

Open Joint Stock Company "Oil Company "LUKOIL" Summary of 2007 performance results and main objectives for 2008

The year 2007 was a banner year in terms of the financial performance and the implementation of major new projects. In the main production and financial indicators, OAO "LUKOIL" (the "Company") exceeded the marks set in 2006. The Company continues to grow in line with its long-term strategy and strengthen its competitive positions on the global energy market. For example, the Company began to produce gas in Uzbekistan, continued to actively modernise its refineries, and completed its acquisition of a chain of gas stations in Europe.

The LUKOIL Group's net profit in the reporting year rose to a record USD 9.511 billion. Return on capital employed was 22.2%. The high level of operating cash flow allowed the Company to finance capital investments of USD 9.1 billion. About 40% of the LUKOIL Group's capital costs are made up of spending on new projects, the aim of which is the intensive expansion of the Company's operations.

The main factor in the growth of the LUKOIL Group's financial results in 2007 was the favourable price situation and the high margin on oil refining. The growth in financial results was also supported by the expansion of the scale of the Company's operations. First of all we have to note the substantial growth in oil refining. The amount refined at Russian refineries grew by almost 8%. In addition, in contrast to the majority of competitors, the Company continued to increase its production of hydrocarbons. Special note should be made of the high organic increase in production in international projects.

Another positive influence on the Company's financial results was the work to increase the efficiency of operating and financial activity in all areas. The Company continued to maintain rigorous financial discipline. Taking into consideration the high inflation and substantial devaluation of the dollar, the Company effectively controlled its production costs. Important roles in this were played by centralised work with contractors and suppliers, the use of tender procedures, energy savings and an increase in labour productivity.

Financial performance excluding subsidiaries. Revenues from the sale of goods, products, work and services (less value-added tax, excise and similar mandatory payments) totalled RUB 609.8 billion; net profits were RUB 65.1 billion.

Exploration work and reserves of oil and gas. The bulk of oil and gas exploration work in 2007 was concentrated in Western Siberia, the Caspian Sea, Volgograd oblast, and Timan-Pechora oil-and-gas province.

The largest discovery of 2007 was the Bayandyskoe deposit in the Denisovskaya depression (Komi Republic). In tests on exploratory wells, a flow of high-quality oil with a yield of 4,900 bbl/day was achieved. The proved, probable and possible oil reserves of the newly discovered deposit have been assessed at almost 270 million barrels. The Bayandyskoe deposit is located not far from the Usinskoe deposit already being developed by the Company. This will make it possible to put the new deposit into pilot production in 2008 without substantial costs on building transportation infrastructure.

The proven hydrocarbon reserves of the LUKOIL Group as at 1 January 2008 under the SPE international classification equalled 20.369 billion BOE, including oil reserves of 15.715 billion barrels, and gas reserves of 27.921 trillion cubic feet.

In 2007 the proven hydrocarbon reserves of the LUKOIL Group remained at virtually the same level as the previous year, and if production is taken into account, reserves rose by 4.0%. The level of replenishment of hydrocarbon production with new reserves was 101%.

Production of marketable hydrocarbons. The LUKOIL Group's production of marketable hydrocarbons (including the shares of production of associates) increased by 1.5% and equalled 2.18 million BOE/day. The slowdown in the rate of increase in production compared to previous years was related to the sale of a 50% share in Caspian Investments Resources Ltd, a drop in purchases of natural gas by Gazprom, and also interruptions in energy supply of the deposits of Western Siberia.

The Company increased oil production by 1.4% year on year, and produced 713 million barrels (1,953,000 bbl/day), or 96.6 million tonnes. Production of marketable gas in 2007 equalled 13.955 billion m³ (225,000 BOE/day), or 2.5% more than in 2006.

Over the year, 12 new oil deposits and one gas condensate deposit were brought into development. The most significant event of 2007 was the production of gas in Uzbekistan in the Kandym-Khauzak–Shady project. The strong potential for increased production and the market terms for the sale of gas make this project the most effective in the Company's gas segment. It is also a major international project for the Company, taking into account the equity share: the maximum level of production for the project as a whole is about 12 billion m³/year of gas.

Preparations continued for production at the Company's largest deposit in the north of Timan-Pechora, the Yuzhno-Khylchuyuskoe, which will provide the bulk of the Company's increase in production in 2008–2009. It should be especially noted that construction has been completed on the Varandei Terminal in the northern part of European Russia – the world's first oil transshipment terminal capable of operating year-round under Arctic conditions. The terminal will be used primarily to export oil from the Yuzhno-Khylchuyuskoe deposit, and in future from other deposits in Timan-Pechora as well.

As part of its effort to increase operating efficiency, the Company continued to use state-of-the-art technology to increase reservoir recovery, including drilling of horizontal wells and offshoots. The optimisation of well stock and development of geological and hydrodynamic modelling also continued. At year end 2007, 264 of the Company's deposits had been incorporated into the multilevel field development monitoring system using geological and hydrodynamic models. This system was actively developed in the reporting year: more than 60 deposits were modelled.

Oil refining. This past year was one of rapid development of oil refining for the LUKOIL Group, especially Russian refineries, thanks to the active modernisation and expanded refining capacity, and also the high margin on oil refining.

The Company refined 56.77 million tonnes of oil (including processing at outside refineries), or 5.4% more than in 2006. The Company's own refineries processed 52.16 million tonnes (6.7% more than in 2006).

Under the refinery modernisation programme, in 2007 the Company commissioned two new isomerisation units with a total capacity of more than 800,000 tonnes/year, one *n*-butane isomerisation unit with a capacity of 50,000 tonnes/year, and one vis-breaking unit with a capacity of 800,000 tonnes/year. In addition, work began on improving the efficiency of the

Company's refineries under the Programme to eliminate disruptions and areas where the Company lags behind industry leaders.

Production of petrochemical products. The LUKOIL Group's petrochemical plants produced 2,041,000 tonnes of marketable goods in 2007, including 844,000 tonnes of polymers and monomers, 578,000 tonnes of organic synthesis products and 611,000 tonnes of pyrolysis products and fuel fractions.

As part of its strategy to develop the petrochemical sector, in 2007 the LUKOIL Group took measures to modernise existing facilities and build new ones. At OOO Saratovorgsintez a unit to produce sodium cyanide was constructed with a capacity of 15,000 tonnes/year. At OOO Stavrolen a unit to produce polypropylene was commissioned, with a designed capacity of 120,000 tonnes/year. At OOO Karpatneftekhim construction work was under way on a unit to produce chlorine and sodium hydroxide using membrane technology, with a capacity of 200,000 tonnes/year. In addition, construction was underway on a PVC suspension unit with a capacity of 300,000 tonnes/year.

Processing of raw materials at the Company's gas-refining companies. In 2007, the gas refineries of the LUKOIL Group processed 3.317 billion m³ of gas stock and 882,000 tonnes of broad-fraction light hydrocarbons. The amount of gas stock refining increased by 25% in comparison with 2006, and refining of broad-fraction light hydrocarbons increased by 40%. The substantial growth in refining volumes is due to the expanded capacity of the Lokosovsky complex, which was completed in 2006. The Company's factories produced 2.595 billion m³ of stripped gas. Also, 960,000 tonnes of liquefied gases were produced, which is 36% more than in 2006. Production of liquid hydrocarbons (stable natural gasoline, isopentane and hexane-heptane fractions, broad-fraction light hydrocarbons) reached 873,000 tonnes, or 38% more than in 2006.

Oil exports. Favourable market trends were seen on the Russian oil market in the reporting year, due to an increase in export duties and the margins on oil products. In order to generate maximum profits, the Company redirected oil from low-efficiency export routes to the country's domestic market and to its own and third-party Russian refineries. For this reason, oil exports from Russia by Company subsidiaries (including oil obtained from third-party producers) dropped by 4.5% compared to 2006, and equalled 42.15 million tonnes.

The bulk of exports in 2007 were made using the OAO AK Transneft transport system. Thanks to work on making transportation more efficient and selecting the most favourable routes for deliveries, average costs on pipeline transport of a tonne of exported oil rose by only 7.3%, or nearly a third less than the increase in tariffs charged by Transneft. Because of the adequate pipeline capacity provided by OAO AK Transneft for oil exports, and also because additional oil was sent to Russian refineries as oil stock, the Company did not use the infrastructure of its own refineries to export oil. For the same reason, the amount of oil exported without using the Transneft system fell by 18.7% in 2007, to 2.16 million tonnes.

Sale of oil products. At the end of 2007, LUKOIL brand oil products were sold through 6,090 filling stations in Russia and the former Soviet Union, Europe and the Baltics, and also in the USA. Total sales of the Company's oil products in 2007 were 90.9 million tonnes, an increase of 8.3% year-on-year. The Company's own stations sold 12.76 million tonnes of oil products, 14.3% more than in 2006. The growth in retail sales was achieved mainly due to an

increase in average sales per filling station. This was fostered by the favourable macroeconomic environment and the streamlining of the distribution network.

At the end of 2007 the LUKOIL Group completed a transaction begun in 2006 to purchase ConocoPhillips' retail business, including 376 filling stations in seven European countries. The transaction amount was USD 442 million. The assets acquired include 156 stations in Belgium and Luxembourg, 49 in Finland, 44 in the Czech Republic, 30 in Hungary, 83 in Poland and 14 in Slovakia. The 49 filling stations in Finland were rebranded in 2007 under the Teboil trademark (which belongs to the LUKOIL Group). The rebranding of the remaining 327 stations in the other European countries is scheduled to be completed in 2008.

Optimisation of the corporate structure. In 2007, 53 companies were removed from the LUKOIL Group through the sale of shares and equity holdings to third parties, and also through liquidation and merger into other LUKOIL Group companies. At the same time, 17 subsidiaries were founded and another 16 were acquired. Thus, in 2007 the total number of companies in the Group dropped by 20: from 311 to 291.

A total of USD 1.136 billion in shares and equity holdings in subsidiaries and associates were sold outside the Group in 2007, the majority which was accounted for by the sale of a holding in Caspian Investments Resources Ltd. A total of USD 1.566 billion was spent on acquisitions and consolidation.

OAO "LUKOIL" shares are one of the most liquid instruments on the stock market. The main trading floors for the Company's shares in Russia were ZAO MMVB (MICEX), where OAO "LUKOIL" shares account for 8.1% of all trading in 2007, and OAO RTS Stock Exchange (6.9% of trading). In terms of trading on these exchanges, the Company's shares were in the top five securities for the year.

The programme of American depositary receipts and global depositary receipts for Company shares continued in 2007; these were traded on the London, Frankfurt, Munich and Stuttgart exchanges, and also on the over-the-counter market in the USA. American depositary receipts issued on OAO "LUKOIL" shares held second place in 2007 in terms of trading in ADRs of foreign companies listed on the London Stock Exchange in the IOB system (15.5% of total monthly trading in this system).

For the first time in the last seven years, in 2007 there was a slight decrease in the Company's share price: over the course of the year, the price dropped 1.1% to USD 87.0 at year end. This was due to a number of internal Russian political factors and the lack of stability in the global financial system.

Despite the drop in capitalisation in 2007 under the effect of short-term negative factors, there are serious fundamental reasons to expect further growth in the Company's shareholder value – these include a rich resource base supporting the potential for increased production; significant refining capacity, which under the current tax regime creates significant value for the Company; and a highly effective network of gas stations. All of these factors provide significant competitive advantages for the Company, creating substantial potential for the growth of its value in the longer term.

Main objectives of the Company for 2008. The Company will make every effort in 2008 to ensure stable and successful operations under market conditions, with the aim of increasing its shareholder value.

The Company's main objectives for 2008 are:

- Growth in proven reserves equal to at least 100% of production;
- Start of development at the Yuzhno-Khylchuyuskoe deposit, the Company's largest deposit in north Timan-Pechora;
- Continued modernisation of the Company's refining capacities;
- Continued development and streamlining of distribution assets;
- Further improvement in performance of all business segments through the use of modern technology, optimisation of the corporate structure, and cost controls.

Among the main measures to be taken to increase the Company's market capitalisation, the most notable is the rigorous implementation of the Strategic Development Programme to 2017, in the area of a reduction in production costs, efficient use of oil resources, asset optimisation and improved corporate governance. Attaining these goals will allow us to meet our commitments to shareholders and investors to increase the value of the Company and the income of shareholders and investors.

Board of Directors of OAO "LUKOIL"