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, 2010, and each of the years ended December 31, 2010, 2009 and 2008, and significant trends that may affect its future performance. It should be read in conjunction with our US GAAP consolidated financial statements and notes and supplemental oil and gas disclosure.

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

This report includes forward-looking statements – words such as "believes," "anticipates," "expects," "estimates," "intends," "plans," etc. – that reflect management's current estimates and beliefs, but are not guarantees of future results. Please see "Forward-looking statement" on page 39 for a discussion of some of the factors that could cause actual results to differ materially.

Key financial and operational results

	2010	Change to 2009, %	2009	Change to 2008, %	2008
Sales (millions of US dollars)	104,956	29.4	81,083	(24.7)	107,680
Net income attributable to OAO LUKOIL (millions of US dollars)	9,006	28.5	7,011	(23.3)	9,144
EBITDA (millions of US dollars)	16,049	19.1	13,475	(14.7)	15,797
Taxes other than income taxes, excise and export tariffs (millions of US dollars)	(27,856)	42.6	(19,532)	(43.9)	(34,804)
Basic earning per share of common stock attributable to OAO LUKOIL (US dollars)	10.95	32.2	8.28	(23.9)	10.88
Diluted earning per share of common stock attributable to OAO LUKOIL (US dollars)	10.94	32.1	8.28	(23.9)	10.88
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	817,335	1.2	807,301	0.5	803,109
Crude oil production by the Group including our share in equity affiliates (thousands of tonnes)	95,992	(1.7)	97,615	2.5	95,240
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	18,554	24.5	14,898	(12.5)	17,020
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes)	63,596	6.2	59,879	12.9	53,033
Hydrocarbon proved reserves including our share in equity affiliates (millions of BOE)	17,254	(1.4)	17,504	(9.5)	19,334

In 2010, our net income was $9,006 million, which is $1,995 million, or 28.5%, more than in 2009.

Positive dynamic of our net income for the 2010 was mainly due to a sharp increase in hydrocarbon prices, compared to 2009. Also, in the third quarter of 2010, we recognized a $438 million gain resulting from a successful completion of the legal dispute regarding one of our joint ventures in Kazakhstan. At the same time, our results were affected by increased extraction taxes and export tariff rates, which growth rates were even higher than those of our revenue, appreciation of the Russian ruble, increase in operating and transportation expenses and impairment losses in total amount of $306 million recognized in the fourth quarter of 2010.

Business overview

The primary activities of OAO LUKOIL and its subsidiaries are crude 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, 2011 amounted to 17.3 billion BOE and comprised of 13.3 billion BOE of crude oil and 23.6 trillion cubic feet of gas.

Our operations are divided into four main business segments:

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

Other businesses include banking, finance and other activities. Each of our four main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the "Domestic crude oil and refined products prices" section on page 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 crude oil refining and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 22 "Segment information" to our consolidated financial statements.

Recent developments and outlook

The following has been achieved in 2010:

Exploration and production

- 11 new oil and gas fields were brought into production (2009: 8 oil and gas fields).
- On April 28, 2010, first oil was extracted at the Yu.Korchagin oilfield in the Russian offshore of the Caspian Sea.
- Consortium of LUKOIL and Vanco won a tender to explore and develop Est Rapsodia and Trident blocks in the Romanian offshore of the Black Sea.
- LUKOIL sighed a contract for exploration and development of West Qurnah-2 field in Iraq.

Refining

- In 2010, we launched a catalytic cracking complex at our refinery in Nizhny Novgorod. With this complex in operation, the refinery's production of high-octane gasoline and diesel fuel increases by 1.4 million tonnes per year and 0.4 million tonnes per year, respectively. The whole volume of motor fuels produced will be fully compliant to Euro-4 and Euro-5. Light distillates output is increased by 12% and refinery's Nelson complexity index is increased by two points.

Marketing

- 64 new petrol stations were brought into operation.
- Retail sales of Euro-5 diesel fuel commenced on domestic market.

Other achievements in 2010 are described in detail further in this report.

Changes in the Group structure

In January 2011, the Company received notice that the Board of Directors of ERG S.p.A. ("ERG") resolved to sell to the Company 11% in the joint venture to operate the ISAB refining complex ("ISAB") located in Priolo (Italy). This is a partial exercise of ERG's option to sell its stake. Thus, the Group's ownership will be increased from 49% to 60%. The transaction is expected to be finalized at the end of the first quarter of 2011 and the amount payable will be €205 million ($283 million), excluding inventory. The notice was received in accordance with the initial agreement on creation of the joint venture signed in 2008. Based on the agreement ERG has a put option, the effect of which would be to increase the Group's stake in the company operating the ISAB refinery complex up to 100%. In December 2008, the Group completed the acquisition of a 49.0% stake in the joint venture for €1.45 billion (approximately $1.83 billion) and paid €600 million (approximately $762 million) as a first installment. The remaining amount was paid in February 2009. The 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, includes three jetties and storage tanks totaling 3,700 thousand cubic meters and has an annual refining capacity of 16 million tonnes.

On July 28, 2010, a Group company signed a stock purchase agreement with a ConocoPhillips' subsidiary to purchase 64.6 million of the Company's ordinary shares at $53.25 per share for the total amount of $3,442 million. This transaction was finalized in August 2010. Additionally, under this agreement the Group had a 60-day option to purchase any or all of the remaining 98.7 million of the Company's ordinary shares held by the ConocoPhillips' subsidiary for the price of $56 per share. On September 26, 2010, the Group company exercised its option to acquire shares from the ConocoPhillips' subsidiary by sending a notice of exercise in respect of 42,500,000 LUKOIL ADRs (each representing one ordinary share of the Company). The Group company sold these ADRs to UniCredit Bank AG. These transactions were completed on September 29, 2010 when 42,500,000 LUKOIL ADRs were directly transferred to UniCredit Bank AG, and UniCredit Bank AG paid the purchase price of $2.38 billion to the ConocoPhillips' subsidiary. Simultaneously, UniCredit Bank AG issued a series of equity-linked notes to the Group company that are redeemable for 17,500,000 LUKOIL ADRs on or before September 29, 2011. These equity-linked notes have been classified within OAO LUKOIL stockholders' equity. UniCredit Bank AG also issued an option to the Group company to purchase from UniCredit Bank AG an additional 25,000,000 LUKOIL ADRs on or before September 29, 2011. The option provides for the purchase of LUKOIL ADRs at market price with a floor of $56 per ADR and is not valid if the market price per ADR is $50 or below. As of February 7, 2011, ConocoPhillips realized the remainder of its holding in LUKOIL in the open market and thereby fully quit LUKOIL share capital.

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

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

In accordance with the Group’s plans to develop its refining capacity in Europe, in June 2009, a Group company entered into an agreement with Total S.A. to acquire a 45.0% interest in TRN refinery in the Netherlands (“TRN”). The transaction was finalized in September 2009 in the amount of approximately $688 million (after completion adjustment). 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 allowed us 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.

In order to expand the Group’s presence on the most advantageous retail markets in the Russian Federation, in the fourth quarter of 2008, the Group acquired for $493 million 100% interests in ZAO Association Grand and OOO Mega Oil M, owning 181 petrol stations in Moscow, the Moscow region and other regions of central European Russia. 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, which between them own 96 petrol stations and plots of land in Moscow, the Moscow region and other regions of central European Russia.

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 made at the date of finalization, the second payment in amount of $150 million was made 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 accordance with the Company’s plans to develop its power generation business, in March 2008, a Group company entered into an agreement with a related party to acquire a 64.31% interest in OAO UGK TGK-8 (“TGK-8”) for approximately $2,117 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%. In September 2009, TGK-8 was reorganized into a limited liability company. 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.

Resource base

The table below summarizes the net oil-equivalent proved reserves of consolidated subsidiaries and our share in equity affiliates under SEC standards (until the economic limit of commercial production is reached) that have been derived or extracted from the reports of Miller and Lents, Ltd., our independent reservoir engineers, dated as at January 1, 2011 and 2010.

(millions of BOE)	January 1, 2011	Changes in 2010			January 1, 2010
		Production[1]	Extensions, discoveries and changes in structure	Revision of previous estimates	
Western Siberia	9,861	(451)	423	138	9,751
Timan-Pechora	2,533	(160)	80	(122)	2,735
Ural region	2,033	(97)	64	(58)	2,124
Volga region	845	(27)	17	(40)	895
Other in Russia	223	(16)	14	(6)	231
Outside Russia	1,760	(83)	89	(14)	1,768
Proved oil and gas reserves	**17,255**	**(834)**	**687**	**(102)**	**17,504**
Probable oil and gas reserves	**8,455**				**9,820**
Possible oil and gas reserves	**3,167**				**5,054**

[1] Gas production shown before own consumption.

The Company's proved reserves as at January 1, 2011 amount to 17,255 million BOE and comprise of 13,319 million BOE of crude oil and 23,615 billion cubic feet of gas.

In 2010, proved reserves growth as a result of geological exploration, production drilling and acquisitions, totaled 687 million BOE of which geological exploration and production drilling accounted for 625 million BOE, while acquisitions accounted for 62 million BOE. The increment of the gas reserves was mainly caused by continued development of the Bolshekhetskaya Depression and the commencement of drilling at Pyakyakhinskoye field.

The adoption of the law on the adjustment of rates of the mineral extraction tax for oil and gas, starting from 2011, resulted in the cutting of our proved reserves by 118 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 OOO LUKOIL-Western Siberia, OOO LUKOIL-Komi and OOO LUKOIL-Perm. Also we have a consolidated joint venture with ConocoPhillips, OOO Narianmarneftegaz ("NMNG"), 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, Iraq, Ghana and Cote d'Ivoire.

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

	2010	2009	2008
	(thousand BOE per day)		
Daily production of hydrocarbons, including the Company's share in equity affiliates, including:	2,239	2,212	2,194
- crude oil	1,940	1,972	1,921
- natural and petroleum gas[(1)]	299	240	273
	(US dollar per BOE)		
Hydrocarbon extraction expenses	4.12	3.56	4.12
- in Russia	4.11	3.53	4.11
- outside Russia	4.29	3.99	4.32
	(millions of US dollars)		
Hydrocarbon extraction expenses	3,241	2,787	3,208
- in Russia	3,023	2,592	3,006
- outside Russia	218	195	202
Exploration expenses	336	218	487
- in Russia	96	71	131
- outside Russia	240	147	356
Mineral extraction tax	7,864	5,452	12,267
- in Russia	7,795	5,399	12,267
- outside Russia	69	53	–

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

Crude oil production. In 2010, our daily crude oil production decreased by 1.6%, compared to 2009. The Group produced (including our share in equity affiliates) 708.1 million barrels, or 96.0 million tonnes of crude oil.

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

		Change to 2009			
(thousands of tonnes)	2010	Total, %	Change in structure	Organic change	2009
Western Siberia	50,934	(3.8)	–	(2,028)	52,962
Timan-Pechora	21,175	(2.2)	–	(487)	21,662
Ural region	12,385	3.6	–	427	11,958
Volga region	2,916	2.4	–	68	2,848
Other in Russia	2,021	(5.1)	–	(109)	2,130
Crude oil produced in Russia	89,431	(2.3)	–	(2,129)	91,560
Crude oil produced internationally	3,460	(1.6)	–	(55)	3,515
Total crude oil produced by consolidated subsidiaries	**92,891**	**(2.3)**	**–**	**(2,184)**	**95,075**
Our share in crude oil produced by equity affiliates:					
in Russia	336	9.1	–	28	308
outside Russia	2,765	23.9	575	(42)	2,232
Total crude oil produced	**95,992**	**(1.7)**	**575**	**(2,198)**	**97,615**

The main oil producing region of the Company is Western Siberia where we produced 54.8% of our crude oil in 2010 (55.7% in 2009 and 60.5% in 2008). A significant impact on our production in Western Siberia was caused by increased field depletion rate as well as a reduced drilling footage. The reduction in drilling footage was due to implementation of the Company's strategy aiming at strengthening its financial position through focusing on high return projects and boosting cash flows.

In line with our strategy the Company is developing new oil fields in the Northern Timan-Pechora and Caspian regions in order to compensate for the decrease in crude oil production in the traditional regions. In August 2008, we began commercial production on the Yuzhnoye Khylchuyu oil field, located in the Timan-Pechora region. We produced 6.9 million tonnes from this field in 2010, compared to 7.0 in 2009. This oil field is developed by NMNG, our joint venture with ConocoPhillips.

In December 2009, we started production drilling on the Yu. Korchagin field in the Caspian Sea. In April 2010, we began commercial production at the field. Maximum annual production from this field is expected to be 2.5 million tonnes of crude oil and gas condensate, and 1.0 billion cubic meters of gas. Starting from December 2010, a reduced export tariff rate is applied to crude oil produced and exported from this field. According to the current legislation, extraction tax for this field is zero. In 2010, we produced 55 thousand tonnes from that field and thereby couldn't benefit a lot from above mentioned tax incentives.

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

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

	2010		**2009**		**2008**	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	2,243	306	4,442	606	1,730	236
Crude oil purchases internationally.....	156,759	21,386	150,258	20,499	76,078	10,379
Total crude oil purchased.................	**159,002**	**21,692**	**154,700**	**21,105**	**77,808**	**10,615**

Substantial part of crude oil purchased on the international market was made for refining. In 2010, we purchased 12,516 thousand tonnes of crude oil to process at our and at third party refineries (including 4,574 thousand tonnes at ISAB and 2,292 thousand tonnes at TRN), compared to 11,313 thousand tonnes in 2009 (including 5,116 thousand tonnes at ISAB and 698 thousand tonnes at TRN refinery complex).

Gas production. In 2010, we produced 18,554 million cubic meters of gas available for sale (including our share in equity affiliates), an increase of 24.5%, compared to 2009.

Our major gas production field is the Nakhodkinskoe gas field, where we produced 8,146 million cubic meters of natural gas in 2010, compared to 5,936 million cubic meters in 2009. This 37.2% increase in gas production from the field resulted from the increase in purchases of our gas by OAO Gazprom ("Gazprom") starting from the second half of 2009. Also, during 2010, we increased utilization rates of petroleum gas in Western Siberia.

Our international gas production increased by 16.2%. Production from the Khauzak gas field in Uzbekistan was 2,655 million cubic meters of natural gas, compared to 2,227 million cubic meters in 2009. In 2010, our share in production from the Shakh-Deniz field in Azerbaijan was 545 million cubic meters, compared to 518 million cubic meters in 2009. As a result of acquisition of the remaining share in LUKARCO we increased our share in production of petroleum gas from Tengiz field by 300 million cubic meters.

Refining, marketing and trading

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

Compared to 2009, production at our consolidated and affiliated refineries increased by 6.2%. Russian refineries increased their production by 1.8%. Production of our international refineries including our share of production at ISAB and TRN increased by 16.9%. The increase was a result of acquisition of TRN in September 2009. The production at our Bulgarian and Ukrainian refineries was lower due to performed overhauls. The Odessa refinery was stopped in the fourth quarter of 2010 due to unfavorable economic conditions in Ukraine. In 2010, our share of refined products produced at ISAB amounted to 6,540 thousand tonnes (6,153 thousand tonnes in 2009) and our share in production of TRN amounted to 4,468 thousand tonnes (1,528 thousand tonnes in 2009).

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

In Russia, LUKOIL holds the leading position in production and sales of European standards motor fuel being ahead of the official terms of their obligatory implementation in the country. At our Russian refineries we produced 8,429, 7,266 and 7,224 thousand tonnes of Euro 4 and Euro 5 diesel fuel, and 5,373, 4,746 and 4,191 thousand tonnes of Euro 3 gasoline in 2010, 2009 and 2008, respectively. In the end of 2010 we commenced production of Euro-4 gasoline.

Along with our own production of refined products we can refine crude oil at third party refineries depending on market conditions and other factors. Before 2010, we processed crude oil at third party refineries in Russia primarily to supply our network in the Ural region and for export sales. In 2010, we sell our crude oil to these refineries and purchase refined products from them. In order to supply our retail networks in Eastern Europe, we refined crude oil in Belarus and Serbia. Refined products processed in Belarus were used for supplying our local retail network and for wholesale export. In the end of 2009, we ceased refining of crude oil in Belarus due to decreased profitability of such operations as a result of certain amendments in the customs legislation. However, in the third quarter of 2010, we began refining our crude oil at a third party refinery in Kazakhstan. The following table summarizes key figures for our refining activities.

	2010	**2009**	**2008**
	(millions of US dollars)		
Own refining expenses	1,088	923	1,115
- in Russia	806	671	780
- outside Russia	282	252	335
Refining expenses at ISAB and TRN	719	543	39
Refining expenses at third party refineries	5	170	400
- in Russia	1	126	341
- outside Russia	4	44	59
Capital expenditures	702	828	1,023
- in Russia	542	520	688
- outside Russia	160	308	335
	(thousand barrels per day)		
Refinery throughput at the Group refineries	1,103	1,099	1,112
- in Russia[(1)]	904	889	881
- outside Russia	199	210	231
Refinery throughput at ISAB and TRN[(2) (3)]	222	155	13
Refinery throughput at third party refineries	2	77	110
- in Russia	–	41	64
- outside Russia	2	36	46
Total refinery throughput	**1,327**	**1,331**	**1,235**
	(thousand of tonnes)		
Refined products produced at the Group refineries	52,588	52,198	52,455
- in Russia[(1)]	43,172	42,408	42,067
- outside Russia	9,416	9,790	10,388
Production of ISAB and TRN[(2)]	11,008	7,681	578
Refined products produced at third party refineries	107	3,485	5,004
- in Russia	–	1,873	2,881
- outside Russia	107	1,612	2,123
Total refined products produced	**63,703**	**63,364**	**58,037**

[(1)] Excluding mini refineries.
[(2)] Group's share.
[(3)] Including refined products processed.

Marketing and trading. Our marketing and trading activities mainly include wholesale and bunkering operations in Western Europe, South-East Asia, Central America and retail operations in the USA, Central and Eastern Europe, the Baltic States and other regions. In Russia we purchase refined products on occasion, primarily to manage supply chain bottlenecks.

The Group retails its refined products in 27 countries through 6 thousand petrol stations. Most of the stations operate under the LUKOIL brand. We continuously develop our retail business and the LUKOIL brand by expanding our retail network.

The table below summarizes figures for our trading activities.

	2010	2009	2008
	(thousand of tonnes)		
Retail sales	14,336	14,079	14,164
Wholesale sales	91,020	86,681	80,983
Total refined products sales	**105,356**	**100,760**	**95,147**
Refined products purchased in Russia	1,853	625	1,635
Refined products purchased internationally	45,816	41,445	38,743
Total refined products purchased	**47,669**	**42,070**	**40,378**

Refined products purchases in Russia increased in 2010 compared to 2009 due to termination of processing activities at third-party refineries. We began to sell our crude oil to these refineries and purchased refined products back from them. In 2010, these purchases amounted to approximately 870 thousand tonnes. Our international purchases increased due to expansion of trading activities and increased purchases for refining at ISAB and TRN refineries.

Exports of crude oil and refined products from Russia. In 2010, our export of crude oil from Russia was 3.4% less than in 2009, and we exported 45.4% of our total domestic crude oil production (45.9% in 2009 and 43.8% in 2008).

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

	2010		2009		2008	
	(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	231,525	31,586	241,890	33,000	264,393	36,070
Exports of crude oil bypassing Transneft	65,999	9,004	66,109	9,019	23,639	3,225
Total crude oil exports	**297,524**	**40,590**	**307,999**	**42,019**	**288,032**	**39,295**

The overall decrease of our export from Russia was a result of decreased crude oil production, cease of processing operations in Belarus and respective decrease of export to CIS. However, export to far-abroad increased by 2,984 thousand tonnes, or by 8.9%, compared to 2009.

In 2010, the crude oil exported through our own export infrastructure amounted to 8,732 thousand tonnes and was on the level of 2009.

In 2010, we exported from Russia 25.8 million tonnes of refined products, a decrease of 6.9%, compared to 2009. This was mainly due to decreased export to CIS. Released volumes were sold on domestic market. Primarily, we export from Russia diesel fuel, fuel oil and gasoil. These products account for approximately 92% of our refined products export volumes.

In 2010, our revenue from export of crude oil and refined products from Russia both to the Group companies and third parties amounted to $22,178 million and $14,088 million, respectively ($17,485 million for crude oil and $11,414 million for refined products in 2009).

Power generation. In 2010, we continued to develop the new power generation sector of our business as part of our strategic development program. This new sector encompasses all aspects of the power generation business, from generation to transmission and sale of heat and electrical power. Our power generation business sector now includes OOO "LUKOIL-Kubanenergo", OOO "LUKOIL-Astrakhanenergo", OOO "LUKOIL-Volgogradenergo", OOO "LUKOIL-Rostovenergo", OOO "LUKOIL-TTK" (all spun off from TGK-8), our own power generating facilities at our oil and gas fields and power generators in Bulgaria, Romania and Ukraine. Our total output of electrical energy was 13.2 billion kW-h in 2010 and 13.1 billion kW-h in 2009. Our total output of heat energy was approximately 15.3 million Gcal in 2010 (15.1 million Gcal in 2009).

Main macroeconomic factors affecting our results of operations

Changes in the price of crude oil and refined products

The price at which we sell crude oil and refined products is the primary driver of our revenues. During 2010, the Brent crude oil price fluctuated between $67 and $94 per barrel and reached its peak of $94.00 in late December of 2010.

In 2008, the crude oil prices were the highest ever in real terms. Starting from July 2008, crude oil prices began to descend and by the end of the year crude oil price dropped by more than $100 per barrel down to $37 per barrel driven by the world economic downturn. Despite that, average international crude oil prices for 2008 were almost $100 per barrel.

During the second half of 2009, the crude oil price stabilized around $70 per barrel and since then fluctuated within sloping upward trend. At the same time, average international crude oil prices for 2009 were about $60 per barrel, which was significantly lower compared to 2008.

Substantially all crude oil we export is Urals blend. The following table shows the average crude oil and refined product prices products in 2010, 2009 and 2008.

	2010	Change to 2009, %	2009	Change to 2008, %	2008
	(in US dollars per barrel, except for figures in percent)				
Brent crude..	79.50	28.9	61.67	(36.6)	97.26
Urals crude (CIF Mediterranean) [(1)]	78.29	27.9	61.22	(35.4)	94.76
Urals crude (CIF Rotterdam) [(1)]	78.26	28.0	61.15	(35.5)	94.83
	(in US dollars per metric tonne, except for figures in percent)				
Fuel oil 3.5% (FOB Rotterdam)........................	442.35	28.0	345.72	(24.8)	459.74
Diesel fuel 10 ppm (FOB Rotterdam)...............	688.46	28.7	534.84	(43.6)	948.11
High-octane gasoline (FOB Rotterdam)............	735.24	27.0	579.01	(30.8)	836.79

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 2010, 2009 and 2008.

	2010	Change from 2009, %	2009	Change from 2008, %	2008
	(in US dollars per metric tonne, except for figures in percent)				
Fuel oil..	245.27	51.3	162.12	(32.1)	238.87
Diesel fuel...	557.36	20.5	462.65	(37.8)	744.07
High-octane gasoline (Regular)................	714.26	22.1	584.87	(22.2)	751.95
High-octane gasoline (Premium)..............	743.17	16.8	636.24	(26.0)	860.07

Source: InfoTEK (excluding VAT).

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenue is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, ruble inflation and movements of exchange rates can significantly affect the results of our operations.

In particular, the devaluation of the ruble against the US dollar generally causes our costs to decrease in US dollar terms, and vice versa. The devaluation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 11.6% in 2010, compared to 2009.

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

	2010	**2009**	**2008**
Ruble inflation (CPI), %	8.7	8.9	13.3
Change of the ruble-dollar exchange rate, %	(0.8)	(2.9)	(19.7)
Average exchange rate for the period (ruble to US dollar)	30.37	31.72	24.86
Exchange rate at the end of the period (ruble to US dollar)	30.48	30.24	29.38

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 2010, 2009 and 2008, the tax charge on the operations in Russia was approximately 85%, 81% 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 and 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 2010, 2009 and 2008, respectively, were 77%, 75% and 81%. In 2010, tax expenses in Russia were about 49% 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.

		2010[(1)]	**Change to 2009, %**	**2009**[(1)]	**Change to 2008, %**	**2008**[(1)]
Export tariffs on crude oil	\$/tonne	273.55	52.0	179.93	(49.3)	355.08
Export tariffs on refined products						
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	\$/tonne	196.60	47.2	133.54	(46.9)	251.53
Liquid fuels (fuel oil)	\$/tonne	105.91	47.2	71.93	(46.9)	135.51
Excise on refined products						
Straight-run gasoline	RUR/tonne	4,290.00	10.0	3,900.00	46.8	2,657.00
High-octane gasoline	RUR/tonne	3,992.00	10.0	3,629.00	–	3,629.00
Low-octane gasoline	RUR/tonne	2,923.00	10.0	2,657.00	–	2,657.00
Diesel fuel	RUR/tonne	1,188.00	10.0	1,080.00	–	1,080.00
Motor oils	RUR/tonne	3,246.10	10.0	2,951.00	–	2,951.00
Mineral extraction tax						
Crude oil	RUR/tonne	3,075.76	33.6	2,302.85	(30.8)	3,328.35
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:

		2010[1]	Change to 2009, %	2009[1]	Change to 2008, %	2008[1]
Excise on refined products						
Straight-run gasoline	$/tonne	141.26	14.9	122.94	15.0	106.90
High-octane gasoline	$/tonne	131.45	14.9	114.40	(21.7)	146.01
Low-octane gasoline	$/tonne	96.25	14.9	83.76	(21.7)	106.90
Diesel fuel	$/tonne	39.12	14.9	34.04	(21.7)	43.45
Motor oils	$/tonne	106.89	14.9	93.02	(21.7)	118.73
Mineral extraction tax						
Crude oil	$/tonne	101.28	39.5	72.59	(45.8)	133.91
Natural gas	$/1,000 m^3	4.84	4.5	4.63	(21.7)	5.91

[1] Average values.

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

Crude oil extraction tax rate. The base rate is 419 rubles per metric tonne extracted and it is adjusted depending on the international market price of Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals blend international market price for a tax period was less than or equal to $15.00 per barrel. Each $1.00 per barrel increase in the international Urals blend price over the threshold ($15.00 per barrel) resulted in an increase of the tax rate by $1.61 per tonne extracted (or $0.22 per barrel extracted using a conversion factor of 7.33).

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

The crude oil extraction tax rate varies depending on the development and depletion of a particular oilfield. The tax rate is zero for extra-heavy crude oil and for crude oil produced in certain regions of Eastern Siberia, the Caspian Sea and the Nenetsky Autonomous District, depending on the period and volume of production. 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.

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

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

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

Effective from December 2008, the crude oil export duty rate is revised monthly on the basis of the immediately preceding one-month period of crude oil price monitoring.

Starting from the end of 2009, zero export duty rate was set for crude oil produced at certain fields in Eastern Siberia. However, in July 2010, a zero rate for these fields was substituted for special reduced export duty rate. Effective from December 2010, the list of the oilfields where reduced rate applies also includes our Yu. Korchagin and V. Filanovsky oilfields located in the Caspian Sea.

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

	2011	2012	2013
Multiplier for:			
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	0.670	0.640	0.600
Liquid fuels (fuel oil)	0.467	0.529	0.600
Motor and other oils	0.467	0.529	0.600
Other products	0.467	0.529	0.600

Equivalent average ratios calculated for 2010 would be 0.719 for light and middle distillates, diesel fuel and gasoils and 0.387 for liquid fuels and motor oils.

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

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 was not subject to export duty. Volumes of crude oil above this limit were taxed at a regular export duty rate.

In 2009, crude oil exported from Russia to Belarus was subject to export duties calculated with the application of a coefficient 0.356 (0.335 in 2008) to the regular export duty rate set by the Russian government.

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

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

Gasoline		
Below Euro 3	RUR/tonne	5,995.00
Euro 3	RUR/tonne	5,672.00
Euro 4 and 5	RUR/tonne	5,143.00
Diesel fuel		
Below Euro 3	RUR/tonne	2,753.00
Euro 3	RUR/tonne	2,485.00
Euro 4 and 5	RUR/tonne	2,247.00
Motor oils	RUR/tonne	4,681.00
Straight-run gasoline	RUR/tonne	6,089.00

Income tax. Starting from January 1, 2009, the Federal income tax rate is 2.0% and the regional income tax rate varies between 13.5% and 18.0%. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

Transportation of crude oil, gas 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.

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

Year ended December 31, 2010, compared to years ended December 31, 2009 and December 31, 2008

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

	2010	2009	2008
	(millions of US dollars)		
Revenues			
Sales (including excise and export tariffs)	104,956	81,083	107,680
Costs and other deductions			
Operating expenses	(7,969)	(7,124)	(8,126)
Cost of purchased crude oil, gas and products	(43,579)	(31,977)	(37,851)
Transportation expenses	(5,608)	(4,830)	(5,460)
Selling, general and administrative expenses	(3,558)	(3,306)	(3,860)
Depreciation, depletion and amortization	(4,154)	(3,937)	(2,958)
Taxes other than income taxes	(8,978)	(6,474)	(13,464)
Excise and export tariffs	(18,878)	(13,058)	(21,340)
Exploration expense	(336)	(218)	(487)
Loss on disposals and impairments of assets	(363)	(381)	(425)
Income from operating activities	**11,533**	**9,778**	**13,709**
Interest expense	(712)	(667)	(391)
Interest and dividend income	174	134	163
Equity share in income of affiliates	472	351	375
Currency translation loss	(122)	(520)	(918)
Other non-operating income (expense)	125	(13)	(244)
Income before income taxes	**11,470**	**9,063**	**12,694**
Current income taxes	(2,104)	(1,922)	(4,167)
Deferred income taxes	(247)	(72)	700
Total income tax expense	**(2,351)**	**(1,994)**	**(3,467)**
Net income	**9,119**	**7,069**	**9,227**
Less: net income attributable to noncontrolling interests	(113)	(58)	(83)
Net income attributable to OAO LUKOIL	**9,006**	**7,011**	**9,144**
Basic earning per share of common stock attributable to OAO LUKOIL (in US dollars)	10.95	8.28	10.88
Diluted earning per share of common stock attributable to OAO LUKOIL (in US dollars)	10.94	8.28	10.88

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

Sales revenues

Sales breakdown	2010	2009	2008
	(millions of US dollars)		
Crude oil			
Export and sales on international markets other than CIS	25,251	18,276	22,382
Export and sales to CIS	1,091	1,638	1,625
Domestic sales	956	735	600
	27,298	**20,649**	**24,607**
Refined products			
Export and sales on international markets			
Wholesale	50,340	38,023	50,553
Retail	9,678	8,865	11,989
Domestic sales			
Wholesale	5,427	3,820	8,049
Retail	5,501	4,281	5,823
	70,946	**54,989**	**76,414**
Petrochemicals			
Export and sales on international markets	642	574	1,232
Domestic sales	728	514	880
	1,370	**1,088**	**2,112**
Gas and gas products			
Export and sales on international markets	1,565	1,091	926
Domestic sales	786	548	985
	2,351	**1,639**	**1,911**
Sales of energy and related services	**1,416**	**1,087**	**654**
Other			
Export and sales on international markets	890	1,030	1,286
Domestic sales	685	601	696
	1,575	**1,631**	**1,982**
Total sales	**104,956**	**81,083**	**107,680**

Sales volumes	2010	2009	2008
Crude oil	(thousands of barrels)		
Export and sales on international markets other than CIS	326,669	305,273	242,784
Export and sales to CIS	23,280	39,106	31,629
Domestic sales	26,637	21,909	15,408
	376,586	**366,288**	**289,821**
Crude oil	(thousands of tonnes)		
Export and sales on international markets other than CIS	44,566	41,647	33,122
Export and sales to CIS	3,176	5,335	4,315
Domestic sales	3,634	2,989	2,102
	51,376	**49,971**	**39,539**
Refined products	(thousands of tonnes)		
Export and sales on international markets			
Wholesale	80,043	76,885	67,669
Retail	7,314	7,863	8,200
Domestic sales			
Wholesale	10,977	9,796	13,314
Retail	7,022	6,216	5,964
	105,356	**100,760**	**95,147**
Total sales volume of crude oil and refined products	**156,732**	**150,731**	**134,686**

Realized average sales prices

	2010		2009		2008	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international						
Oil (excluding CIS)	77.30	566.60	59.87	438.84	92.19	675.76
Oil (CIS)	46.84	343.35	41.89	307.05	51.38	376.58
Refined products						
Wholesale		628.91		494.55		747.06
Retail		1,323.31		1,127.44		1,462.14
Average realized price within Russia						
Oil	35.90	263.18	33.56	245.97	38.97	285.66
Refined products						
Wholesale		494.37		389.92		604.55
Retail		783.49		688.74		976.40

During 2010, our revenues increased by $23,873 million, or by 29.4%, compared to 2009 (in 2009 decreased by $26,597 million, or by 24.7%, compared to 2008). Our revenues from crude oil sales increased by $6,649 million, or by 32.2% (in 2009 decreased by $3,958 million, or by 16.1%, compared to 2008). Our revenues from sales of refined products increased by $15,957 million, or by 29.0% (in 2009 decreased by $21,425 million, or by 28.0%, compared to 2008). In 2010, the increase in sales revenue was due to sharp increase in hydrocarbon prices, compared to 2009. Moreover, the appreciation of the ruble against the US dollar also seriously affected our average realized prices in Russia.

Sales of crude oil

2010 vs. 2009

Our total crude oil sales revenues increased by $6,649 million, or by 32.2%, mainly due to growth of crude oil prices.

Cease in crude oil refining at third party refineries in Russia and Belarus released crude oil volumes for marketing. As a result, our crude oil sales raised by 2.8% in terms of volumes.

In 2010, revenue from export of crude oil from Russia both to the Group companies and third parties amounted to $22,178 million.

2009 vs. 2008

Our total crude oil sales revenues decreased by 16.1%. We sold crude oil to third parties mostly outside Russia and the 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, revenue from export of crude oil from Russia both to the Group companies and third parties amounted to $17,485 million.

Sales of refined products

2010 vs. 2009

In 2010, our revenue from the wholesale of refined products outside of Russia increased by $12,317 million, or by 32.4%, due to increased average realized price by 27.2%. The decrease in output at our refineries in Bulgaria due to overhaul and in Ukraine due to refinery stand-by and termination of processing activities in Russia were almost fully compensated by commencement of crude oil refining at TRN in September 2009. At the same time, expansion of trading activities led to an increase in wholesales volumes by 4.1%.

In 2010, our revenue from international retail sales increased by $813 million, or by 9.2%. Positive effect from the increase of average retail prices by 17.4% was partially offset by 7.0% sales volumes decrease, that reflects restructuring of our retail network in the USA.

In 2010, our revenue from the wholesale of refined products on the domestic market increased by $1,607 million, or by 42.1%, mainly due to an increase in the average realized price by 26.8%. Sales volumes increased by 1,181 thousand tonnes, or by 12.1%. This was primarily due to a decrease in refined products export to Belarus.

In 2010, our revenue from retail sales in Russia increased by $1,220 million, or by 28.5%, due to an increase both in volumes, being a result of higher average daily sales per petrol station, and in prices. In 2010, our retail sales revenue was 50.3% of total refined products sales in Russia (in 2009 – 52.8%).

In 2010, our revenue from export of refined products from Russia both to Group companies and third parties amounted to $14,088 million.

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%, 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%, 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%, 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.

Sales of petrochemical products

2010 vs. 2009

In 2010, our revenue from sales of petrochemical products increased by $282 million, or by 25.9%. Outside of Russia, decrease in sales volumes due to decreased refining and trading was compensated by price growth. At the same time, in the fourth quarter of 2010, we commenced production at our petrochemical plant Karpatnaftochim Ltd. in Ukraine after modernization and construction of a chlorine and caustic production line. The growth of domestic sales revenue was largely a result of increase in realized prices and the effect of the real ruble appreciation against the US dollar.

2009 vs. 2008

In 2009, our revenue from sales of petrochemical products decreased by $1,024 million, or by 48.5%. 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.

Sales of gas and gas products

2010 vs. 2009

In 2010, sales of gas and gas refined products increased by $712 million, or by 43.4%. Gas products sales revenue increased by $424 million, or by 40.8%, primarily as a result of an increase in sales prices. Retail gas product revenue increased up to $506 million, or by 22.2%, due to price growth. Retail revenue represented 37.8% and 44.0% of our total gas product revenue in 2010 and 2009, respectively.

Natural gas sales revenue amounted to $835 million – an increase of 46.2%, compared to 2009. Our domestic natural gas sales revenue significantly increased as a result of increased sales to Gazprom, the major purchaser of our natural gas produced in the Russian Federation. In 2010, we sold 8,146 million cubic meters of natural gas to Gazprom (5,936 million cubic meters in 2009). The average realized price increased by 4.5% to $34.9 per 1,000 cubic meters as a result of the ruble appreciation.

In 2010, natural gas sales revenue outside of Russia increased by $174 million mostly as a result of a revision of sale prices related to the Shakh-Deniz field for 2008-2010 which led to additional revenue of $101 million, recognized in the third quarter of 2010.

2009 vs. 2008

In 2009, sales of gas and gas refined products decreased by $272 million, or by 14.2%. 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.

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.

Sales of energy and related services

We have been developing our power generation business since the acquisition of TGK-8 in May 2008. Substantially we sell energy and related services domestically. International sales are relatively insignificant.

2010 vs. 2009

In 2010, our revenue from sales of electricity, heat and related services increased by $329 million, or by 30.3%, as we continued to develop the new power generation segment as part of our strategic development program. The ruble appreciation also contributed to the increase of this revenue.

2009 vs. 2008

In 2009, our revenue from sales of electricity, heat and related services increased by $433 million, or by 66.2%. Our power generation and distribution business emerged in May 2008 and substantially expanded in 2009 that was reflected in sales growth.

Sales of other products

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

2010 vs. 2009

In 2010, our other sales decreased by $56 million, or by 3.4%. A decrease of transportation services provided abroad was partially compensated by higher non-petroleum retail revenue. During 2010, sales of goods and other products from our retail stations amounted to $606 million, an increase of $38 million compared to 2009.

2009 vs. 2008

In 2009, our other sales decreased by $351 million, or by 17.7%. Other sales in Russia were affected by devaluation of the ruble. Outside of Russia we had a decrease of transportation services provided and volumes of non-petroleum sales from our retail stations.

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.

Operating expenses

Operating expenses include the following:

	2010	2009	2008
	(millions of US dollars)		
Hydrocarbon extraction expenses	3,241	2,787	3,208
Own refining expenses	1,088	923	1,115
Refining expenses at third parties and affiliated refineries	724	713	439
Expenses for crude oil transportation to refineries	1,048	955	1,072
Power generation and distribution expenses	654	450	260
Petrochemical expenses	221	127	235
Other operating expenses	1,322	1,385	1,547
	8,298	**7,340**	**7,876**
Change in operating expenses in crude oil and refined products inventory originated within the Group[(1)]	(329)	(216)	250
Total operating expenses	**7,969**	**7,124**	**8,126**

[(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 2009, operating expenses increased by $845 million, or by 11.9%, which is mainly explained by general increase in operating expenses in Russia due to the real ruble appreciation against the US dollar by 11.6%, increase in hydrocarbon extraction expenses, refining expenses and power generation and distribution expenses.

Hydrocarbon extraction expenses

Our extraction expenses include expenditures related to repairs of extraction equipment, labor costs, expenses on enhancing reservoir recovery, fuel and electricity costs, property insurance of extraction equipment and other similar costs.

2010 vs. 2009

In 2010, our extraction expenses increased by $454 million, or by 16.3%. This was due to increase in expenses for power supply, general increase in expenses and the effect of the real ruble appreciation against the US dollar. Our average hydrocarbon extraction cost increased from $3.56 to $4.12 per BOE, or by 15.7%, compared to 2009.

2009 vs. 2008

In 2009, our extraction expenses decreased by $421 million, or by 13.1%, 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.

Own refining expenses

2010 vs. 2009

In 2010, our refining expenses increased by $165 million, or by 17.9%.

Refining expenses at our domestic refineries increased by 20.1%, or by $135 million, mainly as a result of the real ruble appreciation against the US dollar, increase in power supply costs and higher consumption of additives.

Refining expenses at our international refineries increased by 11.9%, or by $30 million, mainly as a result of increased power supply costs.

2009 vs. 2008

In 2009, our refining expenses decreased by $192 million, or by 17.2%.

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.

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.

2010 vs. 2009

As opposed to 2009, we did not process crude oil on third party refineries during 2010 in Russia and Belarus. Nevertheless, the commencement of crude oil refining at TRN in late September 2009 almost fully compensated for that. As a result, the overall decrease of throughput at third party and affiliated refineries was 2.8%, compared to 2009 (including refined products processed). At the same time, in 2010, refining expenses at third party and affiliated refineries increased by 1.5%, compared to 2009, because processing cost at our refineries in Western Europe is higher than at the refineries in Russia or Belarus. Starting from the third quarter of 2010, we also refined crude oil on a third party refinery in Kazakhstan.

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.

Petrochemical operating expenses

2010 vs. 2009

In 2010, operating expenses of our petrochemical plants increased by $94 million, or by 74.0%. Expenses in Russia were impacted by increased production, increased cost of raw materials and ruble appreciation to the US dollar. Despite petrochemical capacity downtime in Bulgaria and Ukraine in 2010, the decrease of our international petrochemical operating expenses compared to 2009 was insignificant due to sizeable share of fixed costs. In the fourth quarter of 2010, we commenced production at our petrochemical plant Karpatnaftochim Ltd. in Ukraine after modernization and construction of a chlorine and caustic production line.

2009 vs. 2008

In 2009, operating expenses of our petrochemical companies decreased by $108 million, or by 46.0%, 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.

Expenses for crude oil transportation to refineries

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

2010 vs. 2009

Expenses for crude oil transportation to refineries increased in 2010 by $93 million, or by 9.7%, due to an increase in transportation tariffs and as a result of a real ruble appreciation in Russia (see Transportation expenses below). Moreover, in 2010, we dramatically increased volumes of own crude oil supplies to TRN.

2009 vs. 2008

Expenses for crude oil transportation to refineries decreased in 2009 by $117 million, or by 10.9%, 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.

Power generation and distribution expenses

2010 vs. 2009

Power generation and distribution expenses increased by $204 million, or by 45.3%, following expansion of our power generating business and as a result of the real ruble appreciation in Russia.

2009 vs. 2008

Power generation and distribution expenses increased by $190 million, or by 73.1%. Our power generation and distribution business emerged in May 2008 and substantially expanded in 2009 that was reflected in operating expenses growth.

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

2010 vs. 2009

In 2010, our other operating expenses decreased by $63 million, or by 4.5%, mainly due to decrease of volume of transportation services provided abroad.

2009 vs. 2008

In 2009, our other operating expenses decreased by $162 million, or by 10.5%. In 2008, other operating expenses included $116 million of excise included in processing fee paid to third parties refineries, compared to $54 million in 2009. Besides, other operating expenses in Russia were affected by the ruble devaluation. Outside of Russia, operating expenses were lower than in 2008 due to a decrease of transportation services provided.

Cost of purchased crude oil, gas and products

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

2010 vs. 2009

In 2010, cost of purchased crude oil, gas and products increased by $11,602 million, or by 36.3%, due to an increase in crude oil and refined products prices and increase in volumes of refined products purchases.

In 2010, we recognized a $232 million expense from hedging, compared to a $781 million expense in 2009.

2009 vs. 2008

Cost of purchased crude oil, gas and products decreased by $5,874 million in 2009, or by 15.5%, 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.

In 2009, we recognized a $781 million expense from hedging, compared to a $902 million gain in 2008.

Transportation expenses

2010 vs. 2009

In 2010, our transportation expenses increased by $778 million, or by 16.1%. This was primarily due to increase of ruble denominated pipeline and railway transportation tariffs in Russia, which was emphasized by the ruble appreciation.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed in 2010, compared to 2009, as follows: crude oil pipeline tariffs increased by 23.3%, railway tariffs for refined products transportation increased by 21.1%, crude oil freight rates decreased by 7.8%, and refined products freight rates increased by 23.8%.

2009 vs. 2008

In 2009, our transportation expenses decreased by $630 million, or by 11.5%. 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.

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.

2010 vs. 2009

In 2010, our selling, general and administrative expenses increased by $252 million, or by 7.6%, substantially due to the effect of ruble appreciation on selling, general and administrative expenses in Russia and salaries indexation.

2009 vs. 2008

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

Depreciation, depletion and amortization

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

2010 vs. 2009

Our depreciation, depletion and amortization expenses increased by $217 million, or by 5.5%.

2009 vs. 2008

Our depreciation, depletion and amortization expenses increased by $979 million, or by 33.1%. 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 Khylchuyu oil field.

Exploration expenses

2010 vs. 2009

During 2010, exploration expense increased by $118 million, or 54.1%. Dry hole costs increased by $108 million to $225 million.

In 2010, we charged to expense cost of dry wells in Columbia and Cote d'Ivoire in amount of $112 million and $68 million, respectively. Dry hole write-off in Russia amounted to $42 million in 2010.

2009 vs. 2008

During 2009, exploration expense decreased by $269 million, or by 55.2%. 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.

Interest expense

2010 vs. 2009

In 2010, interest expense increased by $45 million, which is 6.7% more than in the previous year. This increase mainly relates to discounting of the VAT recoverable of our refinery in Ukraine as a result of the restructuring of this receivable.

2009 vs. 2008

In 2009, interest expense amounted to $667 million, or 70.6% more than in 2008. 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).

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.

2010 vs. 2009

At the end of 2009, we increased our share in LUKARCO from 54% to 100%, thus increasing our stake in Tengizchevroil, an exploration and production joint-venture in Kazakhstan, to 5%. Largely as a result of this, our share in income of affiliates increased by $121 million, or by 34.5%.

2009 vs. 2008

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

Other non-operating income

In 2010, other non-operating income included a $438 million gain related to successful settlement of a corporate dispute between a Group company and a CNPC group company regarding Turgai Petroleum, our joint venture in Kazakhstan, and a $96 million expense related to provisions accrued in respect of claims to the Group companies by Federal Anti-monopoly Service of the Russian Federation (FAS of Russia).

As a result, other non-operating income in 2010 amounted to $125 million, compared to a $13 million loss in 2009 and a $244 million loss in 2008.

Taxes other than income taxes

	2010	2009	2008
	(millions of US dollars)		
In Russia			
Mineral extraction taxes	7,795	5,399	12,267
Social security taxes and contributions	327	330	435
Property tax	479	438	374
Other taxes	93	92	180
Total in Russia	**8,694**	**6,259**	**13,256**
International			
Mineral extraction taxes	69	53	–
Social security taxes and contributions	102	69	77
Property tax	39	32	31
Other taxes	74	61	100
Total internationally	**284**	**215**	**208**
Total	**8,978**	**6,474**	**13,464**

2010 vs. 2009

In 2010, taxes other than income taxes increased by $2,504 million, or 38.7%, mainly due to an increase in mineral extraction taxes in Russia. This is explained by an increase in the tax rate following the increase of international crude oil prices.

Application of zero tax rate for crude oil produced in Timan-Pechora and decreased rate for depleted oilfields led to approximately $1,313 million tax reduction (in 2009 – about $961 million). The major oilfield where we benefited from zero extraction tax rate was the Yuzhnoye Khylchuyu field. In early December 2010, accumulated volume of production from the Yuzhnoye Khylchuyu field exceeded the incentive level of 15 million tonnes and since that moment we have been paying extraction tax in full.

2009 vs. 2008

In 2009, taxes other than income taxes decreased by 51.9%, or by $6,990 million, 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 decreased rate for depleted oilfields led to approximately $961 million tax reduction.

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.

	2010	2009	2008
	(millions of US dollars)		
In Russia			
Excise tax and sales taxes on refined products	951	763	956
Crude oil export tariffs	10,513	6,251	11,911
Refined products export tariffs	3,574	2,306	4,119
Total in Russia	**15,038**	**9,320**	**16,986**
International			
Excise tax and sales taxes on refined products	3,700	3,524	3,984
Crude oil export tariffs	136	107	143
Refined products export tariffs	4	107	227
Total internationally	**3,840**	**3,738**	**4,354**
Total	**18,878**	**13,058**	**21,340**

2010 vs. 2009

In spite of a decrease in crude oil and refined products export volumes, export tariffs increased by $5,456 million, or by 62.2%, due to an increase in tariff rates in Russia as a result of international crude oil prices growth. The increase in excises in Russia resulted from the ruble appreciation, increase of excise rate and increase in sales volumes.

Starting from the end of 2009, for crude oil produced at certain fields in Eastern Siberia a reduced export duty rate was set. Starting from December, 2010 the Group applies reduced export duty rate for the crude oil produced from the Yu. Korchagin field in the Caspian Sea, however due to relatively small amount of crude oil export from that field the effect of this incentive on our 2010 financial results was insignificant.

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%, 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.

Loss on disposals and impairments of assets

2010 vs. 2009

In 2010, loss on disposals and impairments of assets amounted to $363 million, compared to $381 million in 2009.

As a result of an impairment test performed in December 2010, we recognized an impairment loss of $163 million for certain upstream properties in the Timan-Pechora, Western Siberia and Central European regions of Russia; and an impairment loss of $29 million related to certain our European downstream assets. We also wrote off goodwill related to our Turkish downstream subsidiary in amount of $114 million due to a change in market conditions partly caused by legislative changes.

2009 vs. 2008

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

In 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.

Income taxes

2010 vs. 2009

In 2010, our total income tax expense increased by $357 million, or by 17.9%. Income before income tax increased by $2,407 million, or by 26.6%.

In 2010, our effective income tax rate was 20.5%, compared to 22.0% in 2009, while the maximum statutory rate for the Russian Federation is 20%.

2009 vs. 2008

In 2009, our total income tax expense decreased by $1,473 million, or by 42.5%, 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).

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

	2010	2009 (millions of US dollars)	2008
Net income	**9,006**	**7,011**	**9,144**
Add back:			
Income tax expense	2,351	1,994	3,467
Depreciation and amortization	4,154	3,937	2,958
Interest expense	712	667	391
Interest and dividend income	(174)	(134)	(163)
EBITDA	**16,049**	**13,475**	**15,797**

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

	2010	2009	2008
	(millions of US dollars)		
Net cash provided by operating activities	13,541	8,883	14,312
Net cash used in investing activities	(7,296)	(8,551)	(13,559)
Net cash (used in) provided by financing activities	(6,146)	(285)	763

Operating activities

Our primary source of cash flow is funds generated from our operations. During 2010, cash generated by operating activities amounted to $13,541 million, which is 52.4% more than in 2009, mainly due to an increase in net revenue. On the other hand, our operating cash flows were affected by an increase in working capital by $826 million, compared to January 1, 2010. But this increase was relatively small, compared to 2009, when our working capital increased by $2,483 million.

The increase of working capital was mainly caused by:

- a $813 million net increase in inventory
- a $783 million net increase in trade accounts receivable and payable
- a $134 million net increase in other assets and liabilities

At the same time, the negative effect from the above mentioned factors was partly offset by an $830 million net decrease in VAT accounts receivable and a $74 million net decrease in other taxes accounts receivable and payable.

Investing activities

The decrease in cash used in investing activities resulted from a decrease in payments for acquisitions by $1,541 million. Our capital expenditures, including non-cash transactions, increased by $310 million, or 4.7%, compared to the previous year.

In 2010, we paid $800 million as a second installment within the acquisition of LUKARCO and invested $122 million in common stock of National oil consortium, a joint venture of five major Russian oil companies involved into exploration activities in Venezuela.

In 2009, we paid the remaining amount of $1,066 million for the acquisition of a 49% stake in the ISAB refinery complex, approximately $600 million within the acquisition of 45% interest in the TRN refinery, and settled a $150 million liability within the acquisition of Akpet. Other acquisitions refer to advances for downstream assets in Russia.

Financing activities

In 2010, net movements of short-term and long-term debt generated an inflow of $35 million, compared to an inflow of $1,489 million in 2009.

In December 2010, we completed the issuance of $1.5 billion 2.625% senior unsecured convertible bonds due June 2015. The bonds are convertible into LUKOIL ADRs listed on the London Stock Exchange each representing one ordinary share of LUKOIL. The bonds were issued by a Group company at 100% of their principal amount with the conversion price set at $73.7087 per LUKOIL ADR. Bondholders will be able to convert their bonds into LUKOIL ADRs at any point from 40 days after the issue date to the sixth dealing day prior to the final maturity date. We will have the right to redeem the bonds at any time after December 31, 2013.

In November 2010, we completed the issuance of a dual-tranche offering of 6.125% notes due 2020 in aggregate principal amount of $1.0 billion. The notes were issued in two tranches at the same time and form part of the same series. $800 million of the notes were issued at a price of 99.081% of their face value, resulting in a yield to maturity of 6.25%, and $200 million of the notes were issued at a price of 102.44% of their face value, resulting in a yield to maturity of 5.80%.

As a part of Company’s shares purchase option from a subsidiary of ConocoPhillips, in September 2010, a Group company purchased a series of equity-linked notes exchangeable for 17,500,000 LUKOIL ADRs issued by UniCredit Bank AG for approximately $980 million.

In August 2010, we raised a $1.5 billion loan facility from a group of banks due in one year. The facility was partially prepaid in November 2010 in amount of $1.0 billion.

In August 2010, we purchased approximately 7.599% of our shares at $53.25 per share for approximately $3.44 billion from a subsidiary of ConocoPhillips.

In June 2009, we completed offering of three series of stock exchange bonds on MICEX, altogether worth 15 billion rubles. Coupon rate for each of the issues was set at 13.5%. The bonds had maturity period of 364 days and were repaid in June 2010.

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

Credit rating

In November 2010, 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 October 2010, Moody's affirmed the Company's long-term corporate family rating and long-term issuer rating of Baa2 with stable outlook.

In February 2011, Fitch Ratings affirmed the Company's long-term issuer default rating of BBB- with stable outlook and short-term issuer default rating of F3.

Our credit ratings have not changed since then.

Analysis of capital expenditures

	2010	**2009**	**2008**
	(millions of US dollars)		
Capital expenditures[1]			
Exploration and production			
Russia	3,936	3,916	6,813
International	997	771	1,076
Total exploration and production	4,933	4,687	7,889
Refining, marketing and distribution			
Russia	945	808	1,346
International	375	508	721
Total refining, marketing and distribution	1,320	1,316	2,067
Chemicals			
Russia	27	13	23
International	49	100	98
Total chemicals	76	113	121
Power generation and distribution	420	283	364
Other	95	135	148
Total capital expenditures	**6,844**	**6,534**	**10,589**
Acquisitions of subsidiaries [2]			
Exploration and production			
Russia	–	–	4
International	922	300	357
Total exploration and production	922	300	361
Refining, marketing and distribution			
Russia	7	212	636
International	3	2,069[3]	1,397
Total refining, marketing and distribution	10	2,281	2,033
Power generation and distribution	–	10	3,191[4]
Other	–	1	3
Less cash acquired	–	(19)	(190)
Total acquisitions	**932**	**2,573**	**5,398**

[1] Including non-cash transactions and prepayments.
[2] Including prepayments related to acquisitions of subsidiaries 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 2010, our capital expenditures, including non-cash transactions, increased by $310 million, or 4.7%, compared to the previous year. Our capital expenditures in exploration and production increased by $246 million, or by 5.2%. Our capital expenditures in Iraq in 2010 included payment of $112 million non-recoverable signature bonus for entering West Qurnah-2 project. In April 2010, we started commercial production on the Yu. Korchagin field in the Caspian Sea. 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.

Capital expenses of our power generation and distribution entities related to fulfillment of their investment program.

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

	2010	**2009**	**2008**
	(millions of US dollars)		
Northern Timan-Pechora	285	385	1,878
Yamal	162	131	161
Caspian region[1]	370	532	420
Ghana	87	73	34
Cote d'Ivoire	92	31	11
Iraq	172	–	–
Total	**1,168**	**1,152**	**2,504**

[1]Russian and international projects.

Contractual obligations, other contingencies and off balance sheet arrangements

Capital commitments and contractual obligations

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 $720 million related to various production sharing agreements over the next 27 years.

The Company has signed a three-year agreement for the years 2010–2012 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 2011 to be approximately $1,139 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 2011 to be approximately $349 million.

The Group has a commitment to execute the capital construction program of its power generation segment 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, including its extension by the end of 2013. As of December 31, 2010, the Group estimates the amount of this commitment to be approximately $660 million.

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

(millions of US dollars)	Total	2011	2012	2013	2014	2015	After
On balance sheet							
Short term debt	794	794	–	–	–	–	–
Long-term bank loans and borrowings	2,071	954	337	378	129	119	154
Long-term non-bank loans and borrowings	1,693	53	51	50	24	21	1,494
6.375% Non-convertible US dollar bonds, maturing 2014	896	–	–	–	896	–	–
2.625% Convertible US dollar bonds, maturing 2015	1,388	–	–	–	–	1,388	–
6.356% Non-convertible US dollar bonds, maturing 2017	500	–	–	–	–	–	500
7.250% Non-convertible US dollar bonds, maturing 2019	595	–	–	–	–	–	595
6.125% Non-convertible US dollar bonds, maturing 2020	998	–	–	–	–	–	998
6.656% Non-convertible US dollar bonds, maturing 2022	500	–	–	–	–	–	500
7.10% Russian ruble bonds, maturing 2011	262	262	–	–	–	–	–
13.35% Russian ruble bonds, maturing 2012	820	–	820	–	–	–	–
9.20% Russian ruble bonds, maturing 2012	328	–	328	–	–	–	–
7.40% Russian ruble bonds, maturing 2013	197	–	–	197	–	–	–
Capital lease obligations	152	62	20	20	20	20	10
TOTAL	**11,194**	**2,125**	**1,556**	**645**	**1,069**	**1,548**	**4,251**
Off balance sheet							
Operating lease obligations	846	220	168	130	110	100	118
Capital commitments in PSAs	720	662	20	2	2	2	32
Capital commitments of power generating segment	660	345	169	146	–	–	–
Obligation under contract with OOO Eurasia Drilling Company	1,139	1,139	–	–	–	–	–
Obligation under contract with ZAO Globalstroy-Engineering	349	349	–	–	–	–	–

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 to the Bankruptcy Court and requesting the case be heard by the 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 were stayed pending further order of the Court. On July 7, 2010, the District Court denied ADC's Motion for Withdrawal of reference and returned the case to the Bankruptcy Court for the determination of the Company's Motion for Remand and Abstention seeking return of the case to the Colorado state court. On October 28, 2010, the Bankruptcy Court granted the Company's Motion for Remand and Abstention and remanded the case to the Denver District Court (Colorado state court) where it is now pending. ADC is expected to commence discovery regarding general jurisdiction shortly after the Court holds a status conference on March 18, 2011. Management intends to contest jurisdiction and denies all material allegations against the Company. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

As of the date the financial statements were available to be issued 76 claims in relation to a violation of the anti-monopoly regulation were initiated against several Group companies in Russia and abroad. The Group companies were accused of violations primarily involving abuse of their dominant market position and execution of coordinated actions in oil products retail markets.

In 2008 and 2009, the Federal Anti-monopoly Service of the Russian Federation ("FAS of Russia") considered two cases which resulted in decisions being issued against a number of 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.

As for the first case, the Group refinery plants appealed the decisions of FAS of Russia in the Moscow Arbitration Court. These appeals were combined in one proceeding. In addition the Group's refinery plants appealed against the administrative fines accrued by FAS of Russia to the courts in their locations. Due to abandonment of the claim by the Group's refinery plants the combined proceeding was terminated on December 13, 2010. Due to the same reason appeals against the administrative fines of the Group's refinery plants have also been terminated. The Group's refinery plants filed an application to FAS of Russia asking for payment deferrals for the fines accrued. As of the date the financial statements were available to be issued, deferral has been approved for some of the Group's refineries. The remaining applications are under consideration.

As for the second case, the Group's refinery plants filed claims against the decisions of FAS of Russia and administrative fines accrued. Due to the signing of the agreement between FAS of Russia and OOO LUKOIL-Volgogradneftepererabotka, OOO LUKOIL-Nizhegorodnefteorgsintez and OOO LUKOIL-Permnefteorgsintez fines were significantly reduced and lawsuits were terminated. A similar agreement is agreed to be signed with OOO LUKOIL-UNP. Currently, proceedings on this case are stayed. OOO LUKOIL-Nizhegorodnefteorgsintez has already paid the fines. FAS of Russia approved payment deferrals for OOO LUKOIL-Volgogradneftepererabotka and OOO LUKOIL-Permnefteorgsintez. OOO LUKOIL-UNP is going to file an application for payment deferrals to FAS of Russia.

The total amount of administrative penalties claimed from the Group which are estimated to be possible and probable is currently $106 million, of which a provision of $96 million was accrued in the Group's consolidated financial statements as of December 31, 2010 as probable to be paid. These expenses were included in "Other non-operating expense" of the consolidated statements of income.

On February 9, 2011, FAS of Russia filed a new lawsuit against the three largest Russian oil companies, including the Company, accusing them of abuse of their dominant position in the oil products market. However, the Company is not aware of the claim details until the case starts being considered. The order of legal proceedings has not been received by the Company as of the date the financial statements were available to be issued.

In March 2010, an ethanol purchase agreement signed by Getty Petroleum Marketing Inc., a Group Company, and Bionol Clearfield LLC came into force. The initial term of the agreement was five years. On June 1, 2010, Getty Petroleum Marketing Inc. filed an Arbitration claim to make amendments to the ethanol purchase agreement and to compensate for losses. On June 18, 2010, Bionol Clearfield LLC filed a counter-claim to the Arbitration tribunal of the American Arbitration Association with examination of a case in Boston to execute the agreement or to pay compensation. The amount of the claim of Bionol Clearfield LLC is $250 million. The counterparties came to an agreement about the schedule of court hearings and documents submission. Hearings began on February 16, 2011. At this time it is not possible to predict whether any of the issues in the Arbitration are remote or probable, or the likely outcome of the Arbitration. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

The Group is involved in cost recovery disputes with the Republic of Kazakhstan. The Group's share of the claim is approximately $244 million. Management is of the view that substantially all of the amounts subject to dispute are in fact recoverable under the Final Production Sharing Agreement. Management believes that the ultimate resolution of the claim 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.

An income tax position is recognized only if the uncertain position is more likely than not of being sustained upon examination, based on its technical merits. A recognized income tax position is measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

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 December 2010, the FASB issued Accounting Standards Update ("ASU") No. 2010-29, "*Disclosure of Supplementary Pro Forma Information for Business Combinations.*" This ASU requires that the pro forma information be presented at if the business combination occurred at the beginning of the prior annual reporting period for purposes of calculating both the current reporting period and the prior reporting period pro forma financial information. The ASU also requires that this disclosure be accompanied by a narrative description of the amount and nature of material nonrecurring pro forma adjustments. The ASU No. 2010-29 is effective for the Group for the reporting periods ending after December 15, 2010. The Group adopted ASU No. 2010-29 for the 2010 annual financial statements. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In December 2010, the FASB issued ASU No. 2010-28, "*When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*." This ASU modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. As a result, ASU No. 2010-28 is eliminating an entity's ability to assert that a reporting unit is not required to perform Step 2 because the carrying amount of the reporting unit is zero or negative despite the existence of qualitative factors that indicate the goodwill is more likely than not impaired. Therefore, goodwill impairments may be reported sooner than under current practice. The ASU No. 2010-28 is effective for the Group for the reporting periods ending after December 15, 2010. The Group adopted ASU No. 2010-28 for the 2010 annual financial statements. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In July 2010, the FASB issued ASU No. 2010-20, "*Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*," which amends Accounting Standards Codification ("ASC") No. 310, "*Receivables*." This ASU provides financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables and requires entities provide disclosures that facilitate financial statement users' evaluation of the following: 1) the nature of credit risk inherent in the entity's portfolio of financing receivables; 2) how that risk is analyzed and assessed in arriving at the allowance for credit losses; 3) the changes and reasons for those changes in the allowance for credit losses. The ASU No. 2010-20 is effective for the Group for the reporting periods ending after December 15, 2010. The Group adopted ASU No. 2010-20 for the 2010 annual financial statements. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

In January 2010, the FASB issued ASU No. 2010-06, "*Improving Disclosures about Fair Value Measurements*," which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information about purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. This ASU also clarifies existing fair-value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques. ASU No. 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the detailed Level 3 roll forward disclosures (which are effective for the annual reporting periods starting after December 15, 2010 and for interim periods within those annual reporting periods). The Group adopted the requirements of ASU No. 2010-06 (except for the detailed Level 3 roll forward disclosures) starting from the first quarter of 2010. 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.