686	532
- in Russia .....	264	189	514	381
- outside Russia .....	80	70	172	151
Refining expenses at ISAB and TRN.....	256	172	422	349
Refining expenses at third party refineries .....	2	–	5	2
Capital expenditures.....	174	166	299	336
- in Russia .....	129	119	214	238
- outside Russia .....	45	47	85	98
	(thousand barrels per day)			
Refinery throughput at the Group refineries .....	1,098	1,134	1,075	1,088
- in Russia .....	925	899	912	898
- outside Russia .....	173	235	163	190
Refinery throughput at ISAB and TRN <sup>(1) (2)</sup> .....	258	235	222	222
Refinery throughput at third party refineries.....	6	–	7	–
<b>Total refinery throughput .....</b>	<b>1,362</b>	<b>1,369</b>	<b>1,304</b>	<b>1,310</b>
	(thousand of tonnes)			
Refined products produced at the Group refineries .....	13,032	13,525	25,285	25,731
- in Russia .....	10,977	10,720	21,467	21,274
- outside Russia .....	2,055	2,805	3,818	4,457
Production of ISAB and TRN <sup>(1)</sup> .....	3,241	2,905	5,560	5,446
Refined products produced at third party refineries .....	74	–	169	4
<b>Total refined products produced .....</b>	<b>16,347</b>	<b>16,430</b>	<b>31,014</b>	<b>31,181</b>

<sup>(1)</sup> Group's share.

<sup>(2)</sup> Including refined product processed.

**Marketing and trading.** 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 Russia we purchase refined products on occasion, primarily to manage supply chain bottlenecks.

The Group retails its refined products in 27 countries through nearly 5.6 thousand petrol stations. Most of the stations operate under the LUKOIL brand. The decrease of petrol stations number compared to the beginning of the year (over 6 thousand stations) was due to restructuring of our retail network in the USA.

The table below summarizes figures for our trading activities.

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
	(thousand of tonnes)			
Retail sales .....	3,679	3,510	6,948	6,768
Wholesale sales .....	22,653	23,745	43,325	44,241
<b>Total refined products sales .....</b>	<b>26,332</b>	<b>27,255</b>	<b>50,273</b>	<b>51,009</b>
Refined products purchased in Russia.....	477	563	896	855
Refined products purchased internationally .....	11,379	11,784	22,460	23,015
<b>Total refined products purchased.....</b>	<b>11,856</b>	<b>12,347</b>	<b>23,356</b>	<b>23,870</b>

**Exports of crude oil and refined products from Russia.** The volumes of crude oil exported from Russia by our subsidiaries are summarized as follows:

	2 <sup>nd</sup> quarter of			
	2011 (thousand of barrels)	2011 (thousand of tonnes)	2010 (thousand of barrels)	2010 (thousand of tonnes)
Exports of crude oil using Transneft export routes .....	52,168	7,117	56,757	7,743
Exports of crude oil bypassing Transneft.....	9,947	1,357	16,749	2,285
<b>Total crude oil exports .....</b>	<b>62,115</b>	<b>8,474</b>	<b>73,506</b>	<b>10,028</b>

	1 <sup>st</sup> half of			
	2011 (thousand of barrels)	2011 (thousand of tonnes)	2010 (thousand of barrels)	2010 (thousand of tonnes)
Exports of crude oil using Transneft export routes .....	104,497	14,256	116,650	15,914
Exports of crude oil bypassing Transneft.....	21,228	2,896	32,919	4,491
<b>Total crude oil exports .....</b>	<b>125,725</b>	<b>17,152</b>	<b>149,569</b>	<b>20,405</b>

In the first half of 2011, our export of crude oil from Russia was 15.9% less than in the same period of 2010, and we exported 40.5% of our total domestic crude oil production (45.5% in the first half of 2010).

The reduction of our export was mainly caused by a decline in production as well as by an increase of domestic crude oil sales and increased domestic refining.

In the first half of both 2011 and 2010, all of the volume of crude oil exported bypassing Transneft was routed through our own export infrastructure.

In the first half of 2011, we exported from Russia 12.7 million tonnes of refined products, a decrease of 1.8%, compared to the first half of 2010. The reason for this decrease was certain transportation constraints. Primarily we export from Russia diesel fuel, fuel oil and gasoil. These products account for approximately 88.2% of our refined products export volumes.

In the first half of 2011, our revenue from export of crude oil and refined products from Russia both to Group companies and third parties amounted to \$12,249 million and \$9,488 million, respectively (\$10,718 million for crude oil and \$6,922 million for refined products in the first half of 2010).

### Power generation

In the first half of 2011, we continued to develop the new power generation sector of our business as part of our strategic development program. This new sector encompasses all aspects of the power generation business, from generation to transmission and sale of heat and electrical power. Our power generation business sector now includes OOO LUKOIL-Kubanenergo, OOO LUKOIL-Astrakhanenergo, OOO LUKOIL-Volgogradenergo, OOO LUKOIL-Rostovenergo, OOO LUKOIL-TTK (all spun off from OOO UGK TGK-8), OOO LUKOIL-Ecoenergo (former OOO UGK TGK-8), our own power generating facilities at our oil and gas fields and power generators in Bulgaria, Romania and Ukraine.

## 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 the Group's revenues. During the first half of 2011, the Brent crude oil price fluctuated between \$93 and \$126 per barrel and reached its peak of \$126.7 in the beginning of April of 2011.

The crude oil price growth that started in December 2010 and continued during the first half of 2011 was caused mainly by speculative factors as a consequence of political instability in the Middle East and Northern Africa.

Substantially all the crude oil the Group exports is Urals blend. The following table shows the average crude oil and refined product prices in the respective periods of 2011 and 2010.

	2 <sup>nd</sup> quarter of		Change,	1 <sup>st</sup> half of		Change,
	2011	2010	%	2011	2010	%
	(in US dollars per barrel, except for figures in percent)					
Brent crude.....	117.04	78.24	49.6	111.09	77.29	43.7
Urals crude (CIF Mediterranean) <sup>(1)</sup> .....	113.75	76.86	48.0	108.08	76.12	42.0
Urals crude (CIF Rotterdam) <sup>(1)</sup> .....	113.73	76.92	47.9	108.00	76.10	41.9
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam).....	624.82	434.28	43.9	590.78	402.84	46.7
Diesel fuel 10 ppm (FOB Rotterdam).....	983.45	684.45	43.7	946.86	691.46	36.9
High-octane gasoline (FOB Rotterdam).....	1,058.25	732.82	44.4	988.59	671.64	47.2

Source: Platts.

<sup>(1)</sup> 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.

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 the respective periods of 2011 and 2010.

	2 <sup>nd</sup> quarter of		Change,	1 <sup>st</sup> half of		Change,
	2011	2010	%	2011	2010	%
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil.....	362.88	239.12	51.8	315.92	223.60	41.3
Diesel fuel.....	738.88	530.54	39.3	760.76	546.91	39.1
High-octane gasoline (Regular) .....	940.25	720.62	30.5	840.50	692.65	21.3
High-octane gasoline (Premium) .....	971.04	736.97	31.8	877.58	710.26	23.6

Source: InfoTEK (excluding VAT).



## Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenue 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 appreciation of the ruble against the US dollar generally causes our costs to increase in US dollar terms, and vice versa. 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 15.0% in the first half of 2011, compared to the first half of 2010.

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

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
Ruble inflation (CPI), % .....	1.1	1.2	5.0	4.4
Change of the ruble-dollar exchange rate, % .....	1.2	(6.2)	7.9	(3.2)
Average exchange rate for the period (ruble to US dollar) .....	27.99	30.24	28.62	30.07
Exchange rate at the end of the period (ruble to US dollar) .....	28.08	31.20	–	–

## Tax burden

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

		2 <sup>nd</sup> quarter of		Change, %
		2011 <sup>(1)</sup>	2010 <sup>(1)</sup>	
Export tariffs on crude oil .....	\$/tonne	446.58	281.69	58.5
Export tariffs on refined products				
Middle distillates (jet fuel), diesel fuel and gasoils .....	\$/tonne	299.22	202.12	48.0
Light distillates				
gasoline .....	\$/tonne	369.76	202.12	82.9
straight-run gasoline .....	\$/tonne	334.23	202.12	65.4
Liquid fuels (fuel oil) .....	\$/tonne	208.54	108.88	91.5
Mineral extraction tax				
Crude oil .....	RUR/tonne	4,464.47	2,977.27	50.0
Natural gas .....	RUR/1,000 m <sup>3</sup>	237.00	147.00	61.2

<sup>(1)</sup> Average values.

		1 <sup>st</sup> half of		Change, %
		2011 <sup>(1)</sup>	2010 <sup>(1)</sup>	
Export tariffs on crude oil .....	\$/tonne	395.03	272.66	44.9
Export tariffs on refined products				
Middle distillates (jet fuel), diesel fuel and gasoils .....	\$/tonne	266.99	196.03	36.2
Light distillates				
gasoline .....	\$/tonne	302.46	196.03	54.3
straight-run gasoline .....	\$/tonne	284.59	196.03	45.2
Liquid fuels (fuel oil) .....	\$/tonne	179.94	105.60	70.4
Mineral extraction tax				
Crude oil .....	RUR/tonne	4,278.72	2,928.87	46.1
Natural gas .....	RUR/1,000 m <sup>3</sup>	237.00	147.00	61.2

<sup>(1)</sup> Average values.

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

		2 <sup>nd</sup> quarter of		Change,
		2011 <sup>(1)</sup>	2010 <sup>(1)</sup>	%
Mineral extraction tax				
Crude oil .....	\$/tonne	159.53	98.44	62.1
Natural gas .....	\$/1,000 m <sup>3</sup>	8.47	4.86	74.2

<sup>(1)</sup> Average values.

		1 <sup>st</sup> half of		Change,
		2011 <sup>(1)</sup>	2010 <sup>(1)</sup>	%
Mineral extraction tax				
Crude oil .....	\$/tonne	149.48	97.41	53.5
Natural gas .....	\$/1,000 m <sup>3</sup>	8.28	4.89	69.3

<sup>(1)</sup> Average values.

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

**Crude oil extraction tax rate.** The base rate is 419 rubles per metric tonne extracted and it is adjusted depending on the international market price of Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals blend international market price for a tax period is less than or equal to \$15.00 per barrel. Each \$1.00 per barrel increase in the international Urals blend price over the threshold (\$15.00 per barrel) results 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).

The base rate for 2012 and 2013 is currently set at 446 rubles and 470 rubles per metric tonne extracted, respectively. However, the rate may be amended by the authorities later on.

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, the Caspian Sea and the Nenetsky Autonomous District, depending on the period and volume of production.

The Group produced crude oil from certain oilfields in the Caspian Sea and the Nenetsky Autonomous District and benefited from the application of zero tax rate. However, in early December 2010, we exceeded the accumulated production limit of 15 million tonnes at Yuzhnoye Khylichuyu oilfield eligible for the incentive. Thus, starting from December 2010, we pay mineral extraction tax at a regular rate at this field.

**Natural gas extraction tax rate.** The mineral extraction tax on natural gas production is calculated using a flat rate. During the period from January 1, 2006 until December 31, 2010, the rate of 147 rubles per thousand cubic meters of natural gas extracted was in effect. However, the rate was raised to 237 rubles per thousand cubic meters on January 1, 2011.

**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.

The crude oil export duty rate is revised monthly on the basis of the immediately preceding one-month period of crude oil price monitoring.

A special export duty regime is in place for certain greenfields. Effective from December 2010, the list of the oilfields where the reduced rate applies also includes our Yu. Korchagin and V. Filanovsky oilfields located in the Caspian Sea.

**Export duty rates on refined products** prior to 2011 were set by the Russian government. The rate of export duty depended on internal demand for refined products and international crude oil market conditions. Starting from 2011, export duty rates on crude oil refined products are calculated as follows: export duty rate on refined products equals current crude oil export duty rate multiplied by a coefficient according to the table below.

Multiplier for:

Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils .....	0.670
Liquid fuels (fuel oil) .....	0.467
Motor and other oils .....	0.467
Other products.....	0.467

Starting from May 2011, a special gasoline export duty rate is set by the Russian Government.

**Crude oil and refined products exported to CIS countries**, other than Ukraine, are not subject to export duties.

**Excise on refined products.** The responsibility to pay excises on refined products in Russia is imposed on refined product producers (except for straight-run gasoline). In other countries where the Group operates, excises are paid either by producers or retailers depending on the local legislation.

Starting from 2011, excise rates on refined products in Russia were increased and tied to the ecological class of fuel. Excise tax rates for 2011 are listed below:

		2 <sup>nd</sup> quarter of		Change, %
		2011	2010	
Gasoline				
Low-octane gasoline not compliant to Euro 3.....	RUR/tonne	5,995.00	2,923.00	105.1
High-octane gasoline not compliant to Euro 3 .....	RUR/tonne	5,995.00	3,992.00	50.2
Euro 3.....	RUR/tonne	5,672.00	3,992.00	42.1
Euro 4 and 5 .....	RUR/tonne	5,143.00	3,992.00	28.8
Diesel fuel				
Below Euro 3 .....	RUR/tonne	2,753.00	1,188.00	131.7
Euro 3.....	RUR/tonne	2,485.00	1,188.00	109.2
Euro 4 and 5 .....	RUR/tonne	2,247.00	1,188.00	89.1
Motor oils.....	RUR/tonne	4,681.00	3,246.10	44.2
Straight-run gasoline.....	RUR/tonne	6,089.00	4,290.00	41.9

		2 <sup>nd</sup> quarter of		Change, %
		2011	2010	
Gasoline				
Low-octane gasoline not compliant to Euro 3.....	\$/tonne	214.22	96.65	121.6
High-octane gasoline not compliant to Euro 3 .....	\$/tonne	214.22	132.00	62.3
Euro 3.....	\$/tonne	202.67	132.00	53.5
Euro 4 and 5 .....	\$/tonne	183.77	132.00	39.2
Diesel fuel				
Below Euro 3 .....	\$/tonne	98.37	39.28	150.4
Euro 3.....	\$/tonne	88.80	39.28	126.0
Euro 4 and 5 .....	\$/tonne	80.29	39.28	104.4
Motor oils.....	\$/tonne	167.26	107.33	55.8
Straight-run gasoline.....	\$/tonne	217.58	141.85	53.4

		1 <sup>st</sup> half of		Change,
		2011	2010	%
<b>Gasoline</b>				
Low-octane gasoline not compliant to Euro 3.....	RUR/tonne	5,995.00	2,923.00	105.1
High-octane gasoline not compliant to Euro 3.....	RUR/tonne	5,995.00	3,992.00	50.2
Euro 3.....	RUR/tonne	5,672.00	3,992.00	42.1
Euro 4 and 5.....	RUR/tonne	5,143.00	3,992.00	28.8
<b>Diesel fuel</b>				
Below Euro 3.....	RUR/tonne	2,753.00	1,188.00	131.7
Euro 3.....	RUR/tonne	2,485.00	1,188.00	109.2
Euro 4 and 5.....	RUR/tonne	2,247.00	1,188.00	89.1
Motor oils.....	RUR/tonne	4,681.00	3,246.10	44.2
Straight-run gasoline.....	RUR/tonne	6,089.00	4,290.00	41.9

		1 <sup>st</sup> half of		Change,
		2011	2010	%
<b>Gasoline</b>				
Low-octane gasoline not compliant to Euro 3.....	\$/tonne	209.44	97.21	115.4
High-octane gasoline not compliant to Euro 3.....	\$/tonne	209.44	132.77	57.7
Euro 3.....	\$/tonne	198.15	132.77	49.2
Euro 4 and 5.....	\$/tonne	179.67	132.77	35.3
<b>Diesel fuel</b>				
Below Euro 3.....	\$/tonne	96.18	39.51	143.4
Euro 3.....	\$/tonne	86.81	39.51	119.7
Euro 4 and 5.....	\$/tonne	78.50	39.51	98.7
Motor oils.....	\$/tonne	163.53	107.96	51.5
Straight-run gasoline.....	\$/tonne	212.72	142.68	49.1

**Income tax.** Starting from January 1, 2009, the Federal income tax rate is 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 by crude oil production companies to the markets is dependent on the extent of diversification of the 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 OAO AK Transneft or by railway transport.

Transportation of refined products in Russia is performed by railway transport and the pipeline system of OAO AK Transnefteproduct. The Russian railway infrastructure is owned and operated by OAO Russian Railways. Both these companies are state-owned. We transport the major part of our refined products by railway transport.

In Russia, the gas is mostly sold at the wellhead and then transported through the Unified Gas Supply System ("UGSS"). The UGSS is responsible for gathering, transporting, dispatching and delivering substantially all natural gas supplies in Russia and is owned and operated by OAO Gazprom. The FST regulates natural gas transportation tariffs. We are not able to sell our gas other than through UGSS.

## Three and six months ended June 30, 2011, compared to three and six months ended June 30, 2010

The table below presents our consolidated statements of income for the periods indicated.

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
	(millions of US dollars)			
<b>Revenues</b>				
Sales (including excise and export tariffs).....	34,912	25,853	64,538	49,755
<b>Costs and other deductions</b>				
Operating expenses.....	(2,440)	(2,046)	(4,578)	(4,034)
Cost of purchased crude oil, gas and products.....	(15,162)	(10,741)	(28,007)	(20,043)
Transportation expenses.....	(1,653)	(1,429)	(3,073)	(2,780)
Selling, general and administrative expenses.....	(977)	(853)	(1,802)	(1,655)
Depreciation, depletion and amortization.....	(1,149)	(1,030)	(2,208)	(2,060)
Taxes other than income taxes.....	(3,547)	(2,269)	(6,369)	(4,349)
Excise and export tariffs.....	(5,777)	(4,762)	(10,391)	(9,340)
Exploration expense.....	(85)	(29)	(113)	(146)
(Loss) gain on disposals and impairments of assets.....	(157)	13	(160)	10
<b>Income from operating activities.....</b>	<b>3,965</b>	<b>2,707</b>	<b>7,837</b>	<b>5,358</b>
Interest expense.....	(177)	(196)	(350)	(373)
Interest and dividend income.....	46	45	91	98
Equity share in income of affiliates.....	173	129	342	236
Currency translation loss.....	(93)	(2)	(158)	(42)
Other non-operating income (expense).....	113	(46)	335	(75)
<b>Income before income taxes.....</b>	<b>4,027</b>	<b>2,637</b>	<b>8,097</b>	<b>5,202</b>
Current income taxes.....	(649)	(584)	(980)	(1,140)
Deferred income taxes.....	(165)	10	(473)	44
<b>Total income tax expense.....</b>	<b>(814)</b>	<b>(574)</b>	<b>(1,453)</b>	<b>(1,096)</b>
<b>Net income.....</b>	<b>3,213</b>	<b>2,063</b>	<b>6,644</b>	<b>4,106</b>
Net loss (income) attributable to noncontrolling interests.....	38	(114)	124	(104)
<b>Net income attributable to OAO LUKOIL.....</b>	<b>3,251</b>	<b>1,949</b>	<b>6,768</b>	<b>4,002</b>
Earning per share of common stock attributable to OAO LUKOIL (in US dollars):				
Basic.....	4.16	2.30	8.66	4.72
Diluted.....	4.08	2.30	8.48	4.72

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

## Sales revenues

Sales breakdown	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS ....	7,184	5,882	13,771	12,175
Export and sales to CIS.....	695	227	1,231	513
Domestic sales .....	420	295	843	481
	<b>8,299</b>	<b>6,404</b>	<b>15,845</b>	<b>13,169</b>
Refined products				
Export and sales on international markets				
Wholesale.....	17,734	12,877	32,266	23,868
Retail.....	2,973	2,397	5,434	4,546
Domestic sales				
Wholesale.....	1,960	1,314	3,497	2,474
Retail.....	1,879	1,313	3,370	2,499
	<b>24,546</b>	<b>17,901</b>	<b>44,567</b>	<b>33,387</b>
Petrochemicals				
Export and sales on international markets .....	295	138	572	270
Domestic sales .....	264	181	503	350
	<b>559</b>	<b>319</b>	<b>1,075</b>	<b>620</b>
Gas and gas products				
Export and sales on international markets .....	493	354	881	645
Domestic sales .....	236	195	471	386
	<b>729</b>	<b>549</b>	<b>1,352</b>	<b>1,031</b>
Domestic sales of energy and related services .....	<b>362</b>	<b>282</b>	<b>908</b>	<b>730</b>
Other				
Sales on international markets .....	216	245	423	483
Domestic sales .....	201	153	368	335
	<b>417</b>	<b>398</b>	<b>791</b>	<b>818</b>
<b>Total sales .....</b>	<b>34,912</b>	<b>25,853</b>	<b>64,538</b>	<b>49,755</b>

Sales volumes	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
Crude oil				
	(thousands of barrels)			
Export and sales on international markets other than CIS ....	63,119	78,138	127,872	162,792
Export and sales to CIS.....	13,025	5,535	22,899	12,073
Domestic sales .....	8,723	8,906	17,189	14,279
	<b>84,867</b>	<b>92,579</b>	<b>167,960</b>	<b>189,144</b>
Crude oil				
	(thousands of tonnes)			
Export and sales on international markets other than CIS ....	8,611	10,660	17,445	22,209
Export and sales to CIS.....	1,777	755	3,124	1,647
Domestic sales .....	1,190	1,215	2,345	1,948
	<b>11,578</b>	<b>12,630</b>	<b>22,914</b>	<b>25,804</b>
Refined products				
	(thousands of tonnes)			
Export and sales on international markets				
Wholesale.....	19,819	21,019	38,067	39,112
Retail.....	1,737	1,838	3,341	3,503
Domestic sales				
Wholesale.....	2,834	2,726	5,258	5,129
Retail.....	1,942	1,672	3,607	3,265
	<b>26,332</b>	<b>27,255</b>	<b>50,273</b>	<b>51,009</b>
<b>Total sales volume of crude oil and refined products.....</b>	<b>37,910</b>	<b>39,885</b>	<b>73,187</b>	<b>76,813</b>

Realized average sales prices	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of		
	2011	2010	2011	2010	
Average realized price international					
Oil (excluding CIS) .....	(\$/barrel)	113.83	75.28	107.70	74.79
Oil (CIS) .....	(\$/barrel)	53.30	41.01	53.73	42.47
Refined products					
Wholesale .....	(\$/tonne)	894.81	612.58	847.60	610.25
Retail.....	(\$/tonne)	1,711.82	1,303.90	1,626.53	1,297.44
Average realized price within Russia					
Oil.....	(\$/barrel)	48.13	33.17	49.02	33.69
Refined products					
Wholesale .....	(\$/tonne)	691.55	482.29	664.98	482.54
Retail.....	(\$/tonne)	967.43	784.71	934.40	765.05

During the second quarter of 2011, our revenues increased by \$9,059 million, or by 35.0%, compared to the same period of 2010, crude oil sales increased by \$1,895 million, or by 29.6%, refined products sales increased by \$6,645 million, or by 37.1%.

During the first half of 2011, our revenues increased by \$14,783 million, or by 29.7%, compared to the same period of 2010. Our revenues from crude oil sales increased by \$2,676 million, or by 20.3%. Our revenues from sales of refined products increased by \$11,180 million, or by 33.5%.

The increase in sales revenue was a result of a sharp increase in hydrocarbon prices, compared to the first half of 2010. Moreover, the appreciation of the ruble against the US dollar also increased the US dollar value of our sales revenue denominated in Russian rubles.

#### *Sales of crude oil*

Our total crude oil sales revenues increased by \$1,895 million, or by 29.6%, in the second quarter of 2011 and by \$2,676 million, or by 20.3%, in the first half of 2011. This increase was a result of the growth of crude oil prices.

At the same time, our sales volumes decreased by 8.3%, or by 1,052 thousand tonnes, in the second quarter of 2011 and by 11.2%, or by 2,890 thousand tonnes, in the first half of 2011. The reasons for this were a decrease of production and lower scale of trading operations.

Compared to 2010, we increased significantly crude oil supplies to Belarus, while sales to the far-abroad decreased correspondingly.

In the second quarter and the first half of 2011, our revenue from export of crude oil from Russia both to the Group companies and third parties amounted to \$6,258 million and \$12,249 million, respectively.

#### *Sales of refined products*

Our revenue from the wholesale of refined products outside of Russia increased by \$4,857 million, or by 37.7%, in the second quarter of 2011 and by \$8,398 million, or by 35.2%, in the first half of 2011, compared to the same periods of 2010. Largely, it was due to an increase in the average realized price by 46.1% in the second quarter of 2011 and by 38.9% in the first half of 2011. At the same time, in the second quarter and in the first half of 2011, the wholesales volumes decreased by 5.7% and by 2.7%, respectively.

Our revenue from international retail sales increased by \$576 million, or by 24.0%, in the second quarter of 2011 and by \$888 million, or by 19.5%, in the first half of 2011 also due to an increase in average prices by 31.3% in the second quarter of 2011 and by 25.4% in the first half of 2011. Retail sales volumes decreased by 101 thousand tonnes, or by 5.5%, in the second quarter of 2011 and by 162 thousand tonnes, or by 4.6%, in the first half of 2011 following continuing restructuring of our retail network in the USA. At the same time, this was partially compensated by increased retail sales volumes in Europe.

Our revenue from the wholesale of refined products on the domestic market increased by \$646 million, or by 49.2%, in the second quarter of 2011 and by \$1,023 million, or by 41.4%, in the first half of 2011, mainly due to an increase in the average realized price by 43.4% and 37.8%, respectively. The increase of sales volumes was not significant in the considered periods.

Our revenue from retail sales in Russia increased by \$566 million, or by 43.1%, in the second quarter of 2011 and by \$871 million, or by 34.9%, in the first half of 2011, due to an increase in prices and sales volumes.

In the second quarter and the first half of 2011, our revenue from the export of refined products from Russia both to Group companies and third parties amounted to \$5,443 million and \$9,488 million, respectively.

#### *Sales of petrochemical products*

In the second quarter of 2011, our revenue from sales of petrochemical products increased by \$240 million, or by 75.2%, and in the first half of 2011, our revenue increased by \$455 million, or by 73.4%, mainly as a result of an increase in international sales volumes. In the fourth quarter of 2010, we commenced production at our petrochemical plant Karpatnaftochim Ltd. in Ukraine after modernization and construction of a chlorine and caustic production line.

#### *Sales of gas and gas products*

Sales of gas and gas refined products increased by \$180 million, or by 32.8%, in the second quarter of 2011 and by \$321 million, or by 31.1%, in the first half of 2011.

Gas products sales revenue increased by \$154 million, or by 44.0%, in the second quarter of 2011 and by \$251 million, or by 38.5%, in the first half of 2011 primarily as a result of an increase in sales prices. Retail gas products revenue increased to \$161 million, or by 37.6%, in the second quarter of 2011 and to \$293 million, or by 32.0%, in the first half of 2011 due to price growth. Retail revenue represented approximately one-third of our gas products sales revenue.

Natural gas sales revenue increased by \$20 million, or by 10.4%, in the second quarter of 2011 and by \$55 million, or by 15.5%, in the first half of 2011. The increase was both at the domestic market, driven by the ruble appreciation, and outside of Russia, as a result of the growth of sales prices in Uzbekistan.

#### *Domestic sales of energy and related services*

We sell substantially all our energy and related services domestically. International sales are relatively insignificant.

In the second quarter of 2011, our revenue from sales of electricity, heat and related services increased by \$80 million, or by 28.4%, while in the first half of 2011, this revenue increased by \$178 million, or by 24.4%. This growth was a result of an increase in tariff rates, the ruble appreciation and some increase in sales volumes.

#### *Sales of other products*

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

In the second quarter of 2011, other sales increased by \$19 million, or by 4.8%, while in the first half of 2011, other sales decreased by \$27 million, or by 3.3%.



## Operating expenses

Operating expenses include the following:

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
	(millions of US dollars)			
Hydrocarbon extraction expenses .....	924	800	1,777	1,584
Own refining expenses .....	344	259	686	532
Refining expenses at third party and affiliated refineries .....	258	172	427	351
Expenses for crude oil transportation to refineries .....	308	275	540	541
Power generation and distribution expenses .....	181	145	369	293
Petrochemical expenses .....	80	40	148	80
Other operating expenses .....	345	355	631	653
<b>Total operating expenses .....</b>	<b>2,440</b>	<b>2,046</b>	<b>4,578</b>	<b>4,034</b>

The method of allocation of operating expenses in this table differs from the approach used in preparing the data for Note 19 “Segment information” to our interim consolidated financial statements. Expenditures in the segment reporting are grouped depending on the segment to which a particular company belongs. Operating expenses for the purposes of this analysis are grouped based on the nature of the costs incurred.

In the second quarter of 2011, our operating expenses increased by \$394 million, or by 19.3%, and in the first half of 2011, operating expenses increased by \$544 million, or by 13.5%, as a result of the increase in hydrocarbon extraction expenses, refining expenses and energy generation and distribution expenses. Operating expenses of Group’s entities in Russia were sizably affected by the ruble appreciation in amount of 15.0%.

### *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.

In the second quarter of 2011, our extraction expenses increased by \$124 million, or by 15.5%, and in the first half of 2011, our extraction expenses increased by \$193 million, or by 12.2%. The increase was mainly a result of the real ruble appreciation against the US dollar and increased expenses for power supply and maintenance in Russia. Our average hydrocarbon extraction cost increased from \$4.07 per BOE in the second quarter of 2010 to \$4.93 per BOE in the second quarter of 2011, or by 21.1%, and from \$4.02 per BOE in the first half of 2010 to \$4.72 per BOE the first half of 2011, or by 17.4%.

### *Own refining expenses*

Our own refining expenses increased by \$85 million, or by 32.8%, in the second quarter of 2011 and by \$154 million, or by 28.9%, in the first half of 2011.

Refining expenses at our domestic refineries increased by 39.7%, or by \$75 million, in the second quarter of 2011 and by 34.9%, or by \$133 million, in the first half of 2011. This increase was a result of an increase in power supply costs, higher expenses on repairs, increased consumption and cost of additives and the ruble appreciation against the US dollar.

Refining expenses at our international refineries increased by 14.3%, or by \$10 million, in the second quarter and by 13.9%, or by \$21 million, in the first half of 2011, mainly as a result of increased production, increased power supply costs and accrual of costs related to the purchase of additional carbon dioxide emission quotas in Romania.

### *Refining expenses at third party and affiliated refineries*

Along with our own production of refined products we have the ability to refine crude oil at third party and affiliated refineries both in Russia and abroad.

In the second quarter and the first half of 2011, refining expenses at third party and affiliated refineries increased by 50.0% and 21.7%, respectively. This was due to increased energy costs, appreciation of euro to the US dollar, overhauls performed at the ISAB complex in the first quarter of 2011 and the increase of our share in ISAB from 49% to 60% since April, 2011, resulting in the increase of our share of costs.

### *Petrochemical expenses*

In the second quarter of 2011, operating expenses of our petrochemical plants increased by \$40 million, or by 100.0%, compared to the second quarter of 2010, and in the first half of 2011, these expenses increased by \$68 million, or by 85.0%, compared to the first half of 2010, due to an increase of production volumes as a result of the commencement of production at our petrochemical plant Karpatnaftochim Ltd. in Ukraine in the fourth quarter of 2010. Additionally, the increased consumption of raw materials due to the changes in production mix and ruble appreciation contributed to the increase of expenses.

### *Expenses for crude oil transportation to refineries*

Expenses for crude oil transportation to refineries include pipeline, railway, freight and other costs related to delivery of the Group's own crude oil to refineries for further processing.

Expenses for crude oil transportation to refineries in the second quarter of 2011 increased by \$33 million, or by 12.0%, while in the first half of 2011 they didn't change significantly. The increase in transportation tariffs compared to 2010 was compensated for by a decrease of volumes of own supply to refineries.

### *Power generation and distribution expenses*

Power generation and distribution expenses increased by \$36 million, or by 24.8%, in the second quarter of 2011 and by \$76 million, or by 25.9%, in the first half of 2011 reflecting the real ruble appreciation in Russia and general increase of expenses.

### *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 rendering of transportation and extraction services, operating expenses of our gas processing plants, costs of other services provided and goods sold by our marketing companies, and of non-core businesses of the Group.

In the second quarter of 2011, other operating expenses decreased by \$10 million, or by 2.8%, and in the first half of 2011, other operating expenses decreased by \$22 million, or by 3.4%. The decrease was a result of a lower volume of transportation services provided outside of Russia and the restructuring of our retail network in the USA.

### **Cost of purchased crude oil, gas and products**

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

Cost of purchased crude oil, gas and products increased by \$4,421 million in the second quarter of 2011, or by 41.2%, compared to the same period of 2010, and by \$7,964 million, or by 39.7%, in the first half of 2011, due to an increase in crude oil and refined products prices. The effect of increased prices was partially offset by a decrease of trading volumes.

In the second quarter of 2011, we recognized a \$185 million gain from hedging, compared to a \$319 million gain in the second quarter of 2010. At the same time, in the first half of 2011, we recognized a \$642 million expense from hedging, compared to a \$247 million gain in the first half of 2010.

### **Transportation expenses**

Our transportation expenses increased by \$224 million, or by 15.7%, in the second quarter of 2011 and by \$293 million, or by 10.5%, in the first half of 2011. This increase was primarily related to Russia and resulted from the ruble appreciation, increased tariffs and change in supply directions.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed in the first half of 2011, compared to the first half of 2010, as follows: crude oil pipeline tariffs increased by 12.9%, railway tariffs for refined products transportation increased by 9.4%, crude oil freight rates decreased by 6.1%, and refined products freight rates decreased by 12.0%.

### **Selling, general and administrative expenses**

Selling, general and administrative expenses include 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.

Our selling, general and administrative expenses increased by \$124 million, or by 14.5%, in the second quarter of 2011 and by \$147 million, or by 8.9%, and in the first half of 2011. The reasons for this were an increase of selling expenses, labor cost and the effect of the real ruble appreciation on our expenses in Russia. At the same time, the above mentioned factors were partially compensated by decrease of provisions for bad debts.

### **Depreciation, depletion and amortization**

Our depreciation, depletion and amortization expenses increased by \$119 million, or by 11.6%, in the second quarter of 2011 and by \$148 million, or by 7.2%, in the first half of 2011.

### **Exploration expenses**

Our exploration expense increased by \$56 million, or by 193.1%, during the second quarter of 2011 but decreased by \$33 million, or by 22.6%, during the first half of 2011. Dry hole costs amounted to \$47 million in the second quarter of 2011 and \$50 million in the first half of 2011. In the second quarter and in the first half of 2010, dry hole costs amounted to \$7 million and \$94 million, respectively.

In the first quarter of 2011, dry hole costs were insignificant, but in the second quarter of 2011, we charged to expense the cost of an exploratory well in the Komi Republic of Russia in the amount of \$28 million and in Kazakhstan in the amount of \$17 million.

In the first quarter of 2010, we charged to expense the cost of an exploratory well in Cote d'Ivoire totaling \$65 million. In the second quarter of 2010, we didn't make any individually significant write-offs.

### **(Loss) gain on disposals and impairments of assets**

The losses include the financial result from disposals of a number of non-core assets and individually insignificant impairments of non-performing business units. Loss on disposals and impairments of assets included a loss related to withdrawal from the Tub-Karagan project in Kazakhstan in the amount of \$68 million.

### **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. Our largest affiliates are Turgai Petroleum and Tengizchevroil, exploration and production companies operating in Kazakhstan, and ISAB and TRN refineries.

Our share in income of affiliates increased by \$44 million, or by 34.1%, in the second quarter of 2011 and by \$106 million, or by 44.9%, in the first half of 2011, mostly due to increase in income of Tengizchevroil.

## Taxes other than income taxes

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
	(millions of US dollars)			
<b>In Russia</b>				
Mineral extraction taxes .....	3,171	1,973	5,612	3,723
Social security taxes and contributions .....	146	95	298	203
Property tax .....	140	117	269	238
Other taxes .....	19	5	37	58
<b>Total in Russia .....</b>	<b>3,476</b>	<b>2,190</b>	<b>6,216</b>	<b>4,222</b>
<b>International</b>				
Mineral extraction taxes .....	21	18	45	34
Social security taxes and contributions .....	26	32	51	48
Property tax .....	5	11	24	18
Other taxes .....	19	18	33	27
<b>Total internationally .....</b>	<b>71</b>	<b>79</b>	<b>153</b>	<b>127</b>
<b>Total .....</b>	<b>3,547</b>	<b>2,269</b>	<b>6,369</b>	<b>4,349</b>

In the second quarter of 2011, taxes other than income taxes increased by 56.3%, or by \$1,278 million, compared to the second quarter of 2010. In the first half of 2011, taxes other than income taxes increased by 46.4%, or by \$2,020 million, compared to the first half of 2010. This was mainly due to an increase in mineral extraction taxes in Russia. This is explained by an increase in the tax rate following the increase of international crude oil prices.

Application of decreased rate for depleted oilfields in the second quarter of 2011 led to \$304 million tax reduction (\$344 million in the second quarter of 2010). In the first half of 2011, application of decreased rate for depleted oilfields led to \$566 million tax reduction (\$679 million in the first half of 2010). The major oilfield where we benefited from zero extraction tax rate was the Yuzhnoye Khylichuyu field. In early December 2010, accumulated volume of production from this field exceeded the incentive level of 15 million tonnes and since that moment we have been paying extraction tax in full.

## Excise and export tariffs

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
	(millions of US dollars)			
<b>In Russia</b>				
Excise tax on refined products .....	451	218	824	435
Crude oil export tariffs .....	2,872	2,685	5,328	5,363
Refined products export tariffs .....	1,456	915	2,401	1,752
<b>Total in Russia .....</b>	<b>4,779</b>	<b>3,818</b>	<b>8,553</b>	<b>7,550</b>
<b>International</b>				
Excise tax and sales taxes on refined products .....	910	918	1,679	1,732
Crude oil export tariffs .....	88	26	159	54
Refined products export tariffs .....	–	–	–	4
<b>Total internationally .....</b>	<b>998</b>	<b>944</b>	<b>1,838</b>	<b>1,790</b>
<b>Total .....</b>	<b>5,777</b>	<b>4,762</b>	<b>10,391</b>	<b>9,340</b>

Export tariffs increased by \$790 million, or by 21.8%, in the second quarter of 2011 and by \$715 million, or by 10.0%, in the first half of 2011. The effect of increase of crude oil tariff rates was partially compensated for by a significant decrease in export volumes. Our crude oil export volumes decreased by 15.5% in the second quarter of 2011 and by 15.9% in the first half of 2011. In 2011, particularly in the second quarter, we faced significant growth of export tariff rates for refined products. For instance, tariff rates for fuel oil nearly doubled compared to the same periods of 2010. Given the considerable share of such products in our export portfolio, our expenses on refined products export tariffs were significantly affected.

Starting from 2011, excise rates on refined products in Russia were increased and tied to the ecological class of fuel. Despite the fact that the Company produces high quality ecological motor fuel subject to lower excise rates compared to fuel of lower quality, average excise rates roughly doubled for us compared to the respective periods of 2010.

### Other non-operating income (expense)

Other non-operating income included the effect of the recalculation of the extraction tax incentive by certain Group companies for prior periods in total amounts of \$189 million in the second quarter of 2011 and \$433 million in the first half of 2011.

### Income taxes

In the second quarter of 2011, our total income tax expense increased by \$240 million, or by 41.8%, compared to the second quarter of 2010, due to the increase in income before income tax by \$1,390 million, or by 52.7%.

In the first half of 2011, our total income tax expense increased by \$357 million, or by 32.6%, compared to the first half of 2010, due to the increase in income before income tax by \$2,895 million, or by 55.7%.

In the second quarter of 2011, our effective income tax rate was 20.2%, compared to 21.8% in the second quarter of 2010, while in the first half of 2011, our effective income tax rate was 17.9%, compared to 21.1% in the first half of 2010. The maximum statutory rate for the Russian Federation is 20%. The lower level of the effective income tax rate in the first half of 2011 was attributable to the effect of currency translation losses of our Russian subsidiaries, mostly relevant to the first quarter of 2011.

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

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
	(millions of US dollars)			
<b>Net income attributable to OAO LUKOIL .....</b>	<b>3,251</b>	<b>1,949</b>	<b>6,768</b>	<b>4,002</b>
Add back:				
Income tax expense.....	814	574	1,453	1,096
Depreciation and amortization.....	1,149	1,030	2,208	2,060
Interest expense .....	177	196	350	373
Interest and dividend income .....	(46)	(45)	(91)	(98)
<b>EBITDA .....</b>	<b>5,345</b>	<b>3,704</b>	<b>10,688</b>	<b>7,433</b>

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

	1 <sup>st</sup> half of	
	2011	2010
	(millions of US dollars)	
Net cash provided by operating activities .....	8,290	6,259
Net cash used in investing activities.....	(5,660)	(3,147)
Net cash used in financing activities .....	(992)	(1,565)

### Operating activities

Our primary source of cash flow is funds generated from our operations. During the first half of 2011, cash generated from operating activities was \$8,290 million, which is 32.4% more than in the same period of 2010, mainly due to the increase in sales revenues. On the other hand, our operating cash flows were affected by an increase in working capital by \$2,088 million, compared to January 1, 2011.

The increase of working capital was mainly caused by:

- a \$1,343 million increase in inventory
- a \$164 million net increase in trade accounts receivable and payable
- a \$341 million net increase in other assets and liabilities
- a \$511 million net increase in tax accounts receivable and payable

At the same time, the negative effect from the above mentioned factors was partially offset by a \$271 million net decrease in VAT receivable and payable.

### Investing activities

The increase in cash used in investing activities resulted from an increase in payments for acquisitions.

In the first half of 2011, we made an advance payment of \$1,778 million for expected acquisition of certain upstream assets and a payment of \$342 million for 11% share in ISAB.

Capital expenditures increased by \$450 million, or by 14.4%, compared to the first half of 2010.

### Financing activities

In the first half of 2011, net movements of short-term and long-term debt generated an outflow of \$888 million, compared to an outflow of \$1,362 million in the first half of 2010.

## Analysis of capital expenditures

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
(millions of US dollars)				
<b>Capital expenditures<sup>(1)</sup></b>				
Exploration and production				
Russia.....	1,305	976	2,490	1,838
International.....	257	297	489	552
Total exploration and production.....	1,562	1,273	2,979	2,390
Refining, marketing and distribution				
Russia.....	203	219	374	379
International.....	68	85	124	153
Total refining, marketing and distribution.....	271	304	498	532
Chemicals				
Russia.....	12	10	19	12
International.....	2	10	9	31
Total chemicals.....	14	20	28	43
Power generation and distribution.....	28	111	78	200
Other.....	17	14	31	25
<b>Total capital expenditures.....</b>	<b>1,892</b>	<b>1,722</b>	<b>3,614</b>	<b>3,190</b>

### Acquisitions of subsidiaries<sup>(2)</sup>

Exploration and production				
Russia.....	–	–	18	3
International.....	–	–	1,760	–
Total exploration and production.....	–	–	1,778	3
Refining, marketing and distribution				
Russia.....	10	–	10	50
International.....	342	–	342	–
Total refining, marketing and distribution.....	352	–	352	50
Less cash acquired.....	–	–	–	–
<b>Total acquisitions.....</b>	<b>352</b>	<b>–</b>	<b>2,130</b>	<b>53</b>

<sup>(1)</sup> Including non-cash transactions and prepayments.

<sup>(2)</sup> Including prepayments related to acquisitions of subsidiaries and non-cash transactions.

Our capital expenditures, including non-cash transactions, amounted to \$3,614 million, which is 13.3% more than in the first half of 2010. Capital expenditures in exploration and production segment increased by \$589 million, or by 24.6%, mainly resulting from the effect of ruble appreciation on our expenses in Russia. This increase mostly included investments in drilling, field development and construction of gas transportation facilities in Western Siberia, and petroleum gas utilization program in Komi Republic.

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

	2 <sup>nd</sup> quarter of		1 <sup>st</sup> half of	
	2011	2010	2011	2010
(millions of US dollars)				
Northern Timan-Pechora.....	75	72	128	129
Yamal.....	66	34	196	91
Caspian region <sup>(1)</sup> .....	135	100	219	165
Ghana.....	39	16	47	52
Cote d'Ivoire.....	8	8	12	74
Iraq.....	44	125	75	125
<b>Total.....</b>	<b>367</b>	<b>355</b>	<b>677</b>	<b>636</b>

<sup>(1)</sup> Russian and international projects.