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 March 31, 2010, and for the three months ended March 31, 2010 and 2009, and significant trends 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

	3 months of		Change, %
	2010	**2009**	
Sales (millions of US dollars)	23,902	14,745	62.1
Net income attributable to OAO LUKOIL (millions of US dollars)	2,053	905	126.9
EBITDA (millions of US dollars)	3,729	2,414	54.5
Taxes other than income taxes, excise and export tariffs (millions of US dollars)	(6,658)	(3,717)	79.1
Basic and diluted earning per share of common stock attributable to OAO LUKOIL (US dollars)	2.42	1.07	126.9
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	205,191	200,263	2.5
Crude oil production by the Group including our share in equity affiliates (thousands of tonnes)	24,055	24,127	(0.3)
Gas produced by the Group including our share in equity affiliates (millions of cubic meters)[1]	4,721	3,810	23.9
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes)	14,703	13,578	8.3

[1] Gas available for sale.

During the first quarter of 2010, our net income was $2,053 million, which is $1,148 million, or 126.9%, more than in the same period of 2009.

Positive dynamics of our net income were mainly due to a sharp increase in hydrocarbon prices in the first quarter of 2010, compared to the respective period of 2009. At the same time our results were affected by increase in extraction taxes and export tariff rates, appreciation of the Russian ruble and increase in transportation expenses.

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.

The Group 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. The Company's proved reserves as of January 1, 2010 amounted to 17.5 billion BOE and comprised of 13.7 billion BOE of crude oil and 22.9 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.
- **Energy** – which includes generation, transportation and sales of electricity, heat and related services.

Other businesses include banking, finance and other activities. 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 our interim consolidated financial statements.

Changes in the Group structure

In January 2010, the Company signed an agreement to develop West Qurna-2 field located in the south of Iraq. The parties of the agreement are: 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% and as at the day of the agreement it had a commitment in the amount of approximately $375 million. The West Qurna-2 field has recoverable reserves of about 12.9 billion barrels.

In December 2009, the Group acquired the remaining 46.0% interests 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 amount of $300 million was paid in December 2009. $800 million should be paid no later than December 2010 and the remaining amount – no later than December 2011.

In June 2009, a Group company entered into an agreement with Total to acquire a 45.0% interest in TRN refinery in the Netherlands (“TRN”). The transaction was finalized in September 2009 in the amount of approximately $700 million. The Group provides crude oil and market refined products in line with its equity stake in the refinery. The refinery has the flexibility to process Urals blend crude oil as well as significant volumes of straight-run fuel oil and vacuum gasoil, which allows to integrate the plant into the Group’s crude oil supply and refined products marketing operations. This plant with a Nelson complexity index of 9.8 has an annual topping capacity of 7.9 million tonnes and an annual capacity of a hydro-cracking unit of approximately 3.4 million tonnes. This acquisition was made in accordance with the Group’s plans to develop its refining capacity in Europe.

In the first quarter of 2009, the Group acquired 100% interests in OOO Smolenskneftesnab, OOO IRT Investment, OOO PM Invest and OOO Retaier House for $238 million. These are holding companies, which between them own 96 petrol stations and plots of land 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 market in the Russian Federation.

In the fourth quarter of 2008, the Group acquired 100% interests 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, the second payment in amount of $150 million was paid in April 2009, and the remaining amount was paid in October 2009. The Akpet group operated 689 petrol filling stations on the basis of dealer agreements and owned 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 (“ISAB”) in Priolo, Italy. In December 2008, the Group completed the acquisition of a 49.0% stake in the joint venture for €1.45 billion (approximately $1.83 billion) and paid €600 million (approximately $762 million) as a first installment. 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 ISAB up to 100%. The agreement states that each partner is responsible for procuring crude oil and marketing refined products in line with its equity stake in the joint venture. ISAB has the flexibility to process Urals blend crude oil, and the Group integrated its share of ISAB capacity into its crude oil supply and refined products marketing operations. ISAB includes three jetties and storage tanks totaling 3,700 thousand cubic meters and has an annual refining capacity of 16 million tonnes.

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 OAO UGK TGK-8 (“TGK-8”) for approximately $2,117 million. The purchase consideration partly consisted 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 2008 to June 2009, a Group company acquired the remaining interest in TGK-8 for a total of $1,202 million, increasing the Group’s ownership to 100%. 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 power generation business.

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 LUKOIL-Western Siberia, LUKOIL-Komi and LUKOIL-Perm. Also we have a consolidated joint venture with ConocoPhillips, 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.

	3 months of	
	2010	**2009**
Daily production of hydrocarbons, including the Company's share in equity affiliates (thousand BOE per day), including:	2,280	2,225
- crude oil	1,971	1,976
- natural and petroleum gas[(1)]	309	249
Hydrocarbon extraction expenses (US dollar per BOE)	3.97	3.10
	(millions of US dollars)	
Hydrocarbon extraction expenses	784	602
- in Russia	738	563
- outside Russia	46	39
Exploration expenses	117	37
- in Russia	36	15
- outside Russia	81	22
Mineral extraction tax	1,766	920
- in Russia	1,750	911
- outside Russia	16	9

[(1)] Gas available for sale (excluding gas produced for our own consumption).

Crude oil production. In the first quarter of 2010, we decreased our daily crude oil production by 0.3%, compared to the same period of 2009. We produced (including the Company's share in equity affiliates) 177.4 million barrels, or 24.1 million tonnes.

The following table represents our crude oil production in the first quarters of 2010 and 2009 by major regions.

		Change to 2009			
(thousands of tonnes)	**3 months of 2010**	**Total, %**	**Change in structure**	**Organic change**	**3 months of 2009**
Western Siberia	12,720	(4.5)	–	(595)	13,315
Timan-Pechora	5,414	4.2	–	220	5,194
Ural region	3,036	3.7	–	107	2,929
Volga region	715	2.6	–	18	697
Other in Russia	505	(3.1)	–	(16)	521
Crude oil produced in Russia	22,390	(1.2)	–	(266)	22,656
Crude oil produced internationally	895	3.6	–	31	864
Total crude oil produced by consolidated subsidiaries	**23,285**	**(1.0)**	–	**(235)**	**23,520**
Our share in crude oil produced by equity affiliates:					
in Russia	81	8.0	–	6	75
outside Russia	689	29.5	148	9	532
Total crude oil produced	**24,055**	**(0.3)**	**148**	**(220)**	**24,127**

The main oil producing region of the Company is Western Siberia where we produced 54.6% of our crude oil in the first quarter of 2010 (56.6% in the first quarter of 2009). In 2010, 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 generation 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. In order to overcome this problem, which arose in the region several years ago, the Group is continuously increasing its own power generation capacity by construction power plants in the oil fields.

In line with our strategy the Company is developing new oil fields in the Northern Timan-Pechora and Caspian regions in order to compensate for the decrease in crude oil production in the traditional regions. In August 2008, we began commercial production on the Yuzhnoye Khylchuyu oil field, located in the Timan-Pechora region. We produced 1.8 million tonnes from this field in the first quarter of 2010 and 1.5 million tonnes in the first quarter of 2009. This oil field is developed within our strategic partnership with ConocoPhillips. In December 2009, we started production drilling on the Yu. Korchagin field in the Caspian Sea. In April 2010, we started commercial production at the field. We plan to produce about 340 thousand tonnes from the field in 2010, whilst the maximum annual production from this field is expected to be 2.5 million tonnes of oil and gas condensate, and 1.0 billion cubic meters of gas.

The structural growth of our share in equity affiliates' production outside of Russia is explained by the increase of our effective share in Tengizchevroil, a joint venture which develops the Tengiz and Korolevskoe fields in Kazakhstan, to 5.0% as a result of acquiring the remaining 46.0% interest in LUKARCO.

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.

	3 months of			
	2010		**2009**	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	147	20	147	20
Crude oil purchases internationally........	34,216	4,668	34,063	4,647
Total crude oil purchased....................	**34,363**	**4,688**	**34,210**	**4,667**

Significant part of our crude oil purchases is for processing. In the first quarter of 2010, we purchased 1,517 thousand tonnes of crude oil to process at our and at third party refineries (including 918 thousand tonnes at ISAB and 451 thousand tonnes at TRN), compared to 1,925 thousand tonnes in the first quarter of 2009 (including 969 thousand tonnes at ISAB).

Gas production. In the first quarter of 2010, we produced 4,721 million cubic meters of gas available for sale (including our share in equity affiliates), an increase of 23.9%, compared to the first quarter of 2009.

Our major gas production field is the Nakhodkinskoe gas field, where we produced 2,099 million cubic meters of natural gas in the first quarter of 2010, compared to 1,566 million cubic meters in the same period of 2009. The 34.0% increase in gas production from this field resulted from the increase of purchases of our gas by OAO Gazprom ("Gazprom") starting from the second half of 2009.

Our international gas production did not change significantly. Production from the Khauzak gas field in Uzbekistan was 628 million cubic meters of natural gas, compared to 687 million cubic meters in the same period of 2009. In the first quarter of 2010, our share in production from the Shakh-Deniz field in Azerbaijan was 159 million cubic meters, which equaled to the amount of the first quarter of 2009.

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 49.0% stake in the ISAB refinery complex in Italy and a 45% interest in TRN refinery in the Netherlands.

Compared to the first quarter of 2009, production at our consolidated and affiliated refineries increased by 8.3%. Russian refineries increased their production by 1.0%. Production of our international refineries including our share of production at ISAB and TRN increased by 32.1%, despite lower production at our Bulgarian and Ukrainian refineries due to performed overhauls.

In the first quarter of 2010, our share of refined products produced at ISAB amounted to 1,328 thousand tonnes (1,208 thousand tonnes in the first quarter of 2009) and our share in production of TRN amounted to 1,213 thousand tonnes.

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 2,084 and 1,693 thousand tonnes of Euro 4 and Euro 5 diesel fuel in the first quarters of 2010 and 2009, respectively. In the first quarters of 2010 and 2009, our production of Euro 3 gasoline amounted to 1,287 and 1,083 thousand tonnes, respectively.

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 Russia we processed 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 in Belarus and Serbia. Refined products processed in Belarus were used for supplying our local retail network and for wholesale export. In the first quarter of 2010, we did not process our crude oil at third party refineries.

The following table summarizes key figures for our refining activities.

	3 months of	
	2010	**2009**
	(millions of US dollars)	
Refining expenses at the Group refineries	263	202
- in Russia	192	143
- outside Russia	71	59
Refining expenses at ISAB and TRN	177	99
Refining expenses at third party refineries	2	60
- in Russia	1	52
- outside Russia	1	8
Capital expenditures	170	202
- in Russia	119	103
- outside Russia	51	99
	(thousand barrels per day)	
Refinery throughput at the Group refineries	1,038	1,073
- in Russia(1)	894	886
- outside Russia	144	187
Refinery throughput at ISAB and TRN(2) (3)	208	98
Refinery throughput at third party refineries	–	89
- in Russia	–	61
- outside Russia	–	28
Total refinery throughput	**1,246**	**1,260**
	(thousand of tonnes)	
Refined products produced at the Group refineries	12,162	12,370
- in Russia(1)	10,510	10,403
- outside Russia	1,652	1,967
Production of ISAB and TRN(2)	2,541	1,208
Refined products produced at third party refineries	4	979
- in Russia	–	664
- outside Russia	4	315
Total refined products produced	**14,707**	**14,557**

(1) Excluding mini refineries.
(2) Group's share.
(3) 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 26 countries through 6.3 thousand petrol stations. Most of the stations operate under the LUKOIL brand. We continuously develop our retail business and LUKOIL brand by expanding our retail network.

The table below summarizes figures for our trading activities.

	3 months of	
	2010	**2009**
	(thousand of tonnes)	
Retail sales	3,216	3,200
Wholesale sales	20,538	20,264
Total refined products sales	**23,754**	**23,464**
Refined products purchased in Russia	292	86
Refined products purchased internationally	11,231	9,687
Total refined products purchased	**11,523**	**9,773**

Exports of crude oil and refined products from Russia. In the first quarter of 2010, our export of crude oil from Russia was 4.5% less than in the same period of 2009, and we exported 46.3% of our total domestic crude oil production (48.0% in the first quarter of 2009).

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

	3 months of			
	2010		**2009**	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Exports of crude oil using Transneft export routes	59,893	8,171	65,288	8,907
Exports of crude oil bypassing Transneft	16,170	2,206	14,389	1,963
Total crude oil exports	**76,063**	**10,377**	**79,677**	**10,870**

In the first quarter of 2010, the crude oil exported through our own export infrastructure was 2,206 thousand tonnes or 13.2% more than in the first quarter of 2009. This increase was due to export of crude oil produced from the Yuzhnoye Khylchuyu oil field through our export terminal in Varandey (1.8 million tonnes in the first quarter of 2010, compared to 1.5 million tonnes in the first quarter of 2009).

In the first quarter of 2010, we exported from Russia 6.3 million tonnes of refined products, a decrease of 8.0%, compared to the same period of 2009. This is explained by a decrease in export sales to CIS. We export from Russia primarily diesel fuel, fuel oil and gasoil. These products account for approximately 91.2% of our refined products export volumes.

In the first quarter of 2010, our revenue from export of crude oil and refined products from Russia both to the Group companies and third parties amounted to $5,446 million and $3,318 million, respectively ($3,236 million for crude oil and $2,015 million for refined products in the first quarter of 2009).

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 the first quarter of 2010, the Brent crude oil price fluctuated between $70 and $80 per barrel and reached its peak of $80.5 in the mid-March of 2010.

In 2008, the crude oil prices were the highest ever in real terms. Starting from July 2008, crude oil prices began to descend and by the end of the year crude oil price dropped by more than $100 per barrel down to $37 per barrel driven by the world economic downturn. During 2009 crude oil prices were in an upward trend and in the second half of the year crude oil price stabilized around $70 per barrel.

Substantially all crude oil we export is Urals blend. The following table shows the average crude oil and refined product prices in the first quarters of 2010 and 2009.

	3 months of 2010	3 months of 2009	Change, %
	(in US dollars per barrel, except for figures in percent)		
Brent crude..	76.36	44.46	71.8
Urals crude (CIF Mediterranean) [(1)]	75.40	43.73	72.4
Urals crude (CIF Rotterdam) [(1)]	75.31	43.65	72.5
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam)....................................	442.64	228.49	93.7
Diesel fuel 10 ppm (FOB Rotterdam)	644.02	437.23	47.3
High-octane gasoline (FOB Rotterdam).......................	726.31	409.98	77.2

Source: Platts.

[(1)] 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 first quarters of 2010 and 2009.

	3 months of 2010	3 months of 2009	Change, %
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil...	207.92	111.56	86.4
Diesel fuel..	563.50	433.75	29.9
High-octane gasoline (Regular)	664.39	393.79	68.7
High-octane gasoline (Premium)	683.29	472.88	44.5

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 devaluation of the ruble against the US dollar generally causes our costs to decrease 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 21.8% in the first quarter of 2010, compared to the first quarter of 2009.

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

	3 months of	
	2010	**2009**
Ruble inflation (CPI), %	3.2	5.5
Change of the ruble-dollar exchange rate, %	2.9	(15.8)
Average exchange rate for the period (ruble to US dollar)	29.89	33.93
Exchange rate at the end of the period (ruble to US dollar)	29.36	34.01

Tax burden

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

		3 months of		Change,
		2010[(1)]	**2009**[(1)]	**%**
Export tariffs on crude oil	$/tonne	263.54	112.13	135.0
Export tariffs on refined products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	189.88	87.88	116.1
Liquid fuels (fuel oil)	$/tonne	102.28	47.33	116.1
Excise on refined products				
Straight-run gasoline	RUR/tonne	4,290.00	3,900.00	10.0
High-octane gasoline	RUR/tonne	3,991.90	3,629.00	10.0
Low-octane gasoline	RUR/tonne	2,922.70	2,657.00	10.0
Diesel fuel	RUR/tonne	1,188.00	1,080.00	10.0
Motor oils	RUR/tonne	3,246.10	2,951.00	10.0
Mineral extraction tax				
Crude oil	RUR/tonne	2,879.93	1,542.89	86.7
Natural gas	RUR/1,000 m^3	147.00	147.00	–

(1) Average values.

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

		3 months of		Change,
		2010[(1)]	**2009**[(1)]	**%**
Excise on refined products				
Straight-run gasoline	$/tonne	143.52	114.94	24.9
High-octane gasoline	$/tonne	133.55	106.95	24.9
Low-octane gasoline	$/tonne	97.78	78.31	24.9
Diesel fuel	$/tonne	39.75	31.83	24.9
Motor oils	$/tonne	108.60	86.97	24.9
Mineral extraction tax				
Crude oil	$/tonne	96.35	45.47	111.9
Natural gas	$/1,000 m^3	4.92	4.33	13.5

(1) 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 was 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) 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).

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, Caspian sea and the Nenetsky Autonomous District, 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.

The Group undertakes crude oil production from certain oilfields in Caspian Sea and the Nenetsky Autonomous District and can benefit from the application of zero tax rate.

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 has been in effect 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.

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.

Starting from the end of 2009, the Russian Government set a zero export duty rate for crude oil produced at certain fields in Eastern Siberia. This benefit does not apply to crude oil production at our new oilfields in Caspian Sea and the Nenetsky Autonomous District.

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 and Belarus, are not subject to export duties. In 2009, crude oil exported from Russia to Belarus was subject to export duties calculated with the application of a coefficient 0.356 to the regular export duty rate set by the Russian government.

In 2010, under the agreement between the Russian Federation and Belarus, crude oil exported from Russia to Belarus up to total amount of 6.3 million tonnes will not be subject to export duty. Volumes of crude oil export above this limit are taxed at a regular rate.

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.

Income tax. Starting on 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 of 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 ("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, cannot obtain benefits from selling it using Transneft's pipeline. Alternative access to international markets bypassing Transneft's export routes can be obtained through railroad transport, by tankers, and by the 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 offshore ice-resistant terminal in Varandey with annual capacity of 12 million tonnes to export crude oil produced by our joint venture with ConocoPhillips located in Northern Timan-Pechora. Through the Svetly terminal we export crude oil primarily produced by OOO LUKOIL-Kaliningradmorneft, our subsidiary operating in the Kaliningrad region, and refined products. Its annual capacity is 6 million tonnes. 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 a capacity of 12 million tonnes per year that 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. The 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 the transport infrastructure, other macroeconomic factors, and compensation of economically reasonable expense, incurred by entities of the natural monopolies. Tariffs are revised by the FST at least annually.

Three months ended March 31, 2010, compared to three months ended March 31, 2009

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

	3 months of	
	2010	**2009**
	(millions of US dollars)	
Revenues		
Sales (including excise and export tariffs)	23,902	14,745
Costs and other deductions		
Operating expenses	(1,770)	(1,232)
Cost of purchased crude oil, gas and products	(9,520)	(5,362)
Transportation expenses	(1,351)	(1,169)
Selling, general and administrative expenses	(802)	(729)
Depreciation, depletion and amortization	(1,030)	(994)
Taxes other than income taxes	(2,080)	(1,198)
Excise and export tariffs	(4,578)	(2,519)
Exploration expense	(117)	(37)
(Loss) gain on disposals and impairments of assets	(3)	27
Income from operating activities	**2,651**	**1,532**
Interest expense	(177)	(163)
Interest and dividend income	53	38
Equity share in income of affiliates	107	111
Currency translation loss	(40)	(15)
Other non-operating expense	(29)	(1)
Income before income taxes	**2,565**	**1,502**
Current income taxes	(556)	(300)
Deferred income taxes	34	(90)
Total income tax expense	**(522)**	**(390)**
Net income	**2,043**	**1,112**
Less: net loss (income) attributable to noncontrolling interests	10	(207)
Net income attributable to OAO LUKOIL	**2,053**	**905**
Basic and diluted earning per share of common stock attributable to OAO LUKOIL (in US dollars)	2.42	1.07

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

Sales revenues

Sales breakdown	3 months of 2010	3 months of 2009
	(millions of US dollars)	
Crude oil		
Export and sales on international markets other than CIS	6,293	3,439
Export and sales to CIS	286	324
Domestic sales	186	5
	6,765	**3,768**
Refined products		
Export and sales on international markets		
Wholesale	11,035	6,404
Retail	2,105	1,796
Domestic sales		
Wholesale	1,160	817
Retail	1,186	800
	15,486	**9,817**
Petrochemicals		
Export and sales on international markets	132	128
Domestic sales	169	76
	301	**204**
Gas and gas products		
Export and sales on international markets	291	186
Domestic sales	191	102
	482	**288**
Domestic sales of energy and related services	**448**	**304**
Other		
Sales on international markets	238	245
Domestic sales	182	119
	420	**364**
Total sales	**23,902**	**14,745**

Sales volumes	3 months of 2010	3 months of 2009
Crude oil	(thousands of barrels)	
Export and sales on international markets other than CIS	84,654	79,391
Export and sales to CIS	6,538	10,057
Domestic sales	5,373	293
	96,565	**89,741**
Crude oil	(thousands of tonnes)	
Export and sales on international markets other than CIS	11,549	10,831
Export and sales to CIS	892	1,372
Domestic sales	733	40
	13,174	**12,243**
Refined products	(thousands of tonnes)	
Export and sales on international markets		
Wholesale	18,135	17,743
Retail	1,623	1,888
Domestic sales		
Wholesale	2,403	2,521
Retail	1,593	1,312
	23,754	**23,464**
Total sales volume of crude oil and refined products	**36,928**	**35,707**

Realized average sales prices

	3 months of 2010		3 months of 2009	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	74.34	544.91	43.31	317.47
Oil (CIS)	43.70	320.33	32.22	236.21
Refined products				
Wholesale		608.53		360.91
Retail		1,296.73		951.57
Average realized price within Russia				
Oil	34.56	253.31	18.40	134.86
Refined products				
Wholesale		482.82		323.93
Retail		744.42		610.20

During the first quarter of 2010, our revenues increased by $9,157 million, or by 62.1%, compared to the same period of 2009. Our revenues from crude oil sales increased by $2,997 million, or by 79.5%. Our revenues from sales of refined products increased by $5,669 million, or by 57.7%. The increase in sales revenue was a result of a sharp increase in hydrocarbon prices, compared to the first quarter of 2009. 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 79.5%, due to growth of crude oil prices and increased sales volumes.

Cease in crude oil refining at third parties refineries in Russia and Belarus released crude oil volumes for marketing. As a result, our crude oil sales raised by 7.6% in terms of volumes.

In the first quarter of 2010, we increased the volume of domestic sales by the crude oil, which in the previous year we put on processing at Russian third party refineries. In 2010, we commence selling crude oil to these refineries.

Sales of refined products

In the first quarter of 2010, our revenue from the wholesale of refined products outside of Russia increased by $4,631 million, or by 72.3%, compared to the same period of 2009, due to increased average realized price by 68.6%. Despite the decrease in output at our refineries in Bulgaria and Ukraine due to overhaul, commencement of crude oil refining at TRN and expansion of trading activities led to an increase in wholesales volumes by 2.2%.

In the first quarter of 2010, our revenue from international retail sales increased by $309 million, or by 17.2%, compared to the first quarter of 2009, mainly due to an increase in average retail prices by 36.3%. Sales volumes decreased by 14.0%, reflecting restructuring of our retail network in the USA.

In the first quarter of 2010, our revenue from the wholesale of refined products on the domestic market increased by $343 million, or by 42.0%, compared to the first quarter of 2009, due to an increase in the average realized price by 49.1%. Sales volumes decreased by 118 thousand tonnes, or by 4.7%.

In the first quarter of 2010, our revenue from retail sales in Russia increased by $386 million, or by 48.3%, compared to the first quarter of 2009, due to an increase in prices and volumes. In the first quarter of 2010, our retail sales revenue was 50.6% of total refined products sales in Russia (in the first quarter of 2009 – 49.5%).

Sales of petrochemical products

In the first quarter of 2010, our revenue from sales of petrochemical products increased by $97 million, or by 47.5%, compared to the first quarter of 2009. This resulted from an increase in prices by 95.1%. At the same time sales volumes decreased by 24.4% due to decrease of production volumes. Production growth at our Russian plants was outweighed by a decrease of production at our Bulgarian plant, at which petrochemical units where temporarily shutdown.

Sales of gas and gas products

In the first quarter of 2010, sales of gas and gas refined products increased by $194 million, or by 67.4%, compared to the first quarter of 2009. Gas products sales revenue increased by $138 million, or by 84.1%, as a result of increase in sales volumes and prices. Natural gas sales revenue amounted to $168 million – an increase of 40.2%, compared to the same period of 2009.

The major purchaser of our natural gas produced in the Russian Federation is Gazprom. In the first quarter of 2010, we sold 2,099 million cubic meters of natural gas to Gazprom (1,566 million cubic meters in the first quarter of 2009). The average realized price increased by 13.5% to $35.4 per 1,000 cubic meters as a result of the ruble appreciation.

Domestic sales of energy and related services

We develop energy business since 2008 after the acquisition of TGK-8. As a result, in the first quarter of 2010, our revenue from sales of electricity, heat and related services increased by $144 million, or by 47.4%. The ruble appreciation also contributed to an increase of this revenue.

Sales of other products

Other sales include non-petroleum sales through our retail network, and revenue from other services provided and goods not related to our primary activities (such as transportation, etc.) sold by our production and marketing companies.

In the first quarter of 2010, our other sales increased by $56 million, or by 15.4%. The increase was a result of increase of non-petroleum sales, supported by appreciation of the ruble.

During the first quarter of 2010, sales of goods and other products from our retail stations amounted to $148 million, an increase of $36 million from the level of the first quarter of 2009, mainly due to increase of such sales in Russia and Eastern Europe.

Operating expenses

Operating expenses include the following:

	3 months of 2010	2009
	(millions of US dollars)	
Hydrocarbon extraction expenses	784	602
Own refining expenses	263	202
Refining expenses at third party and affiliated refineries	179	159
Expenses for crude oil transportation to refineries	266	209
Power generation and distribution expenses	148	97
Petrochemical expenses	40	29
Other operating expenses	308	279
	1,988	**1,577**
Change in operating expenses in crude oil and refined products inventory originating within the Group(1)	(218)	(345)
Total operating expenses	**1,770**	**1,232**

(1) 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 party.

Compared to the first quarter of 2009, operating expenses increased by $538 million, or by 43.7%, which is mainly explained by general increase in operating expenses in Russia due to the real ruble appreciation against the US dollar, increase in hydrocarbon extraction expenses, expenses for crude oil transportation to refineries and refining expenses, energy generation and distribution expenses.

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 first quarter of 2010, our extraction expenses increased by $182 million, or by 30.2%, compared to the first quarter of 2009. The increase was mainly a result of the real ruble appreciation against the US dollar, increased expenses for power supply in Russia and artificial stimulation of reservoirs. Our average hydrocarbon extraction cost increased from $3.10 to $3.97 per BOE, or by 28.1%, compared to the first quarter of 2009.

Own refining expenses

In the first quarter of 2010, our own refining expenses increased by $61 million, or by 30.2%, compared to the first quarter of 2009.

Refining expenses at our domestic refineries increased by 34.3%, or by $49 million, mainly as a result of the real ruble appreciation against the US dollar and increase in power supply and overhaul costs.

Refining expenses at our international refineries increased by 20.3%, or by $12 million, mainly as a result of increased power supply costs.

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.

We did not process crude oil on third party refineries in the first quarter of 2010. Nevertheless, due to commencement of crude oil refining at TRN we increased processing volumes by 11.5%, compared to the first quarter of 2009 (including refined products processed). Thus, in the first quarter of 2010, refining expenses at third party and affiliated refineries increased by 12.6%, compared to the first quarter of 2009.

Petrochemical expenses

In the first quarter of 2010, operating expenses of our petrochemical plants increased by $11 million, or by 37.9%, compared to the first quarter of 2009. Expenses in Russia were impacted by increased production and ruble appreciation. Moreover, despite petrochemical capacity downtime in Bulgaria and Ukraine, our international petrochemical operating expenses decreased insignificantly due to sizeable share of fixed costs.

Expenses for crude oil transportation to refineries

Expenses for crude oil transportation to refineries increased in the first quarter of 2010 by $57 million, or by 27.3%, compared to the first quarter of 2009, due to an increase in transportation tariff rates and as a result of the real ruble appreciation in Russia (see Transportation expenses below).

Power generation and distribution expenses

Power generation and distribution expenses increased by $51 million, or by 52.6%, reflecting expansion of our power generation business and as a result of the real ruble appreciation in Russia.

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 transportation services, other goods, etc., 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 first quarter of 2010, our other operating expenses increased by $29 million, or by 10.4%, compared to the first quarter of 2009.

Cost of purchased crude oil, gas and products

Cost of purchased crude oil, gas and products increased by $4,158 million in the first quarter of 2010, or by 77.5%, compared to the same period of 2009, due to an increase in crude oil and refined products prices and increase in volumes of purchased refined products.

Cost of purchased crude oil, gas and products includes the result of hedging of international crude oil and refined products sales. In the first quarter of 2010, we recognized a $72 million expense from hedging, compared to a $55 million expense in the first quarter of 2009.

Cost of purchased crude oil, gas and products includes purchases of natural gas and fuel oil to supply our power generation segment entities.

Transportation expenses

In the first quarter of 2010, our transportation expenses increased by $182 million, or by 15.6%, compared to the first quarter of 2009. This was primarily due to increase of ruble denominated pipeline and railway transportation tariffs in Russia, which was emphasized by the ruble appreciation.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed in the first quarter of 2010, compared to the first quarter of 2009, as follows: crude oil pipeline tariffs increased by 29.6%, railway tariffs for refined products transportation increased by 32.5%, crude oil and refined products freight rates decreased by 34.6% and 22.8%, respectively.

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.

In the first quarter of 2010, our selling, general and administrative expenses increased by $73 million, or by 10.0%, compared to the first quarter of 2009, reflecting the effect of ruble appreciation on selling, general and administrative expenses in Russia and increase in selling expenses in Russia and abroad. At the same time, decreased expenses on debt provisions and lower labor costs partly compensated the above mentioned effect.

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.

Our depreciation, depletion and amortization expenses increased by $36 million, or by 3.6%, compared to the first quarter of 2009.

Exploration expenses

During the first quarter of 2010, exploration expense increased by $80 million, or tripled, compared to the first quarter of 2009. Dry hole costs increased by $70 million to $87 million.

In the first quarter of 2010, we charged to expense the cost of an exploratory well in Cote d'Ivoire totaling $65 million. Dry hole costs in Russia amounted to $12 million, primarily relating to Timan-Pechora.

Interest expense

In the first quarter of 2010, interest expense increased by $14 million, which is 8.6% more than in the respective period of the previous year.

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, an exploration and production company operating in Kazakhstan, and ISAB and TRN refineries. Moreover at the end of 2009, we increased our share in LUKARCO from 54% to 100%, thus increasing our stake in Tengizchevroil, an exploration and production joint-venture in Kazakhstan, to 5%.

Compared to the first quarter of 2009, our share in income of affiliates decreased by $4 million, or by 3.6%.

Taxes other than income taxes

	3 months of	
	2010	2009
	(millions of US dollars)	
In Russia		
Mineral extraction taxes	1,750	911
Social security taxes and contributions	108	104
Property tax	121	94
Other taxes	53	30
Total in Russia	**2,032**	**1,139**
International		
Mineral extraction taxes	16	9
Social security taxes and contributions	16	16
Property tax	7	7
Other taxes	9	27
Total internationally	**48**	**59**
Total	**2,080**	**1,198**

In the first quarter of 2010, taxes other than income taxes increased by 73.6%, or by $882 million, compared to the first quarter of 2009, 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 zero tax rate for crude oil produced mainly in Timan-Pechora and decreased rate for depleted oilfields led to approximately $335 million tax reduction (in the first quarter of 2009 – about $100 million).

Excise and export tariffs

	3 months of	
	2010	2009
	(millions of US dollars)	
In Russia		
Excise tax on refined products	217	168
Crude oil export tariffs	2,678	1,061
Refined products export tariffs	837	474
Total in Russia	**3,732**	**1,703**
International		
Excise tax and sales taxes on refined products	814	780
Crude oil export tariffs	28	22
Refined products export tariffs	4	14
Total internationally	**846**	**816**
Total	**4,578**	**2,519**

In spite of a decrease in crude oil and refined products export volumes, export tariffs increased by $1,976 million, or by 125.8%, compared to the first quarter of 2009, due to an increase in tariff rates in Russia as a result of international crude oil prices growth. The increase in excises in Russia was due to the ruble appreciation and increase of excise rate.

The Russian Government set a zero export rate for crude oil produced at certain fields in Eastern Siberia starting from the end of 2009. This benefit does not apply to crude oil production at our new oilfields in Caspian Sea and the Nenetsky Autonomous District.

Income taxes

In the first quarter of 2010, our total income tax expense increased by $132 million, or by 33.8%, compared to the first quarter of 2009, due to the increase in income before income tax by $1,063 million, or by 70.8%.

In the first quarter of 2010, our effective income tax rate was 20.4%, compared to 26.0% in the first quarter of 2009, which was higher than the maximum statutory rate for the Russian Federation (20%).

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

	3 months of	
	2010	**2009**
	(millions of US dollars)	
Net income attributable to OAO LUKOIL	**2,053**	**905**
Add back:		
Income tax expense	522	390
Depreciation and amortization	1,030	994
Interest expense	177	163
Interest and dividend income	(53)	(38)
EBITDA	**3,729**	**2,414**

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

	3 months of 2010	3 months of 2009
	(millions of US dollars)	
Net cash provided by operating activities	2,798	1,663
Net cash used in investing activities	(1,515)	(2,643)
Net cash (used in) provided by financing activities	(321)	2,024

Operating activities

Our primary source of cash flow is funds generated from our operations. During the first quarter of 2010, cash generated by operating activities was $2,798 million, which is 68.3% more than in the same period of 2009, mainly due to the increase in sales revenues. On the contrary, in the first quarter of 2010, our operating cash inflows were affected by an increase of working capital by $417 million, compared to January 1, 2010. This was mainly caused by:

- an increase in inventory of $899 million, resulting mainly from increased hydrocarbons prices and increased volumes of trading
- a $256 million net increase in other assets and liabilities.

At the same time, the negative effect from the above mentioned factors was partly offset by a $611 million net increase in tax accounts payable, and an $127 million net increase in trade accounts receivable and payable.

Investing activities

The decrease in cash used in investing activities resulted from a decrease in payments for acquisitions by $1,125 million.

In the first quarter of 2010, we made an advance payment of $235 million for potential acquisitions of downstream assets in Russia.

In the first quarter of 2009, we paid the remaining amount of $1,066 million for the acquisition of 49% stake in ISAB.

Financing activities

In the first quarter of 2010, net movements of short-term and long-term debt generated an outflow of $315 million, compared to an inflow of $2,032 million in the first quarter of 2009.

In February 2009, we received short-term loans of $500 million and 17 billion rubles from Sberbank to finance our working capital. Also, in the first quarter of 2009, we received a long-term loan of €1,000 million from Gazprombank. All these loans were repaid in 2009.

Analysis of capital expenditures

	3 months of	
	2010	**2009**
	(millions of US dollars)	
Capital expenditures[1]		
Exploration and production		
Russia	862	960
International	255	158
Total exploration and production	1,117	1,118
Refining, marketing and distribution		
Russia	160	154
International	68	149
Total refining, marketing and distribution	228	303
Chemicals		
Russia	2	3
International	21	26
Total chemicals	23	29
Power generation and distribution	89	–
Other	11	16
Total capital expenditures	**1,468**	**1,466**
Acquisitions of subsidiaries and minority shareholding interest[2]		
Exploration and production		
Russia	3	80
International	–	–
Total exploration and production	3	80
Refining, marketing and distribution		
Russia	235	206
International	–	1,066
Total refining, marketing and distribution	235	1,272
Other	–	20
Less cash acquired	–	(9)
Total acquisitions	**238**	**1,363**

[1] Including non-cash transactions and prepayments.

[2] Including prepayments related to acquisitions of subsidiaries and minority shareholding interests and non-cash transactions.

During the first quarter of 2010, our capital expenditures, including non-cash transactions, amounted to $1,468 million, which is roughly equal to the level of the first quarter of 2009. Our capital expenditures in exploration and production were also at the level of the same period of 2009. The exploration and production capital expenditures in new regions decreased by $85 million. In the traditional exploration and production regions of Western Siberia and European Russia capital expenditures increased by $4 million and decreased by $29 million, respectively. The decrease in the domestic capital expenditures was compensated by an increase in our international capital expenditures (excluding the Caspian region) amounted to $109 million and was primarily related to our projects in Uzbekistan and Western Africa.

Capital expenses of our power generation and distribution related to fulfillment of the investment programm of our power generation segment entities.

The table below shows our exploration and production capital expenditures in promising new production regions. In April 2010, we started commercial production on the Yu. Korchagin field in the Caspian Sea. We plan to produce about 340 thousand tonnes from the field in 2010, whilst the maximum annual production from this field is expected to be 2.5 million tonnes of oil and gas condensate, and 1.0 billion cubic meters of gas.

	3 months of	
	2010	**2009**
	(millions of US dollars)	
Northern Timan-Pechora	57	144
Yamal	57	25
Caspian region[1]	65	95
Total	**179**	**264**

[1] Russian and international projects.