

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

The following report represents management's discussion and analysis of the financial condition and results of operations of OAO LUKOIL as of December 31, 2009, and each of the years ended December 31, 2009, 2008 and 2007, and significant trends that may affect its future performance. It should be read in conjunction with our US GAAP consolidated financial statements and notes and supplemental oil and gas disclosure.

References to "LUKOIL," "the Company," "the Group," "we" or "us" are references to OAO LUKOIL and its subsidiaries and equity affiliates. All dollar amounts are in millions of US dollars, unless otherwise indicated. Tonnes of crude oil produced are translated into barrels using conversion rates characterizing the density of oil from each of our oilfields. Tonnes of crude oil purchased as well as other operational indicators expressed in barrels were translated into barrels using an average conversion rate of 7.33 barrels per tonne. Translations of cubic meters to cubic feet were made at the rate of 35.31 cubic feet per cubic meter. Translations of barrels of crude oil into barrels of oil equivalent ("BOE") were made at the rate of 1 barrel per BOE and of cubic feet into BOE at the rate of 6 thousand cubic feet per BOE.

This report includes forward-looking statements – words such as "believes," "anticipates," "expects," "estimates," "intends," "plans," etc. – that reflect management's current estimates and beliefs, but are not guarantees of future results. Please see "Forward-looking statement" on page 40 for a discussion of some of the factors that could cause actual results to differ materially.

Key financial and operational results

	2009	Change to 2008, %	2008	Change to 2007, %	2007
Sales (millions of US dollars).....	81,083	(24.7)	107,680	31.5	81,891
Net income attributable to OAO LUKOIL (millions of US dollars).....	7,011	(23.3)	9,144	(3.9)	9,511
Net income before one-off impairment losses (millions of US dollars) ⁽¹⁾	7,352	(22.4)	9,471	(0.4)	9,511
EBITDA (millions of US dollars).....	13,475	(14.7)	15,797	3.0	15,330
Taxes other than income taxes, excise and export tariffs (millions of US dollars).....	(19,532)	(43.9)	(34,804)	42.6	(24,400)
Basic and diluted earning per share of common stock attributable to OAO LUKOIL (US dollars).....	8.28	(23.9)	10.88	(5.2)	11.48
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE).....	807,301	0.5	803,109	1.0	795,099
Crude oil production by the Group including our share in equity affiliates (thousands of tonnes).....	97,615	2.5	95,240	(1.5)	96,645
Gas produced by the Group including our share in equity affiliates (millions of cubic meters) ⁽²⁾	14,898	(12.5)	17,020	22.0	13,955
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes)...	59,879	12.9	53,033	8.6	48,819
Hydrocarbon proved reserves including our share in equity affiliates (millions of BOE).....	17,504	(9.5)	19,334	(5.1)	20,369

⁽¹⁾ One-off impairment losses are discussed in details on page 26.

⁽²⁾ Gas available for sale.

In 2009, our net income was \$7,011 million, which is \$2,133 million, or 23.3%, less than in 2008.

Such decrease in our net income is mainly explained by a sharp decrease in prices for hydrocarbons in 2009, compared to 2008.

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 three main business segments:

- **Exploration and Production** – which includes our exploration, development and production operations relating to crude oil and natural gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, Uzbekistan, the Middle East, South America, and Northern and Western Africa.
- **Refining, Marketing and Distribution** – which includes refining and transport operations, marketing and trading of crude oil, natural gas and refined products.
- **Chemicals** – which includes processing and trading of petrochemical products.

Other businesses include a power generation business, banking, finance and other activities. Each of our three main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the “Domestic crude oil and refined products prices” section on page 10, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of refining crude oil and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 22 “Segment information” to our consolidated financial statements.

Recent developments and outlook

The following has been achieved in 2009:

Exploration and production

- 8 new oil and gas fields were brought on line (2008: 11 oil and gas fields).
- Within the consortium with Norway's Statoil we won the tender to develop the major West Qurna-2 oilfield, which has estimated recoverable reserves of 12.9 billion barrels of crude oil.
- We started production drilling at Yu. Korchagin field in the Caspian Sea, where we plan to begin commercial production in the second quarter of 2010.
- We acquired the remaining 46% interest and so became an owner of full stake in LUKARCO B.V. (“LUKARCO”), thus increasing our reserves by 102.3 million barrels of oil and 129.8 billion cubic feet of gas, and oil production by approximately 13 thousand barrels per day. LUKARCO is a holding company, which owns a 5% share in Tengizchevroil, a joint venture which develops the Tengiz and Korolevskoe fields in Kazakhstan, and a 12.5% share in the Caspian Pipeline Consortium (CPC), which carries Kazakhstani and Russian oil to Novorossiysk marine terminal.

Refining

- We acquired 45% interest in TRN refinery in the Netherlands (“TRN”). TRN has an annual topping capacity of 7.9 million tonnes and a hydro-cracking unit with an annual capacity of approximately 3.4 million tonnes. Our share of production at TRN amounted to 1,528 thousand tonnes.

Marketing

- In the Russian Federation we acquired petrol stations networks of companies OOO Smolenskneftesnab, OOO IRT Investment, OOO PM Invest and OOO Retaier House. Thus, we increased our network by 96 stations and plots of land.
- As a result of our activity for development of retail segment our retail sales in Russia increased by 252 thousand tonnes.

Other

- In 2009, we continued our pursuit to improve the Group structure by divesting our non-core businesses. We spun off and sold outside the Group several transportation and service assets in Western Siberia and a group of security agencies.
- We continued to develop our power generating and distribution business. We successfully fulfil investment program of OAO UGK TGK-8 (“TGK-8”), we invested \$202 million and plan to invest further \$944 million within next 4 years. The revenue of power generating sector in 2009 amounted to \$804 million.

Other achievements in 2009 are described in detail further in this report.

Changes in the Group structure

In December 2009, the Group acquired the remaining 46.0% interests in its equity affiliate LUKARCO for \$1.6 billion, thereby increasing the ownership stake to 100%. LUKARCO is a holding company, which owns a 5% share in Tengizchevroil, a joint venture which develops the Tengiz and Korolevskoe fields in Kazakhstan, and a 12.5% share in CPC, which carries Kazakhstani and Russian oil to Novorossiysk marine terminal. Therefore the Group increased the ownership in Tengizchevroil from 2.7% to 5% and the ownership in CPC from 6.75% to 12.5%. The first installment in amount of \$300 million was paid in December 2009; the remaining amount should be paid no later than two years after the acquisition. The Group is using equity method of accounting for investments in Tengizchevroil and CPC.

During 2009, a Group company acquired the remaining 25.2% of share capital of OAO RITEK (“RITEK”) for \$235 million, thereby increasing the Group’s share to 100%. RITEK is a crude oil producing company operating in European Russia and Western Siberia.

In June 2009, a Group company entered into an agreement with Total to acquire a 45% interest in TRN refinery in the Netherlands. 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% 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%. As of December 31, 2009, the fair value of this option for the Group is zero. 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 to acquire 75 petrol stations and storage facilities in Bulgaria for approximately \$367 million. The transaction was finalized in the second quarter of 2008.

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

In March 2008, a Group company entered into an agreement with a related party, whose management and directors include members of the Group’s management and Board of Directors, to acquire a 64.31% interest in TGK-8 for approximately \$2,117 million. The purchase consideration partly 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 electric power business.

In 2008, the Group acquired the remaining 3.09% of the share capital of OAO LUKOIL-Nizhegorodnefteorgsintez (“Nizhegorodnefteorgsintez”) for \$64 million increasing the Group’s ownership in Nizhegorodnefteorgsintez to 100%. Nizhegorodnefteorgsintez is a refinery plant located in European Russia.

Resource base

The table below summarizes the net oil-equivalent proved reserves of consolidated subsidiaries and our share in equity affiliates that have been derived or extracted from the reports of Miller and Lents, Ltd. (“Miller and Lents”), our independent reservoir engineers, dated as at January 1, 2009 and 2010.

(millions of BOE)	January 1, 2010	Changes in 2009			January 1, 2009
		Production ⁽¹⁾	Extensions, discoveries and changes in structure	Revision of previous estimates	
Western Siberia.....	9,751	(450)	332	(625)	10,494
Timan-Pechora.....	2,735	(163)	38	(157)	3,017
Ural region	2,124	(94)	30	23	2,165
Volga region	895	(26)	142	(891)	1,670
Other in Russia.....	231	(16)	12	1	234
Outside Russia	1,768	(75)	210	(121)	1,754
Proved oil and gas reserves	17,504	(824)	764	(1,770)	19,334
Probable oil and gas reserves	9,820				11,767
Possible oil and gas reserves.....	5,054				5,282

⁽¹⁾ Gas production shown before own consumption.

The Company’s proved reserves as at January 1, 2010 amount to 17.5 billion BOE and comprise of 13.7 billion BOE of crude oil and 22.9 trillion cubic feet of gas.

In 2009, the increase in Company’s proved reserves due to geological exploration and production drilling amounted to 617 million BOE.

Acquisitions increased our proved reserves by 124 million BOE, due to the increase of our share in Tengizchevroil to 5% as a result of increasing our share in LUKARCO to 100%.

Changes in our licences portfolio led to a net increase of our reserves by 23 million BOE.

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, Saudi Arabia, Columbia, Ghana and Cote d'Ivoire.

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

	2009	2008	2007
Daily production of hydrocarbons, including the Company's share in equity affiliates (thousand BOE per day), including:			
- crude oil	2,212	2,194	2,178
- natural and petroleum gas ⁽¹⁾	1,972	1,921	1,953
	240	273	225
Hydrocarbon extraction expenses (US dollar per BOE)	3.56	4.12	3.58
	(millions of US dollars)		
Hydrocarbon extraction expenses	2,787	3,208	2,757
- in Russia	2,592	3,006	2,616
- outside Russia	195	202	141
Exploration expenses	218	487	307
- in Russia	71	131	149
- outside Russia	147	356	158
Mineral extraction tax	5,452	12,267	8,482
- in Russia	5,399	12,267	8,482
- outside Russia	53	-	-

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

Crude oil production. In 2009, we increased our daily crude oil production by 2.7%, compared to 2008. We produced (including the Company's share in equity affiliates) 719.6 million barrels, or 97.6 million tonnes.

The following table represents our crude oil production in 2009 and 2008 by major regions.

(thousands of tonnes)	Change to 2008				2008
	2009	Total, %	Change in structure	Organic change	
Western Siberia	52,962	(5.7)	-	(3,225)	56,187
Timan-Pechora	21,662	29.8	-	4,977	16,685
Ural region	11,958	3.6	-	410	11,548
Volga region	2,848	(6.3)	-	(193)	3,041
Other in Russia	2,130	(2.5)	-	(55)	2,185
Crude oil produced in Russia	91,560	2.1	-	1,914	89,646
Crude oil produced internationally	3,515	9.8	-	315	3,200
Total crude oil produced by consolidated subsidiaries	95,075	2.4	-	2,229	92,846
Our share in crude oil produced by equity affiliates:					
in Russia	308	3.0	-	9	299
outside Russia	2,232	6.5	26	111	2,095
Total crude oil produced	97,615	2.5	26	2,349	95,240

The main oil producing region of the Company is Western Siberia where we produced 55.7% of our crude oil in 2009 (60.5% in 2008 and 63.6% in 2007). In 2009, the Western Siberian producing assets continued to mature resulting in a production decline and water cut increase. A significant impact on our production in the period was caused by a lack of sufficient power generating capacities to meet the growing demand for extra power from a wide range of oil producers in Western Siberia as they faced the need to scale up pumping operations supporting crude oil production. In order to overcome this problem, which arose in the region several years ago, the Group is continuously increasing its own power 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 Khylychuyu oil field, located in the Timan-Pechora region. We produced 7.0 million tonnes from this field in 2009. This oil field is developed within our strategic partnership with ConocoPhillips.

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% as a result of acquiring the remaining 46% interest in LUKARCO.

In December 2009, we started production drilling on the Yu. Korchagin field in the Caspian Sea. 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.

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 used for trading activities, for supplying our international refineries or for processing at third party refineries.

	2009		2008		2007	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	4,442	606	1,730	236	345	47
Crude oil purchases internationally	150,258	20,499	76,078	10,379	32,802	4,475
Total crude oil purchased	154,700	21,105	77,808	10,615	33,147	4,522

The increase in volumes of crude oil purchased internationally resulted from increased refining and trading. In 2009, we purchased 11,313 thousand tonnes of crude oil to process at our and at third party refineries (including 5,116 thousand tonnes at ISAB and 698 thousand tonnes at TRN), compared to 5,029 thousand tonnes in 2008.

Gas production. In 2009, we produced 14,898 million cubic meters of gas available for sale (including our share in equity affiliates), a decrease of 12.5%, compared to 2008.

Our major gas production field is the Nakhodkinskoe gas field, where we produced 5,936 million cubic meters of natural gas in 2009, compared to 8,313 million cubic meters in 2008. The 28.6% decrease in gas production from this field resulted from the decrease of purchases of our gas by OAO Gazprom ("Gazprom"), the Russian gas monopoly.

In 2009, our share in production from the Shakh-Deniz field in Azerbaijan was 518 million cubic meters, compared to 552 million cubic meters in 2008. Our production from the Khauzak gas field in Uzbekistan was 2,227 million cubic meters of natural gas, compared to 2,340 million cubic meters in 2008.

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. In August 2005, we closed our refinery in Odessa, Ukraine to commence a wide-scale upgrade. In April 2008, we put it back into operation after the completion of the upgrade. The annual capacity of the Odessa refinery amounts to 2.8 million tonnes. At the end of 2008, we acquired 49% interest in ISAB, which has an annual refining capacity of 16 million tonnes. In September 2009, we acquired 45% interest in TRN refinery, which has an annual capacity of 7.9 million tonnes.

Compared to 2008, production at our consolidated and affiliated refineries increased in 2009 by 12.9%. Russian refineries increased their production by 0.8%. Production of our international refineries including our share of production at ISAB and TRN increased by 59.3%, notwithstanding the fact that the production at our Romanian refinery was 7.4% lower due to overhaul performed at the refinery in January-February 2009 and decreased production at our Bulgarian refinery, which was 7.1% lower than in 2008 as a result of revision of 2009 production plan due to low refining margins.

In 2009, our share of refined products produced at ISAB amounted to 6,153 thousand tonnes (578 thousand tonnes in 2008) and our share in production of TRN amounted to 1,528 thousand tonnes.

In Russia LUKOIL holds the leading position in production of European standards motor fuel before the official terms of their obligatory implementation in the country. At our Russian refineries we produced 7,266, 7,224 and 7,218 thousand tonnes of Euro 4 and Euro 5 diesel fuel in 2009, 2008 and 2007, respectively. In 2009, 2008 and 2007 our production of Euro 3 gasoline amounted to 4,746, 4,191 and 852 thousand tonnes, respectively.

Along with our own production of refined products we refined crude oil at third party refineries. 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 are used for supplying our local retail network and for wholesale export.

The following table summarizes key figures for our refining activities.

	2009	2008	2007
	(millions of US dollars)		
Own refining expenses	923	1,115	880
- in Russia	671	780	651
- outside Russia	252	335	229
Refining expenses at ISAB and TRN.....	543	39	–
Refining expenses at third party refineries	170	400	242
- in Russia	126	341	214
- outside Russia	44	59	28
Capital expenditures.....	828	1,023	830
- in Russia	520	688	606
- outside Russia	308	335	224
	(thousand barrels per day)		
Refinery throughput at the Group refineries in Russia.....	889	881	851
Refinery throughput at the Group refineries outside Russia.....	210	231	193
Refinery throughput at the Group refineries.....	1,099	1,112	1,044
Refinery throughput at ISAB and TRN ⁽¹⁾	123	11	–
Refinery throughput at the Group and affiliated refineries	1,222	1,123	1,044
Refinery throughput at third party refineries in Russia	41	64	72
Refinery throughput at third party refineries outside Russia.....	36	46	21
Refinery throughput at third party refineries	77	110	93
Total refinery throughput	1,299	1,233	1,137
	(thousand of tonnes)		
Refined products produced at the Group refineries in Russia ⁽²⁾	42,408	42,067	40,381
Refined products produced at the Group refineries outside Russia.....	9,790	10,388	8,438
Total refined products produced at the Group refineries.....	52,198	52,455	48,819
The Group's share of the production of ISAB and TRN.....	7,681	578	–
Total refined products produced at the Group and affiliated refineries	59,879	53,033	48,819
Refined products produced at third party refineries in Russia.....	1,873	2,881	3,270
Refined products produced at third party refineries outside Russia	1,612	2,123	945
Total refined products produced at third party refineries	3,485	5,004	4,215

⁽¹⁾ Group's share.

⁽²⁾ Excluding mini refineries.

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 6.2 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.

	2009	2008	2007
	(millions of US dollars)		
Retail sales	13,146	17,812	12,904
Wholesale sales	41,843	58,602	43,833
Total refined products sales	54,989	76,414	56,737
	(thousand of tonnes)		
Refined products purchased in Russia.....	625	1,635	1,543
Refined products purchased internationally	41,445	38,743	38,745
Total refined products purchased.....	42,070	40,378	40,288

Exports of crude oil and refined products from Russia. In 2009, our export of crude oil from Russia was 6.9% more than in 2008, and we exported 45.9% of our total domestic crude oil production (43.8% in 2008 and 46.5% in 2007). This increase resulted from the commencement of production on the Yuzhnoye Khylochuyu oil field by our joint venture with ConocoPhillips, crude oil from which we export from Russia.

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

	2009		2008		2007	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Exports of crude oil using Transneft export routes	241,890	33,000	264,393	36,070	293,163	39,995
Exports of crude oil bypassing Transneft	66,109	9,019	23,639	3,225	15,818	2,158
Total crude oil exports.....	307,999	42,019	288,032	39,295	308,981	42,153

In 2009, the crude oil exported through our own export infrastructure was 8,712 thousand tonnes or over three times more than in 2008. This was due to export of crude oil produced from the Yuzhnoye Khylochuyu oil field (7.0 million tonnes in 2009) through our export terminal in Varandey.

In 2009, we exported from Russia 27.8 million tonnes of refined products, an increase of 7.7%, compared to 2008. We export from Russia primarily diesel fuel, fuel oil and gasoil. These products account for approximately 89.4% of our refined products export volumes.

In 2009, our revenue from export from Russia both to the Group companies and third parties amounted to \$17,485 million for crude oil and \$11,414 million for refined products.

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 2009, the Brent crude oil price fluctuated between \$39 and \$78 per barrel and reached its peak of \$78.86 in mid-November of 2009.

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 the second half of 2009, the crude oil price stabilized around \$70 per barrel. Expectations for economic recovery help to resist the negative impact of fundamental factors. According to IEA, global oil demand for 2010 is forecasted at 86.5 million barrels daily, which is 1.8% higher than in 2009.

Substantially all crude oil we export is Urals blend. The following table shows the average crude oil and refined product prices for 2009, 2008 and 2007.

	2009	Change to 2008, %	2008	Change to 2007, %	2007
(in US dollars per barrel, except for figures in percent)					
Brent crude.....	61.67	(36.6)	97.26	34.4	72.39
Urals crude (CIF Mediterranean) ⁽¹⁾	61.22	(35.4)	94.76	36.6	69.38
Urals crude (CIF Rotterdam) ⁽¹⁾	61.15	(35.5)	94.83	37.1	69.16
(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam).....	345.72	(24.8)	459.74	35.6	339.00
Diesel fuel 10 ppm (FOB Rotterdam).....	534.84	(40.7)	901.53	42.2	634.09
High-octane gasoline (FOB Rotterdam).....	579.01	(30.8)	836.79	20.2	695.97

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 2009, 2008 and 2007.

	2009	Change from 2008, %	2008	Change from 2007, %	2007
(in US dollars per metric tonne, except for figures in percent)					
Fuel oil.....	162.12	(32.1)	238.87	42.2	167.93
Diesel fuel.....	462.65	(37.8)	744.07	39.0	535.32
High-octane gasoline (Regular)	584.87	(22.2)	751.95	19.9	626.95
High-octane gasoline (Premium)	636.24	(26.0)	860.07	20.3	714.72

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 real devaluation of the ruble against the US dollar generally causes our costs to decrease in US dollar terms, and vice versa. The appreciation 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 12.4% in 2009, compared to 2008. The year-end ruble-dollar exchange rate exceeded the opening rate by 2.9%.

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

	2009	2008	2007
Ruble inflation (CPI), %	8.9	13.3	11.9
Change of the ruble-dollar exchange rate, %	(2.9)	(19.7)	6.8
Average exchange rate for the period (ruble to US dollar)	31.72	24.86	25.58
Exchange rate at the end of the period (ruble to US dollar)	30.24	29.38	24.55

Tax burden

Given the relative size of our activities in Russia, our tax profile is largely determined by the taxes payable in Russia (based on records maintained under Russian legislation – not US GAAP). In 2009, 2008 and 2007, the tax charge on the operations in Russia was approximately 81%, 86% and 86% of our total tax charge, respectively.

Apart of income tax, fundamental taxes specific to the oil industry in Russia are mineral extraction tax, excise and export tariffs. In addition to above mentioned taxes, we are subject to a number of other taxes in Russia, including:

- social taxes
- property tax
- VAT
- other local and regional taxes

The effective rates of total taxes and tariffs (total taxes, including income taxes, taxes other than on income and excise and export tariffs, divided by income before taxes and tariffs) for 2009, 2008 and 2007, respectively, were 75%, 81% and 75%. In 2009, tax expenses in Russia were about 43% of the domestic and export sales revenue of Russian companies of the Group.

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

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

		2009 ⁽¹⁾	Change to 2008, %	2008 ⁽¹⁾	Change to 2007, %	2007 ⁽¹⁾
Export tariffs on crude oil	\$/tonne	179.93	(49.3)	355.08	71.8	206.70
Export tariffs on refined products						
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	\$/tonne	133.54	(46.9)	251.53	65.9	151.59
Liquid fuels (fuel oil)	\$/tonne	71.93	(46.9)	135.51	66.0	81.64
Excise on refined products						
Straight-run gasoline	RUR/tonne	3,900.00	46.8	2,657.00	–	2,657.00
High-octane gasoline.....	RUR/tonne	3,629.00	–	3,629.00	–	3,629.00
Low-octane gasoline	RUR/tonne	2,657.00	–	2,657.00	–	2,657.00
Diesel fuel	RUR/tonne	1,080.00	–	1,080.00	–	1,080.00
Motor oils.....	RUR/tonne	2,951.00	–	2,951.00	–	2,951.00
Mineral extraction tax						
Crude oil	RUR/tonne	2,302.85	(30.8)	3,328.35	34.6	2,472.67
Natural gas	RUR/1,000 m ³	147.00	–	147.00	–	147.00

⁽¹⁾ Average values.

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

		2009 ⁽¹⁾	Change to 2008, %	2008 ⁽¹⁾	Change to 2007, %	2007 ⁽¹⁾
Excise on refined products						
Straight-run gasoline	\$/tonne	122.94	15.0	106.90	2.9	103.88
High-octane gasoline.....	\$/tonne	114.40	(21.7)	146.01	2.9	141.89
Low-octane gasoline	\$/tonne	83.76	(21.7)	106.90	2.9	103.88
Diesel fuel	\$/tonne	34.04	(21.7)	43.45	2.9	42.23
Motor oils.....	\$/tonne	93.02	(21.7)	118.73	2.9	115.38
Mineral extraction tax						
Crude oil	\$/tonne	72.59	(45.8)	133.91	38.5	96.68
Natural gas	\$/1,000 m ³	4.63	(21.7)	5.91	2.9	5.75

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

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

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

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

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

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

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

Crude oil and refined products exported to CIS countries, other than Ukraine and Belarus, are not subject to export duties. Crude oil exported from Russia to Belarus was subject to export duties calculated in 2009 with the application of a coefficient 0.356 (0.335 in 2008) 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 above this limit will be taxed at a regular export duty 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. Before 2009, operations in the Russian Federation were subject to an income tax rate up to 24%. The Federal income tax rate was 6.5% and the regional income tax rate varied from 13.5% to 17.5% at the discretion of the individual regional administrations. Starting on January 1, 2009, the Federal income tax rate was decreased to 2.0% and the regional income tax rate varies between 13.5% and 18.0%. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

Transportation of crude oil and refined products in Russia

The main Russian crude oil production regions are remote from the main crude oil and refined products markets. Therefore, access of crude oil production companies to the markets is dependent on the extent of diversification of 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 and it can be expanded up to 15 million tonnes per year.

Transportation of refined products in Russia is performed by railway transport and the pipeline system of OAO AK Transnefteproduct. 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.

Year ended December 31, 2009, compared to years ended December 31, 2008 and December 31, 2007

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

	2009	2008	2007
	(millions of US dollars)		
Revenues			
Sales (including excise and export tariffs)	81,083	107,680	81,891
Costs and other deductions			
Operating expenses	(7,124)	(8,126)	(6,172)
Cost of purchased crude oil, gas and products	(31,977)	(37,851)	(27,982)
Transportation expenses	(4,830)	(5,460)	(4,457)
Selling, general and administrative expenses	(3,306)	(3,860)	(3,207)
Depreciation, depletion and amortization	(3,937)	(2,958)	(2,172)
Taxes other than income taxes	(6,474)	(13,464)	(9,367)
Excise and export tariffs	(13,058)	(21,340)	(15,033)
Exploration expense	(218)	(487)	(307)
Loss on disposals and impairments of assets	(381)	(425)	(123)
Income from operating activities	9,778	13,709	13,071
Interest expense	(667)	(391)	(333)
Interest and dividend income	134	163	135
Equity share in income of affiliates	351	375	347
Currency translation (loss) gain	(520)	(918)	35
Other non-operating expense	(13)	(244)	(240)
Income before income taxes	9,063	12,694	13,015
Current income taxes	(1,922)	(4,167)	(3,410)
Deferred income taxes	(72)	700	(39)
Total income tax expense	(1,994)	(3,467)	(3,449)
Net income	7,069	9,227	9,566
Less: net income attributable to noncontrolling interests	(58)	(83)	(55)
Net income attributable to OAO LUKOIL	7,011	9,144	9,511
Basic and diluted earning per share of common stock attributable to OAO LUKOIL (in US dollars)	8.28	10.88	11.48

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

Sales revenues

Sales breakdown	2009	2008	2007
	(millions of US dollars)		
Crude oil			
Export and sales on international markets other than CIS	18,276	22,382	18,346
Export and sales to CIS.....	1,638	1,625	912
Domestic sales	735	600	440
	20,649	24,607	19,698
Refined products			
Export and sales on international markets			
Wholesale.....	38,023	50,553	37,971
Retail.....	8,865	11,989	9,183
Domestic sales			
Wholesale.....	3,820	8,049	5,862
Retail.....	4,281	5,823	3,721
	54,989	76,414	56,737
Petrochemicals			
Export and sales on international markets	574	1,232	1,569
Domestic sales	514	880	733
	1,088	2,112	2,302
Gas and gas products			
Export and sales on international markets	1,091	926	562
Domestic sales	548	985	831
	1,639	1,911	1,393
Other			
Export and sales on international markets	1,031	1,286	947
Domestic sales	1,687	1,350	814
	2,718	2,636	1,761
Total sales	81,083	107,680	81,891

Sales volumes	2009	2008	2007
Crude oil			
	(thousands of barrels)		
Export and sales on international markets other than CIS	305,273	242,784	268,974
Export and sales to CIS.....	39,106	31,629	19,879
Domestic sales	21,909	15,408	11,757
	366,288	289,821	300,610
Crude oil			
	(thousands of tonnes)		
Export and sales on international markets other than CIS	41,647	33,122	36,695
Export and sales to CIS.....	5,335	4,315	2,712
Domestic sales	2,989	2,102	1,604
	49,971	39,539	41,011
Refined products			
	(thousands of tonnes)		
Export and sales on international markets			
Wholesale.....	76,885	67,669	64,394
Retail.....	7,863	8,200	7,910
Domestic sales			
Wholesale.....	9,796	13,314	13,704
Retail.....	6,216	5,964	4,853
	100,760	95,147	90,861
Total sales volume of crude oil and refined products.....	150,731	134,686	131,872

Realized average sales prices

	2009		2008		2007	
	(\$/barrel)	(\$/tonne)	(\$/barrel)	(\$/tonne)	(\$/barrel)	(\$/tonne)
Average realized price international						
Oil (excluding CIS)	59.87	438.84	92.19	675.76	68.21	499.96
Oil (CIS)	41.89	307.05	51.38	376.58	45.86	336.15
Refined products						
Wholesale		494.55		747.06		589.66
Retail.....		1,127.44		1,462.14		1,160.90
Average realized price within Russia						
Oil.....	33.56	245.97	38.97	285.66	37.43	274.37
Refined products						
Wholesale		389.92		604.55		427.74
Retail.....		688.74		976.40		766.67

During 2009, our revenues decreased by \$26,597 million, or by 24.7%, compared to 2008 (in 2008 increased by \$25,789 million, or by 31.5%, compared to 2007). Our revenues from crude oil sales decreased by \$3,958 million, or by 16.1% (in 2008 increased by \$4,909 million, or by 24.9%, compared to 2007). Our revenues from sales of refined products decreased by \$21,425 million, or by 28.0% (in 2008 increased by \$19,677 million, or by 34.7%, compared to 2007). In 2009, the decrease in sales revenue was due to sharp decrease in hydrocarbon prices, compared to 2008. Moreover, the devaluation of the ruble against the US dollar also seriously affected our average realized prices in Russia.

At the same time, we increased crude oil production and trading, which raised our crude oil sales by 26.4% in terms of volumes. The increase in crude oil production was a result of commencement of production on the Yuzhnoye Khylychuyu oil field in August 2008, from which we produced about 7.0 million tonnes in 2009, compared to 1.5 million tonnes in 2008.

We also increased our refined product sales outside of Russia in terms of volumes by 11.7%, mainly due to commencement of processing at ISAB and TRN. In 2009, our share of production at these refineries amounted to 6.2 million tonnes and 1.5 million tonnes, respectively. In 2008, we produced 0.6 million tonnes at ISAB.

Sales of crude oil and refined products on international markets, including the CIS, accounted for 87.4% of the total sales volume in 2009 (84.1% in 2008 and 84.7% in 2007).

Sales of crude oil

2009 vs. 2008

Our total crude oil sales revenues decreased by 16.1%. We sell crude oil to third parties mostly outside Russia and CIS, the international sales revenue, which accounted for approximately 88.5% of our total crude oil sales revenue in 2009 and 91.0% in 2008, decreased by 18.3% due to a decrease in sales prices by 35.1%. At the same time, the volume of international crude oil sales increased by 25.7% due to increased crude oil trading and export from Russia.

In 2009, we increased the volume of domestic sales to benefit from current market conditions.

In 2009, our revenue from export of crude oil from Russia both to the Group companies and third parties amounted to \$17,485 million.

2008 vs. 2007

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

Sales of refined products

2009 vs. 2008

In 2009, our revenue from the wholesale of refined products outside of Russia decreased by \$12,530 million, or by 24.8%, compared to 2008, due to decreased average realized price by 33.8%. At the same time, commencement of crude oil refining at ISAB and TRN and expansion of trading activities led to an increase in volumes sold by 13.6%.

In 2009, our revenue from international retail sales decreased by \$3,124 million, or by 26.1%, compared to 2008, mainly due to a decrease in average retail prices by 22.9%. Sales volumes also decreased following the negative economic situation.

In 2009, our revenue from the wholesale of refined products on the domestic market decreased by \$4,229 million, or by 52.5%, compared to the previous year, due to a decrease in the average realized price by 35.5%, and a decrease in volumes sold by 3,518 thousand tonnes, or by 26.4%. The decrease in volume sold was a result of decreased domestic purchases and increased refined product exports from Russia by 7.7%.

In 2009, our revenue from retail sales in Russia decreased by \$1,542 million, or by 26.5%, compared to the 2008, due to a decrease in prices. In 2009, our retail sales revenue was 52.8% of total refined products sales in Russia (in 2008 – 42.0%).

In 2009, our revenue from export of refined products from Russia both to Group companies and third parties amounted to \$11,414 million.

2008 vs. 2007

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

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

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

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

Sales of petrochemical products

2009 vs. 2008

In 2009, our revenue from sales of petrochemical products decreased by \$1,024 million, or by 48.5%, compared to 2008. This resulted from a decrease in prices by 35.8% and a decrease in sales volumes by 19.7%. The decrease in volumes resulted from general overhauls at our Russian plants and a temporary shutdown of our petrochemical plant Karpatnaftochim Ltd. in Ukraine, which was stopped for modernization and construction of a chlorine and caustic production line in May 2008. Besides, the overall negative situation on the world petrochemical markets led to a decrease in sales volumes.

2008 vs. 2007

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

Sales of gas and gas products

2009 vs. 2008

In 2009, sales of gas and gas refined products decreased by \$272 million, or by 14.2%, compared to 2008. Gas products sales revenue decreased by \$158 million, or by 13.2%, primarily as a result of decrease in prices. Natural gas sales revenue amounted to \$571 million – a decrease of 17.2%, compared to 2008. Decrease in domestic sales volumes and selling prices were partly compensated by an increase in realized selling price in Uzbekistan.

Our major purchaser of natural gas produced in the Russian Federation is Gazprom. In 2009, we sold 5,936 million cubic meters of natural gas to Gazprom (7,856 million cubic meters in 2008). The average realized price decreased by 21.6% to \$33.4 per 1,000 cubic meters as a result of the ruble devaluation.

2008 vs. 2007

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

Sales of other products

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

2009 vs. 2008

In 2009, our other sales increased by \$82 million, or by 3.1%. The increase was a result of scaling up our power generating and distribution sector, which emerged in the Group with the acquisition of TGK-8 in May 2008. At the same time, this was partially offset by decrease in other sales outside of Russia primarily through retail stations and transportation services, and effect of devaluation of the ruble in Russia.

During 2009, sales of goods and other products from our retail stations amounted to \$568 million, a decrease of \$45 million from the level of 2008. This was mainly because of an overall decrease of such sales outside of Russia as a result of the adverse macroeconomic environment.

2008 vs. 2007

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

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

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

Operating expenses

Operating expenses include the following:

	2009	2008	2007
	(millions of US dollars)		
Hydrocarbon extraction expenses	2,787	3,208	2,757
Own refining expenses	923	1,115	880
Refining expenses at third parties and affiliated refineries.....	713	439	242
Excise included in processing fee paid to third parties refineries.....	54	116	158
Petrochemical expenses	127	235	272
Expenses on crude oil transportation to refineries.....	955	1,072	848
Other operating expenses	1,781	1,691	1,271
	7,340	7,876	6,428
Change in operating expenses in crude oil and refined products inventory originated within the Group ⁽¹⁾	(216)	250	(256)
Total operating expenses	7,124	8,126	6,172

⁽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 2008, operating expenses decreased by \$1,002 million, or by 12.3%, which is mainly explained by general decrease in operating expenses in Russia due to the ruble devaluation. At the same time, refining expenses at third party and affiliated refineries increased significantly due to the commencement of refining crude oil at ISAB at the end of 2008 and at TRN in September 2009.

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.

2009 vs. 2008

In 2009, our extraction expenses decreased by \$421 million, or by 13.1%, compared to 2008, despite increased crude oil production by 2.5% and an increase in expenses for power supply. The decrease was mainly a result of the effect of the real ruble devaluation against the US dollar. Our average hydrocarbon extraction cost decreased from \$4.12 to \$3.56 per BOE, or by 13.6%, compared to 2008.

2008 vs. 2007

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

Own refining expenses

2009 vs. 2008

In 2009, our refining expenses decreased by \$192 million, or by 17.2%, compared to 2008.

Refining expenses at our domestic refineries decreased by 14.2%, or by \$111 million, mainly as a result of the devaluation of the ruble against the US dollar and cost cutting program implemented since the fourth quarter of 2008. This was despite an increase in power supply and overhaul costs.

Refining expenses at our international refineries decreased by 24.3%, or by \$81 million. This resulted mainly from a decrease in the cost of power supply at our refinery in Bulgaria. In 2009, we produced energy from our own resources, while, in 2008, we purchased gas for this purpose from third party. Besides, decreased production and changes of the exchange rates of local currencies to the US dollar additionally decreased our refining expenses abroad.

2008 vs. 2007

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

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

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

Refining expenses at third party and affiliated refineries

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

2009 vs. 2008

Due to commencement of crude oil refining at ISAB and TRN we doubled the processing volumes compared to 2008. However, this was partially compensated by a decrease of processing costs and decreased volumes in Russia and Belarus. Thus, in 2009 refining expenses at third party and affiliated refineries increased by 62.4%, compared to 2008.

2008 vs. 2007

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

Petrochemical operating expenses

2009 vs. 2008

In 2009, operating expenses of our petrochemical companies decreased by \$108 million, or by 46.0%, compared to 2008, due to a general decrease of production volumes. In May 2008, we stopped our Ukrainian petrochemical plant Karpatnaftochim Ltd. for modernization and construction of a chlorine and caustic production line.

2008 vs. 2007

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

Expenses for crude oil transportation to refineries

2009 vs. 2008

Expenses for crude oil transportation to refineries decreased in 2009 by \$117 million, or by 10.9%, compared to 2008, due to a decrease in transportation tariffs as a result of a real ruble devaluation in Russia (see Transportation expenses below), and change in crude oil supply structure – an increase in the proportion of crude oil we purchased from third parties. The price of purchased crude oil typically includes transportation costs, and the crude oil is purchased from a source geographically closer to the destination refinery than crude oil from our own production.

2008 vs. 2007

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

Other operating expenses

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

2009 vs. 2008

In 2009, our other operating expenses increased by \$90 million, or by 5.3%, compared to 2008. The increase was a result of scaling up our power generating and distribution sector, which emerged in the Group with the acquisition of TGK-8 in May 2008. However, this was partially compensated by the ruble devaluation, decrease in expenses related to other sales through petrol stations and transportation services outside of Russia.

2008 vs. 2007

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

Cost of purchased crude oil, gas and products

2009 vs. 2008

Cost of purchased crude oil, gas and products decreased by \$5,874 million in 2009, or by 15.5%, compared to 2008, due to a decrease in international crude oil and refined products prices. The effect of decreased prices was partly compensated by an increase in purchases due to scaling up trading operations outside of Russia, especially in the fourth quarter of 2009.

Cost of purchased crude oil, gas and products includes the result of hedging of international crude oil and refined products sales. In 2009, we recognized a \$781 million expense from hedging, compared to a \$902 million gain in 2008.

2008 vs. 2007

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

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

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

Transportation expenses

2009 vs. 2008

In 2009, our transportation expenses decreased by \$630 million, or by 11.5%, compared to 2008. This was primarily due to a decrease in freight rates and railway transportation tariffs in Russia. It should be noted that ruble denominated transportation tariffs in Russia increased in 2009, but this increase was offset by the ruble devaluation.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed in 2009, compared to the previous year, as follows: crude oil pipeline tariffs increased by 8.9%, railway tariffs for refined products transportation decreased by 10.9%, crude oil and refined products freight rates decreased by 42.3% and 50.1%, respectively.

2008 vs. 2007

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

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

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.

2009 vs. 2008

In 2009, our selling, general and administrative expenses decreased by \$554 million, or by 14.4%, compared to 2008. The decrease was primarily due to the devaluation of the ruble. Nevertheless, this was partially offset by the increase of expenses for creation of allowance for bad debts and the effect of changes in the Group's structure.

2008 vs. 2007

In 2008, our selling, general and administrative expenses increased by \$653 million, or by 20.4%, compared to 2007. The growth was mainly due to real ruble appreciation, expansion of our activities both in Russia and internationally, and an overall increase in selling expenses.

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.

2009 vs. 2008

Our depreciation, depletion and amortization expenses increased by \$979 million, or by 33.1%, compared to 2008. The increase was a result of the Company's capital expenditures and the corresponding increase in depreciable assets, in particular due to putting in production the Yuzhnoye Khylychuyu oil field.

2008 vs. 2007

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

Exploration expenses

2009 vs. 2008

During 2009, exploration expense decreased by \$269 million, or by 55.2%, compared to 2008. Dry hole costs decreased by \$200 million to \$117 million.

In 2009, we charged to expense the cost of a dry well in Saudi Arabia totaling \$56 million. Also, we expensed dry hole costs related to our project in Azerbaijan in the amount of \$9 million.

In 2009, we charged to expense \$30 million as idle costs related to first phase of drilling an exploratory well in Ghana.

Dry hole costs in Russia amounted to \$22 million, primarily relating to Western Siberia.

2008 vs. 2007

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

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

Interest expense

2009 vs. 2008

In 2009, interest expense amounted to \$667 million, which is 70.6% more than in the previous year. This was a result of the termination of interest capitalization related to assets in Timan-Pechora after completion of their construction and a general increase in our indebtedness and cost of borrowings due to unfavorable situation on capital markets (see Liquidity and capital resources – Financing activities).

2008 vs. 2007

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

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. In 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%.

2009 vs. 2008

Compared to 2008, our share in income of affiliates decreased by \$24 million, or by 6.4%.

2008 vs. 2007

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

Currency translation (loss) gain

2009 vs. 2008

In 2009, currency translation loss amounted to \$520 million, of which \$437 million refer to the Russian segment of the Group, and \$83 million – to the international segment.

2008 vs. 2007

In 2008, currency translation loss amounted to \$918 million, of which \$631 million refer to the Russian segment of the Group, and \$287 million – to the international segment. Those losses mostly refer to the fourth quarter results.

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

Taxes other than income taxes

	2009	2008	2007
	(millions of US dollars)		
In Russia			
Mineral extraction taxes.....	5,399	12,267	8,482
Social security taxes and contributions	330	435	385
Property tax.....	438	374	284
Other taxes	92	180	105
Total in Russia.....	6,259	13,256	9,256
International			
Mineral extraction taxes.....	53	–	–
Social security taxes and contributions	69	77	57
Property tax.....	32	31	29
Other taxes	61	100	25
Total internationally	215	208	111
Total	6,474	13,464	9,367

2009 vs. 2008

In 2009, taxes other than income taxes decreased by 51.9%, or by \$6,990 million, compared to 2008, mainly due to a decrease in mineral extraction taxes in Russia. This is explained by a decrease in the tax rate resulting from the low level of crude oil prices. Moreover, the change in the tax rate calculation effective from January 1, 2009 led to approximately \$754 million decrease in the extraction taxes. Effect from the application of the zero tax rate for crude oil produced mainly in Timan-Pechora and Western Siberia and decreased rate for depleted oilfields led to approximately \$961 million tax reduction.

2008 vs. 2007

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

Excise and export tariffs

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

	2009	2008	2007
	(millions of US dollars)		
In Russia			
Excise tax and sales taxes on refined products.....	763	956	734
Crude oil export tariffs	6,251	11,911	8,160
Refined products export tariffs.....	2,306	4,119	2,654
Total in Russia.....	9,320	16,986	11,548
International			
Excise tax and sales taxes on refined products.....	3,524	3,984	3,468
Crude oil export tariffs	107	143	–
Refined products export tariffs.....	107	227	17
Total internationally	3,738	4,354	3,485
Total	13,058	21,340	15,033

2009 vs. 2008

In spite of an increase in crude oil and refined products export volumes, export tariffs decreased by \$7,629 million, or by 46.5%, compared to 2008, due to the decrease in tariff rates in Russia because of the crude oil prices decline. The decrease in excises in Russia was due to the ruble devaluation. Despite the fact that the changes in the Group structure contributed \$101 million to the excise increase, our international excises decreased by \$460 million, or by 11.5%, compared to 2008. Such a fall was a result of a decrease in sales volumes of refined products subject to excise taxes and decrease in excise rates, caused mainly by the changes of the exchange rates of local currencies to the US dollar.

2008 vs. 2007

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

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

Loss on disposals and impairments of assets

2009 vs. 2008

In 2009, loss on disposals and impairments of assets amounted to \$381 million, compared to \$425 million in 2008.

As a result of an impairment test of exploration and production assets performed in December 2009, the Company recognized an impairment loss of \$238 million for certain properties in the Timan-Pechora and Central European regions of Russia. The Group also recognized an impairment loss in amount of \$63 million related to our project in Iran due to incapability of undertaking further works because of the threat of economic sanctions of the US Government. Besides, we charged to expense \$33 million related to realization of Atashsky project in Kazakhstan.

2008 vs. 2007

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

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

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

Income taxes

2009 vs. 2008

In 2009, our total income tax expense decreased by \$1,473 million, or by 42.5%, compared to 2008, due to the decrease in income before income tax by \$3,631 million, or by 28.6%.

In 2009, our effective income tax rate was 22.0%, compared to 27.3% in 2008, which is higher than the maximum statutory rate for the Russian Federation (20% in 2009 and 24% in 2008).

2008 vs. 2007

In 2008, our total income tax expense increased by \$18 million, or by 0.5%, compared to 2007.

In 2008, our effective income tax rate was 27.3%, compared to 26.5% in 2007, which is higher than the maximum statutory rate for the Russian Federation (24%).

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

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

	2009	2008	2007
	(millions of US dollars)		
Net income	7,011	9,144	9,511
Add back:			
Income tax expense.....	1,994	3,467	3,449
Depreciation and amortization	3,937	2,958	2,172
Interest expense.....	667	391	333
Interest and dividend income	(134)	(163)	(135)
EBITDA	13,475	15,797	15,330

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

	2009	2008	2007
	(millions of US dollars)		
Net cash provided by operating activities	8,883	14,312	10,881
Net cash used in investing activities	(8,923)	(13,559)	(9,715)
Net cash provided by (used in) financing activities	87	763	(1,098)

Operating activities

Our primary source of cash flow is funds generated from our operations. During 2009, cash generated by operating activities was \$8,883 million, or 37.9% less than in 2008, mainly due to the decrease in sales revenues. Besides, in 2009, our operating cash inflows were affected by an increase of working capital by \$2,483 million, compared to January 1, 2009. This was mainly caused by:

- a \$897 million net increase in trade accounts receivable and payable
- an increase in inventory of \$1,719 million, resulting mainly from increased hydrocarbons prices
- a \$141 million net increase in tax accounts receivable and payable

At the same time, the negative effect from the above mentioned factors was partly offset by a \$274 million net decrease in other assets and liabilities.

Investing activities

The decrease in cash used in investing activities resulted from a decrease in cash spent on capital expenditures. In 2009, our capital expenditures decreased by \$4,042 million, or by 38.4%, compared to 2008 (for a detailed analysis of capital expenditures see a later section).

In 2009, we paid the remaining amount of \$1,066 million for the acquisition of a 49% stake in ISAB, we paid \$127 million for the remaining interests in TGK-8. We also made a payment of approximately \$600 million within the acquisition of 45% interest in TRN, settled a \$305 million liability within the acquisition of Akpet group and paid \$244 million for increasing our share in RITEK. We also paid \$300 million as a first installment of the acquisition of the remaining 46% interest in LUKARCO. Other payments for acquisitions refer to advances for downstream assets in Russia.

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

Financing activities

In 2009, net movements of short-term and long-term debt generated an inflow of \$1,489 million, compared to an inflow of \$2,311 million in 2008.

In December 2009, the Company issued stock exchange bonds worth 10 billion rubles. The bonds will mature after 1,092 days and have a coupon period of 182 days. The coupon rate is set at 9.20% per annum.

In November 2009, a Group company issued two-tranche non-convertible bonds totaling \$1.5 billion. The first tranche totaling \$900 million with a coupon yield of 6.375% per annum was placed with a maturity of 5 years at a price of 99.474% of the bond's face value. The resulting yield to maturity for the first tranche is 6.500%. The second tranche totaling \$600 million with a coupon yield of 7.250% per annum was placed with a maturity of 10 years at a price of 99.127% of the bond's face value. The resulting yield to maturity for the second tranche is 7.375%. These tranches have a half year coupon period.

In August 2009, we raised a \$1.2 billion syndicated term loan facility. This three-year loan bears interest at LIBOR plus 4% per annum and is secured by proceeds from our oil export contracts. The proceeds from this loan were used to repay a €1,000 million loan from Gazprombank, which we borrowed in February 2009.

In August 2009, we issued stock exchange bonds in the amount of 25 billion rubles with a coupon rate of 13.35% per annum. The bonds will mature in three years. The proceeds from the issuance were used to repay the majority of our \$500 million and 17 billion ruble loans from Sberbank, which we borrowed in February 2009.

In June 2009, we completed offering of three series of issued stock exchange bonds, altogether worth 15 billion rubles. Coupon rate for each of the issues was set at 13.5%. The bonds will mature in 364 days.

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. We have since repaid these loans.

Credit rating

In 2009, Standard & Poor's Ratings Services affirmed its long-term corporate credit rating and all debt ratings on the Company at BBB- with stable outlook.

In 2009, Moody's affirmed the Company's long-term corporate family rating and long-term issuer rating of Baa2 with stable outlook.

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

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

Analysis of capital expenditures

	2009	2008	2007
	(millions of US dollars)		
Capital expenditures⁽¹⁾			
Exploration and production			
Russia.....	3,916	6,813	6,391
International.....	771	1,076	871
Total exploration and production.....	4,687	7,889	7,262
Refining, marketing and distribution			
Russia.....	832	1,377	1,177
International.....	559	773	645
Total refining, marketing and distribution.....	1,391	2,150	1,822
Chemicals			
Russia.....	13	23	73
International.....	100	98	98
Total chemicals.....	113	121	171
Other.....	343	429	117
Total capital expenditures.....	6,534	10,589	9,372
Acquisitions of subsidiaries and minority shareholding interest⁽²⁾			
Exploration and production			
Russia.....	244	4	77
International.....	300	357	357
Total exploration and production.....	544	361	434
Refining, marketing and distribution			
Russia.....	213	636	685
International.....	2,069 ⁽³⁾	1,397	511
Total refining, marketing and distribution.....	2,282	2,033	1,196
Other.....	138	3,194 ⁽⁴⁾	38
Less cash acquired.....	(19)	(190)	(102)
Total acquisitions.....	2,945	5,398	1,566

⁽¹⁾ Including non-cash transactions and prepayments.

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

⁽³⁾ Including \$100 million of non-cash part of consideration for acquisition of TRN.

⁽⁴⁾ Including \$1,969 million of non-cash part of consideration for acquisition of TGK-8.

During 2009, our capital expenditures, including non-cash transactions, amounted to \$6,534 million, which is 38.3% less than in 2008. The decrease was in compliance with our plan to reduce capital expenditures in 2009 because of the economic downturn. Capital expenditures in our exploration and production segment decreased by \$3,202 million, or by 40.6%, compared to 2008. The exploration and production capital expenditures in new regions decreased by \$1,411 million mainly due to commencement of commercial production on the Yuzhnoye Khylochuyu oil field. In the traditional exploration and production regions of Western Siberia and European Russia capital expenditures decreased by \$1,004 million and \$555 million, respectively. The decrease in the capital expenditures in our international exploration projects (excluding the Caspian region) amounted to \$232 million and was primarily related to our projects in Kazakhstan and Saudi Arabia.

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

	2009	2008	2007
	(millions of US dollars)		
Northern Timan-Pechora.....	385	1,878	2,357
Yamal.....	131	161	75
Caspian region ⁽¹⁾	532	420	441
Total	1,048	2,459	2,873

⁽¹⁾ Russian and international projects.

Following negative trends on international hydrocarbon markets the Company optimized its capital expenditure program for 2009, shifting it from originally expected \$11.2 billion down to \$6.5 billion. In case of continuing decline in crude oil prices the Company is flexible enough to further reduce capital expenditures and maintain its solid financial health.

Contractual obligations, other contingencies and off balance sheet arrangements

Capital commitments and contractual obligations

The Group owns and operates refineries in Bulgaria (LUKOIL Neftochim Bourgas AD) and Romania (Petrotel-LUKOIL S.A.). As a result of Bulgaria and Romania joining the European Union in 2007, LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL S.A. are required to upgrade their refining plants to comply with the requirements of European Union legislation in relation to the quality of produced petroleum products and environmental protection. These requirements are stricter than those which previously existed under Bulgarian and Romanian legislation. The Group estimates the amount of future capital commitment required to upgrade LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL S.A. to be approximately \$49 million and \$44 million, respectively.

Under the terms of existing exploration and production license agreements in Russia the Group has to fulfill certain operations: oil and gas exploration, wells drilling, fields development, etc., and the Group also has commitments to reach a defined level of extraction on the fields. Management believes that the Group's approved annual capital expenditure budgets fully cover all the requirements of the described license obligations.

Group companies have commitments for capital expenditure contributions in the amount of \$565 million related to various production sharing agreements over the next 28 years.

The Company has signed a three-year agreement for drilling services with OOO Eurasia Drilling Company. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for 2010 to be approximately \$610 million.

The Company has signed a strategic agreement for the ongoing provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for 2010 to be approximately \$126 million.

The Group has a commitment to purchase equipment for modernization of its petrochemical refinery Karpatnaftochim Ltd., located in Ukraine, during next two years in the amount of \$55 million.

The Group has a commitment to execute the capital construction program of TGK-8 and under the terms of this program power plants with total capacity of 890 MW should be constructed. Currently the Group is approving certain amendments to the capital construction program, which included its extension by the end of 2013. As of December 31, 2009, the Group estimates the amount of this commitment to be approximately \$944 million.

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

(millions of US dollars)	Total	2010	2011	2012	2013	2014	After
On balance sheet							
Short term debt	519	519	–	–	–	–	–
Long-term bank loans and borrowings	3,967	911	1,515	881	268	134	258
Long-term non-bank loans and borrowings.....	76	11	16	4	6	21	18
Long-term loans and borrowings from related parties	1,939	45	53	42	32	24	1,743
6.375% Non-convertible US dollar bonds, maturing 2014	895	–	–	–	–	895	–
6.356% Non-convertible US dollar bonds, maturing 2017	500	–	–	–	–	–	500
7.250% Non-convertible US dollar bonds, maturing 2019	595	–	–	–	–	–	595
6.656% Non-convertible US dollar bonds, maturing 2022	500	–	–	–	–	–	500
13,50% Russian ruble bonds	496	496	–	–	–	–	–
7.10% Russian ruble bonds, maturing 2011	265	–	265	–	–	–	–
13.35% Russian ruble bonds, maturing 2012 ..	827	–	–	827	–	–	–
9.20% Russian ruble bonds, maturing 2012	331	–	–	331	–	–	–
7.40% Russian ruble bonds, maturing 2013	198	–	–	–	198	–	–
Capital lease obligations.....	215	76	41	20	20	20	38
TOTAL	11,323	2,058	1,890	2,105	524	1,094	3,652
Off balance sheet							
Operating lease obligations	974	276	172	135	104	93	194
Capital commitment in LUKOIL-Neftochim Bourgas AD.....	49	49	–	–	–	–	–
Capital commitment in LUKOIL-Petrotel.....	44	1	17	1	12	13	–
Commitment for modernization of the petrochemical refinery in Ukraine.....	55	52	3	–	–	–	–
Capital commitments in PSAs	565	399	102	27	2	2	33
Capital commitments in TGK-8	944	307	339	184	114	–	–
Obligation under contract with Eurasia Drilling Company.....	610	610	–	–	–	–	–
Obligation under contract with ZAO Globalstroy-Engineering	126	126	–	–	–	–	–

Litigation and claims

On November 27, 2001, Archangel Diamond Corporation (“ADC”), a Canadian diamond development company, filed a lawsuit in the District Court of Denver, Colorado against OAO Archangelskgeoldobycha (“AGD”), a Group company, and the Company (together the “Defendants”). ADC alleged that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. ADC claimed total damages of approximately \$4.8 billion, including compensatory damages of \$1.2 billion and punitive damages of \$3.6 billion. On October 15, 2002, the District Court dismissed the lawsuit for lack of personal jurisdiction. This ruling was upheld by the Colorado Court of Appeals on March 25, 2004. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts’ ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was dismissed from the lawsuit. The Supreme Court found, however, that the trial court made a procedural error by failing to hold an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company, which is whether the Company had systematic and continuous contacts in the State of Colorado at the time the lawsuit was filed. In a modified opinion dated December 19, 2005, the Colorado Supreme Court remanded the case to the Colorado Court of Appeals (instead of the District Court) to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). On June 29, 2006, the Colorado Court of Appeals declined to dismiss the case based on forum non conveniens. The Company filed a petition for certiorari on August 28, 2006, asking the Colorado Supreme Court to review this decision. On March 5, 2007, the Colorado Supreme Court remanded the case to the District Court. On June 11, 2007, the District Court ruled it would conduct an evidentiary hearing on the issue of whether the Company is subject to general personal jurisdiction in the State of Colorado. Discovery regarding jurisdiction was commenced. On June 26, 2009, three creditors of ADC filed an Involuntary Bankruptcy Petition putting ADC into bankruptcy. ADC ultimately confirmed entry of an Order For Relief and the matter was converted to a Chapter 11 Case by order dated September 29, 2009. On November 25, 2009, after adding a claim, ADC removed the case from the Colorado District Court to the US Bankruptcy Court. On December 22, 2009, the Company filed a motion seeking to have the case remanded to the Colorado District Court. On December 31, 2009, before there was a ruling on the motion seeking remand ADC filed a motion seeking withdrawal of the reference from the bankruptcy and the case be heard by US District Court. On February 3, 2010, the US Bankruptcy Court ordered the Motion For Withdrawal Of The Reference be transferred to the US District Court for further action. All pending motions as well as discovery are stayed pending further order of the Court. Management plans to vigorously defend the matter. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group’s financial condition.

In 2008 and 2009, the Federal Anti-monopoly Service of the Russian Federation (“FAS of Russia”) issued two decisions against major Russian oil companies, including the Company and the Group’s refinery plants alleging abuse of their dominant position in the oil products wholesale market of the Russian Federation.

The Moscow Arbitration Court combined all refinery plants’ appeals against the first decision. The next appeal hearing was scheduled for April 8, 2010.

The second decision of FAS of Russia was appealed by the refinery plants in their local courts. On February 8, 2010, the Arbitration Court of Nizhi Novgorod Region satisfied the request of OOO LUKOIL-Nizhnegorodnefteorgsintez to recognize as illegal the decisions of FAS of Russia dated September 10, 2009 and the resolution to impose fines in the amount of \$80 million. The appeals of the other refinery plants are currently suspended.

In the second half of 2008 and first half of 2009, the FAS of Russia filed claims against several Group companies in relation to violation of the anti-monopoly regulation. The companies were accused of violations primarily involving abuse of their dominant market position via setting monopolistically high retail prices in coordination with other market participants. These claims are being appealed in the courts.

The total amount of penalties assessed under the administrative law for the violation of anti-monopoly regulation by the Group in 2008-2009 is \$290 million. Management believes that the Group complied with all regulatory and legal requirements and, consequently, believes that the ultimate resolution of the antimonopoly claims will lead to cancellation or significant reduction of these penalties and will not have a material adverse impact on the Group’s operating results or financial condition.

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

Critical accounting policies

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

Business combinations

Purchase price allocation

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

Principles of consolidation

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

Revenue recognition

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

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

Successful efforts accounting for oil and gas activities

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

Property acquisition costs

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

Exploratory costs

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

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

Proved oil and gas reserves

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

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

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. The Subsoil Law of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. Since the law applies both to newly issued and old licenses and the Group has currently renewed nearly 50% of its licenses, management believes that licenses will be renewed upon their expiration for the remainder of the economic life of each respective field.

Impairment of long-lived assets

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

Deferred income taxes

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

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

Asset retirement obligations

Under various laws, contracts, permits and regulations, the Group has legal obligations to remove tangible equipment and restore the land or seabed at the end of operations at production sites. The largest asset retirement obligations of the Group relate to wells and oil and gas production facilities and pipelines. The Group records the fair value of liabilities associated with such obligations when incurred. Estimating the future asset retirement obligations costs necessary for this accounting calculation involves significant estimates and judgments by management. Most of these obligations are many years in the future and the contracts and regulations often have vague descriptions of what removal practices and criteria will have to be met when the removal event actually occurs. Asset removal technologies and costs are constantly changing, as well as political, environmental, safety and public relations considerations.

Contingencies

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

Use of derivative instruments

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

Recent accounting pronouncements

In February 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-09, “*Subsequent events*” which amends Accounting Standards Codification (ASC) No. 855 (former SFAS No. 165, “*Subsequent events*”), issued in May 2009. The Group adopted ASC No. 855 starting from the second quarter of 2009. These standards address accounting and disclosure requirements related to subsequent events and require management of an entity which is an SEC filer or is a conduit bond obligator for conduit securities that are traded in a public market to evaluate subsequent event through the date that the financial statements are issued. Entities that do not meet these criteria should evaluate subsequent events through the date the financial statements are available to be issued and are required to disclose the date through which subsequent events have been evaluated. The Group determined that it should evaluate subsequent events through the date the financial statements are available to be issued and applied the requirements of ASU No. 2010-09 starting from the financial statements for 2009.

In January 2010, the FASB issued ASU No. 2010-01, “*Accounting for Distributions to Shareholders with Components of Stock and Cash*” which addresses how an entity should account for the stock portion of a dividend in certain arrangements when a shareholder makes an election to receive cash or stock, subject to limitations on the amount of the dividend to be issued in cash. The stock portion of the dividend should be accounted for as a stock issuance upon distribution, resulting in basic earnings per share being adjusted prospectively. Prior to distribution, the entity’s obligation to issue shares would be reflected in diluted earnings-per-share based on the guidance in ASC No. 260, which addresses contracts that may be settled in shares. This ASU is effective for interim and annual periods ending after December 15, 2009. The Group adopted ASU No. 2010-01 for the 2009 annual financial statements. This adoption did not have a material impact on the Group’s results of operations, financial position or cash flows.

In January 2010, the FASB issued ASU No. 2010-02, “*Accounting and Reporting for Decreases in Ownership of a Subsidiary - A Scope Clarification*” to clarify the scope of ASC Subtopic No. 810-10, “*Consolidation – Overall.*” This ASU specifies that the guidance in ASC Subtopic No. 810-10 on accounting for decreases in ownership of a subsidiary applies to: (1) a subsidiary or group of assets that constitutes a business or nonprofit activity; (2) a subsidiary that is a business or a nonprofit activity that is transferred to an equity method investee or a joint venture; and (3) an exchange of a group of assets that constitute a business or nonprofit activity for a noncontrolling interest in an entity. If a company’s ownership interest in a subsidiary that is not a business or nonprofit activity decreases, then other accounting guidance generally would be applied based on the nature of the transaction. The new pronouncement also clarifies that the recent guidance on accounting for decreases in ownership of a subsidiary does not apply if the transaction is a sale of in-substance real estate or a conveyance of oil and gas properties. This ASU is effective for interim and annual periods ending after December 15, 2009 and the guidance should be applied on a retrospective basis to the first period in which the company adopted ASC No. 810. The Group adopted ASU No. 2010-02 for the 2009 annual financial statements. This adoption did not have a material impact on the Group’s results of operations, financial position or cash flows.

In January 2010, the FASB issued ASU No. 2010-03, “*Extractive activities — Oil and Gas (Topic 932): Oil and Gas Reserve Estimation and Disclosures*”. The main provisions of ASU No. 2010-03 are the following: (1) expanding the definition of oil- and gas-producing activities to include the extraction of saleable hydrocarbons, in solid, liquid, or gaseous state, from oil sands, shale, coalbeds, or other nonrenewable resources that are intended to be upgraded into synthetic oil or gas, and activities undertaken with a view to such extraction; (2) entities should use first-day-of-the-month price during the 12-month period (the 12-months average price) in calculating proved oil and gas reserves and estimating related standardized measure of discounted net cash flows; (3) requiring entities to disclose separately information about reserves quantities and financial statement amounts for geographic areas that represent 15 percent or more of proved reserves; (4) separate disclosure for consolidated entities and equity method investments. ASU No. 2010-03 is effective for annual reporting periods ending on or after December 31, 2009. The Group adopted ASU No. 2010-03 for the 2009 annual financial statements. This adoption did not have a material impact on the Group’s reported reserves evaluation, results of operations, financial position or cash flows.

In June 2009, the FASB issued amendments to ASC No. 810 (former FASB Interpretation No. 46(R), “*Consolidation of Variable Interest Entities*”) to address the effects of the elimination of the qualifying special purpose entity concept. More specifically, it requires a qualitative rather than a quantitative approach to determine the primary beneficiary of a variable interest entity, it amends certain guidance pertaining to the determination of the primary beneficiary when related parties are involved, and it amends certain guidance for determining whether an entity is a variable interest entity. Additionally, these amendments require continuous assessment of whether an enterprise is the primary beneficiary of a variable interest entity. Amendments are effective on January 1, 2010, and the Group does not expect any material impact on its results of operations, financial position or cash flows upon adoption.

In June 2009, the FASB issued ASC No. 105 (former SFAS No. 168, “*The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles*”). The FASB Accounting Standards Codification (“Codification”) is the exclusive authoritative reference for US GAAP recognized by the FASB and applied by nongovernmental entities, except for SEC rules and interpretive releases, which are also authoritative US GAAP for SEC registrants. The change established by ASC No. 105 divides nongovernmental US GAAP into authoritative Codification and guidance that is not authoritative. The contents of the Codification carry the same level of authority, eliminating the four-level US GAAP hierarchy previously set forth in SFAS No. 162. The Codification supersedes all non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in the Codification became nonauthoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Group adopted ASC No. 105 starting from the third quarter of 2009. This adoption did not have any impact on the Group’s results of operations, financial position or cash flows.

In December 2008, the FASB amended ASC Nos. 310, 320, 323, 405, 460, 470, 712, 715, 810, 815, 860, 954 and 958 (former FSP FAS 140-4 and FIN 46(R)-8, “*Disclosures about Transfers of Financial Assets and Interest in Variable Interest Entities*”). It requires additional disclosures about transfers of financial assets and requires public entities, including sponsors that have a variable interest in a variable interest entity, to provide additional disclosures about their involvement with variable interest entities. The Group adopted new provisions starting from the fourth quarter of 2008. This adoption did not have a material impact on the Group’s results of operations, financial position or cash flows.

In March 2008, the FASB issued ASC No. 815 (former SFAS No. 161, “*Disclosures about Derivative Instruments and Hedging Activities*”). This ASC improves financial reporting about derivative instruments and hedging activities by enhanced disclosures of their effects on an entity’s financial position, financial performance and cash flows. The Group adopted the provisions of ASC No. 815 starting from the first quarter of 2009. This adoption did not have any impact on the Group’s results of operations, financial position or cash flows.

In December 2007, the FASB issued ASC No. 805 (former SFAS No. 141 (Revised), “*Business combinations*”). This ASC applies to all transactions in which an entity obtains control of one or more businesses. In April 2009, this ASC was amended and requires an entity to recognize the total fair value of assets acquired and liabilities assumed in a business combination; to recognize and measure the goodwill acquired in the business combination or gain from a bargain purchase and modifies the disclosure requirements. The Group adopted the provisions of ASC No. 805 for business combinations for which the acquisition date is after December 31, 2008. This adoption did not have any impact on the Group’s results of operations, financial position or cash flows.

In December 2007, the FASB issued ASC No. 810 (former SFAS No. 160, “*Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51*”). This ASC applies to all entities that prepare consolidated financial statements (except not-for-profit organizations) and affects those which have an outstanding noncontrolling interest (or minority interest) in their subsidiaries or which have to deconsolidate a subsidiary. This ASC changes the classification of a non-controlling interest; establishing a single method of accounting for changes in the parent company’s ownership interest that does not result in deconsolidation and requires a parent company to recognize a gain or loss when a subsidiary is deconsolidated. The Group prospectively adopted the provisions of ASC No. 810 in the first quarter of 2009, except for the presentation and disclosure requirements which were applied retrospectively. This adoption did not have any impact on the Group’s results of operations, financial position or cash flows.

In February 2007, the FASB issued ASC Nos. 470, 825 and 954 (former SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities*”). These ASC expands the possibility of using fair value measurements and permits enterprises to choose to measure certain financial assets and financial liabilities at fair value. Enterprises shall report unrealized gains and losses on items for which the fair value option has been elected in earnings in each subsequent period. The Group adopted the provisions of ASC Nos. 470, 825 and 954 in the first quarter of 2008 and elected not to use the fair value option for its financial assets and financial liabilities not already carried at fair value in accordance with other standards. This adoption did not have any impact on the Group’s results of operations, financial position or cash flows.

In September 2006, the FASB issued ASC No. 820 (former SFAS No. 157, “*Fair Value Measurements*”), which establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair value measurements. Effective January 1, 2009, the Group fully adopted ASC No. 820. Because there usually is a lack of quoted market prices for long-lived assets, the Group determines fair value using the present value of estimated future net cash flows from using these assets or by using historical data of market transactions with similar assets where possible. Fair value used in the initial recognition of asset retirement obligations is determined using the present value of expected future dismantlement costs, which are estimated based on the costs for dismantlement services for similar assets providing by third parties. This adoption did not have a material impact on the Group’s results of operations, financial position or cash flows.

Forward-looking statements

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

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

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

These factors include:

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

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