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

The following report contains a discussion and analysis of the financial condition of OAO LUKOIL as of June 30, 2013 and the results of its operations for the three and six month periods ended June 30, 2013 and 2012, as well as significant factors that may affect its future performance. It should be read in conjunction with our interim US GAAP consolidated financial statements and notes thereto.

References to "LUKOIL," "the Company," "the Group," "we" or "us" are references to OAO LUKOIL and its subsidiaries and equity affiliates. All dollar amounts are in millions of US dollars, unless otherwise indicated. Tonnes of crude oil and natural gas liquids produced are translated into barrels using conversion rates characterizing the density of crude oil from each of our oilfields and actual density of liquids produced at our gas processing plants. 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 – at the rate of 6 thousand cubic feet per BOE.

This report includes forward-looking statements – words such as "believes," "anticipates," "expects," "estimates," "intends," "plans," etc. – that reflect management's current estimates and beliefs, but are not guarantees of future results.

Key financial and operational results

	2nd quarter of		Change, %	1st half of		Change, %
	2013	**2012**		**2013**	**2012**	
Sales (millions of US dollars)	35,053	32,397	8.2	68,823	67,658	1.7
Net income attributable to OAO LUKOIL (millions of US dollars)	2,104	1,018	106.7	4,685	4,807	(2.5)
EBITDA (millions of US dollars)	4,359	3,462	25.9	9,134	8,808	3.7
Taxes other than income taxes, excise and export tariffs (millions of US dollars)	(9,183)	(9,551)	(3.9)	(18,067)	(18,606)	(2.9)
Earning per share of common stock attributable to OAO LUKOIL (US dollars):						
Basic	2.79	1.34	108.0	6.21	6.27	(1.1)
Diluted	2.73	1.32	107.0	6.08	6.15	(1.1)
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	199,522	195,012	2.3	397,136	395,052	0.5
Daily hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	2,193	2,143	2.3	2,194	2,171	1.1
Crude oil and natural gas liquids produced by the Group including our share in equity affiliates (thousands of barrels)	169,998	167,436	1.5	336,613	336,450	–
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	5,017	4,686	7.1	10,284	9,958	3.3
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes)	15,968	15,652	2.0	30,961	30,695	0.9

During the first half of 2013, our net income was $4,685 million, which is $122 million, or 2.5%, less than in the same period of 2012. Our net income for the second quarter of 2013 amounted to $2,104 million, which is twice higher than in the second quarter of 2012. Our EBITDA increased by $897 million, or by 25.9%, as compared to the second quarter of 2012, and by $326 million, or by 3.7%, as compared to the first half of 2012. In 2013, our net income was affected by the decrease in international hydrocarbon prices, increase in operating expenses and depreciation, depletion and amortization. Moreover, our quarterly results are significantly influenced by movements of income tax expense as a result of movements in taxable currency translation gains and tax deductible currency translation losses reported by Russian subsidiaries.

Business overview

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

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

LUKOIL is one of the world's largest energy companies in terms of hydrocarbon reserves that amounted to 17.3 billion BOE as of January 1, 2013 and comprised of 13.4 billion barrels of crude oil and 23.5 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 gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, Uzbekistan, the Middle East, South America, Northern and Western Africa and South-East Asia.
- **Refining, Marketing and Distribution** – which includes refining and transport operations, marketing and trading of crude oil, natural gas and refined products.
- **Chemicals** – which includes processing and trading of petrochemical products.
- **Power generation** – which includes generation, transportation and sales of electricity, heat and related services.

Each of our four main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the "Domestic crude oil and refined products prices" section on page 8, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of crude oil refining and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 20 "Segment information" to the interim consolidated financial statements.

Recent developments

In April 2013, after approval by the Federal Anti-monopoly Service, in line with the strategy to grow oil production in Russia the Company purchased 100% of the shares of ZAO Samara-nafta for $2.1 billion after final adjustments. ZAO Samara-nafta is an exploration and production company operating in the Samara and Uljanovsk regions of the Russian Federation.

In April-May 2013, Group companies acquired the remaining 50% of the shares of ZAO Kama-oil for $400 million increasing the Group's ownership up to 100%. As a result of this acquisition the Group obtained control and consolidated ZAO Kama-oil, an exploration and production company operating in Perm region of the Russian Federation.

In April 2013, a Group company issued two tranches of non-convertible bonds totaling $3 billion. The first tranche totaling $1.5 billion was placed with a maturity of 5 years and a coupon yield of 3.416% per annum. The second tranche totaling $1.5 billion was placed with a maturity of 10 years and a coupon yield of 4.563% per annum. All bonds were placed at face value and have a half year coupon period.

In September 2012, after the approval by European regulatory authorities, the Group acquired a 20% stake in the joint venture operating the ISAB refining complex ("ISAB") for €494 million (approximately $621 million) after final adjustments. The Group's ownership in ISAB increased from 60% to 80% and the Group obtained control over the joint venture. This transaction was a partial exercise of ERG S.p.A. option to sell in full its stake in the joint venture established in 2008 to the Group. In April 2011, within this option, the Group acquired an 11% stake in the joint venture for €241 million (approximately $342 million).

Operational highlights

Hydrocarbon production

We undertake exploration for, and production of, crude oil, natural gas liquids 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. Exploration and production outside of Russia is performed by our 100% subsidiary LUKOIL-Overseas, that has stakes in PSA's and other projects in Kazakhstan, Azerbaijan, Uzbekistan, Iraq, Saudi Arabia, Egypt, Ghana, Cote d'Ivoire, Vietnam, Venezuela, Romania and Sierra Leone.

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

	2nd quarter of		1st half of	
	2013	**2012**	**2013**	**2012**
Crude oil and natural gas liquids production(1)	(thousand BOE per day)			
Consolidated subsidiaries				
Western Siberia	999	1,012	1,004	1,015
Timan-Pechora	297	306	301	310
Ural region	293	284	292	284
Volga region	124	72	105	72
Other in Russia	38	39	38	38
Total in Russia	1,751	1,713	1,740	1,719
Total outside Russia	64	70	65	71
Total consolidated subsidiaries	**1,815**	**1,783**	**1,805**	**1,790**
Our share in equity affiliates				
in Russia	7	8	7	8
outside Russia	46	49	48	51
Total share in equity affiliates	**53**	**57**	**55**	**59**
Total crude oil and natural gas liquids	**1,868**	**1,840**	**1,860**	**1,849**
Natural gas production available for sale(2)				
Consolidated subsidiaries				
Western Siberia	185	170	190	183
Timan-Pechora	14	11	13	11
Ural region	15	13	17	15
Volga region	6	6	6	6
Total in Russia	220	200	226	215
Total outside Russia	96	94	99	98
Total consolidated subsidiaries	**316**	**294**	**325**	**313**
Share in equity affiliates				
in Russia	1	1	1	1
outside Russia	8	8	8	8
Total share in production of equity affiliates	**9**	**9**	**9**	**9**
Total natural gas available for sale	**325**	**303**	**334**	**322**
Total daily hydrocarbon production	**2,193**	**2,143**	**2,194**	**2,171**
	(US dollar per BOE)			
Hydrocarbon extraction expenses	5.59	5.02	5.44	4.86
- in Russia	5.60	5.03	5.47	4.88
- outside Russia	5.51	4.85	5.08	4.58
	(millions of US dollars)			
Hydrocarbon extraction expenses	1,078	944	2,087	1,850
- in Russia	999	873	1,937	1,711
- outside Russia	79	71	150	139
Exploration expenses	75	104	138	147
- in Russia	55	66	98	92
- outside Russia	20	38	40	55
Mineral extraction tax	3,030	3,132	6,043	6,272
- in Russia	3,010	3,108	6,006	6,226
- outside Russia	20	24	37	46

(1) Natural gas liquids produced at the Group gas processing plants.
(2) Gas available for sale (excluding gas produced for our own consumption and including petroleum gas sold to third parties).

Crude oil production. In the first half of 2013, our daily crude oil production increased by 0.6%, compared to the first half of 2012. We produced (including the Company's share in equity affiliates) 44.7 million tonnes, or 330.1 million barrels of crude oil. The main oil producing region for the Company is Western Siberia where we produced 55.5% of our crude oil in the first half of 2013 (56.7% in the first half of 2012).

The following table represents our crude oil production in the first half of 2013 and 2012 by major regions.

(thousands of tonnes)	1st half of 2013	Change to 2012: Total, %	Change to 2012: Change in structure	Change to 2012: Organic change	1st half of 2012
Western Siberia	24,084	(1.8)	–	(442)	24,526
Timan-Pechora	7,522	(3.6)	–	(277)	7,799
Ural region	6,851	3.2	35	175	6,641
Volga region	2,451	47.4	459	329	1,663
Other in Russia	940	(0.1)	–	(1)	941
Crude oil produced in Russia	41,848	0.7	494	(216)	41,570
Crude oil produced internationally	1,564	(7.9)	(75)	(60)	1,699
Total crude oil produced by consolidated subsidiaries	**43,412**	**0.3**	**419**	**(276)**	**43,269**
Our share in crude oil produced by equity affiliates:					
in Russia	179	(5.8)	(18)	7	190
outside Russia	1,114	(6.2)	–	(74)	1,188
Total crude oil produced	**44,705**	**0.1**	**401**	**(343)**	**44,647**

Some decrease in oil production in Western Siberia was due to natural depletion of reserves and an increase in water cut. The increasing water cut was also the reason for the decline of the production from Yuzhnoye Khylchuyu oilfield in Timan-Pechora. Nevertheless, this was compensated by the acquisitions of new upstream properties together with the development the Yu. Korchagin greenfield in the Caspian Sea and greenfields in Timan-Pechora, as well as successful employment of new technologies and an increase in drilling footage in traditional regions. As a result, our daily domestic crude oil and natural gas liquids production volumes increased by 0.6%, compared to the first half of 2012.

The structural increase in our domestic production was a result of acquisition of 100.0% share of ZAO Samara-nafta and an increase of Group's ownership in ZAO Kama-oil from 50.0% to 100.0% during the second quarter of 2013. At the same time, the transfer of ZAO Kama-oil from affiliates to subsidiaries led to some structural decrease in the affiliates' production in Russia. The structural decrease of our international production was a result of sale of 1.5% (10.0% of our share) in Karachaganak Petroleum Operating consortium, an upstream project in Kazakhstan, to a state-owned KazMunayGaz in the end of the second quarter of 2012.

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

	2nd quarter of 2013 (thousand of barrels)	2nd quarter of 2013 (thousand of tonnes)	2nd quarter of 2012 (thousand of barrels)	2nd quarter of 2012 (thousand of tonnes)
Purchases in Russia	946	129	213	29
Purchases for trading internationally	10,673	1,456	5,439	742
Purchases for refining internationally	17,129	2,337	25,589	3,491
Total crude oil purchased	**28,748**	**3,922**	**31,241**	**4,262**

	1st half of			
	2013		2012	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Purchases in Russia	1,151	157	1,305	178
Purchases for trading internationally	14,125	1,927	12,124	1,654
Purchases for refining internationally	32,523	4,437	44,464	6,066
Total crude oil purchased	**47,799**	**6,521**	**57,893**	**7,898**

Significant part of our crude oil purchases is for processing. Compared to the first half of 2012, our purchases for processing at international refineries decreased by 26.9%, largely, as a result of the increase in volumes of own crude oil supplies. Nevertheless, our purchases for trading increased compared to the first half of 2012 by 16.5%.

Production of gas and natural gas liquids. In the first half of 2013, we produced 10,284 million cubic meters (60.5 million BOE) of gas available for sale (including our share in equity affiliates), that is 3.3% more than in the first half of 2012.

Our major gas production field is the Nakhodkinskoe field, where we produced 4,116 million cubic meters of natural gas in the first half of 2013 (4,000 million cubic meters in the first half of 2012). Our international gas production did not change significantly, compared to the first half of 2012.

In the first half of 2013, the output of natural gas liquids at the Group gas processing plants in Western Siberia, Ural and Volgograd regions of Russia was 6.5 million BOE, compared to 6.7 million BOE in the first half of 2012.

Refining, marketing and trading

Refining. We own and operate four refineries located in European Russia and three refineries located outside of Russia – in Bulgaria, Romania and Italy. Moreover, we have a 45% interest in the Zeeland Refinery in the Netherlands.

In September 2012, we increased our interest up to 80% and obtained control over ISAB, in which we previously held 60%. Therefore, starting from September 2012, ISAB became our consolidated subsidiary, rather than equity affiliate.

Compared to the first half of 2012, the total volume of refined products produced by the Group (including our share in equity affiliates production) increased by 0.9%. Production volumes at our Russian refineries increased by 2.5%, while the production of our international refineries decreased by 2.6%. The increase of our share in the ISAB production was offset by the effect of decreased production at this refinery due to overhaul carried out in the first quarter of 2013.

We invested, and continue to invest, significant resources in our refineries aiming at taking the leading position in Russia in producing ecological fuel of high quality standards. Starting from July 1, 2012, all the gasoline and most of diesel fuel produced by the Group in Russia comply with Euro-5 standards.

Along with our own production of refined products we can refine crude oil at third party refineries depending on market conditions and other factors. In the first half of 2013 and 2012, we processed our crude oil at third party refineries in Kazakhstan and Belarus.

The following table summarizes key figures for our refining activities.

	2nd quarter of 2013	2nd quarter of 2012	1st half of 2013	1st half of 2012
	(millions of US dollars)			
Refining expenses at the Group refineries	555	363	1,063	678
- in Russia	291	288	550	528
- outside Russia	264(1)	75	513(1)	150
Refining expenses at affiliated refineries outside of Russia	61	239(2)	118	479(2)
Refining expenses at third party refineries	22	24	42	47
Capital expenditures	395	266	974	560
- in Russia	258	186	692	302
- outside Russia	137	80	282	258
	(thousand barrels per day)			
Refinery throughput at the Group refineries	1,223	1,042	1,198	1,027
- in Russia	888	854	896	874
- outside Russia(3)	335(1)	188	302(1)	153
Refinery throughput at affiliated refineries outside of Russia (3)	101	260(2)	97	253(2)
Refinery throughput at third party refineries	46	56	45	53
Total refinery throughput	**1,370**	**1,358**	**1,340**	**1,333**
	(thousands of tonnes)			
Production of the Group refineries in Russia	10,605	10,130	21,217	20,696
Production of the Group refineries outside Russia	4,104(1)	2,284	7,331(1)	3,665
Production of affiliated refineries outside of Russia	1,259	3,238(2)	2,413	6,334(2)
Refined products produced the Group including our share in equity affiliates	**15,968**	**15,652**	**30,961**	**30,695**
Refined products produced at third party refineries	535	646	1,029	1,235
Total refined products produced	**16,503**	**16,298**	**31,990**	**31,930**

(1) Including 80% share of ISAB.
(2) Including 60% share of ISAB.
(3) Including refined product processed.

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

The Group retails its refined products in 26 countries through nearly 5.6 thousand petrol stations (including franchisees). Most of the stations operate under the LUKOIL brand.

The table below summarizes figures for our trading activities.

	2nd quarter of 2013	2nd quarter of 2012	1st half of 2013	1st half of 2012
	(thousands of tonnes)			
Retail sales	3,919	3,764	7,465	7,268
Wholesale sales	27,036	22,976	50,908	46,935
Total refined products sales	**30,955**	**26,740**	**58,373**	**54,203**
Refined products purchased in Russia	469	493	1,099	751
Refined products purchased internationally	15,901	12,237	29,441	25,426
Total refined products purchased	**16,370**	**12,730**	**30,540**	**26,177**

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

	2nd quarter of 2013 (thousands of barrels)	2nd quarter of 2013 (thousands of tonnes)	2nd quarter of 2012 (thousands of barrels)	2nd quarter of 2012 (thousands of tonnes)
Exports of crude oil using Transneft export routes	49,228	6,716	62,452	8,520
Exports of crude oil bypassing Transneft	12,669	1,728	4,999	682
Total crude oil exports	**61,897**	**8,444**	**67,451**	**9,202**
Exports of refined products		**6,173**		**5,373**

	1st half of			
	2013		2012	
	(thousands of barrels)	(thousands of tonnes)	(thousands of barrels)	(thousands of tonnes)
Exports of crude oil using Transneft export routes	95,906	13,084	121,305	16,549
Exports of crude oil bypassing Transneft.............................	22,482	3,067	11,376	1,552
Total crude oil exports...	**118,388**	**16,151**	**132,681**	**18,101**
Exports of refined products..		**12,140**		**11,687**

In the first half of 2013, the volume of our crude oil export from Russia decreased by 10.8% compared to the first half of 2012, and we exported 38.6% of our total domestic crude oil production (43.5% – in the first half of 2012). The decrease of crude oil export was a result of higher sales in Russia following the increase in domestic demand.

All the volume of crude oil exported bypassing Transneft in the periods considered was routed through our own export infrastructure.

In the first half of 2013, the volume of our export of refined products from Russia increased by 453 thousand tonnes, or by 3.9%, compared to the first half of 2012. Primarily, we export from Russia diesel fuel, fuel oil and gasoil. These products account for approximately 89% of our refined products export volumes.

In the first half of 2013, our revenue from export of crude oil and refined products from Russia both to Group companies and third parties amounted to $11,350 million and $8,952 million, respectively ($13,193 million for crude oil and $8,790 million for refined products in the first half of 2012).

Main macroeconomic factors affecting our results of operations

Changes in the price of crude oil and refined products

The price at which we sell crude oil and refined products is the primary driver of the Group's revenues. During the first half of 2013, the Brent crude oil price fluctuated between $96 and $119 per barrel and reached its peak of $119.02 in February. At the same time, during the second quarter of 2013, the average price of barrel of the Brent crude was 9.0% lower than in the first quarter of 2013.

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

	2nd quarter of 2013	2nd quarter of 2012	Change, %	1st half of 2013	1st half of 2012	Change, %
	(in US dollars per barrel, except for figures in percent)					
Brent crude	102.43	108.29	(5.4)	107.50	113.61	(5.4)
Urals crude (CIF Mediterranean) (1)	102.34	106.84	(4.2)	106.70	112.10	(4.8)
Urals crude (CIF Rotterdam) (1)	101.89	106.31	(4.2)	106.21	111.76	(5.0)
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam)	580.30	625.79	(7.3)	596.69	657.12	(9.2)
Diesel fuel 10 ppm (FOB Rotterdam)	889.35	942.77	(5.7)	931.71	978.04	(4.7)
High-octane gasoline (FOB Rotterdam)	957.59	1,030.22	(7.0)	999.06	1,046.54	(4.5)

Source: Platts.

(1) The Company sells crude oil on foreign markets on various delivery terms. Thus, our average realized sale price of oil on international markets differs from the average prices of Urals blend on Mediterranean and Northern Europe markets.

Domestic crude oil and refined products prices

Substantially all crude oil produced in Russia is produced by vertically integrated oil companies such as ours. As a result, most transactions are between affiliated entities within vertically integrated groups. Thus, there is no concept of a benchmark domestic market price for crude oil. The price of crude oil that is produced but not refined or exported by one of the vertically integrated oil companies is generally determined on a transaction-by-transaction basis against a background of world market prices, but with no direct reference or correlation. At any time there may exist significant price differences between regions for similar quality crude oil as a result of the competition and economic conditions in those regions.

Domestic prices for refined products are determined to some extent by world market prices, but they are also directly affected by local demand and competition.

The table below represents average domestic wholesale prices of refined products in the periods considered.

	2nd quarter of 2013	2nd quarter of 2012	Change, %	1st half of 2013	1st half of 2012	Change, %
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil	302.48	279.63	8.2	332.42	293.25	13.4
Diesel fuel	817.59	746.57	9.5	861.39	791.02	8.9
High-octane gasoline (Regular)	790.42	817.20	(3.3)	805.95	797.61	1.0
High-octane gasoline (Premium)	847.14	881.46	(3.9)	856.26	848.31	0.9

Source: InfoTEK (excluding VAT).

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenue is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, ruble inflation and movements of exchange rates can significantly affect the results of our operations. In particular, the appreciation of the ruble against the US dollar generally causes our costs to increase in US dollar terms, and vice versa. The appreciation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 5.8% in the first half of 2013, compared to the first half of 2012.

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

	2nd quarter of		1st half of	
	2013	**2012**	**2013**	**2012**
Ruble inflation (CPI), %	1.6	1.7	3.5	3.2
Average exchange rate for the period (ruble to US dollar)	31.61	31.01	31.02	30.64
Exchange rate at the end of the period (ruble to US dollar)	32.71	32.82	32.71	32.82

Tax burden

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

		2nd quarter of		Change,
		2013(1)	**2012(1)**	**%**
Export tariffs on crude oil	$/tonne	379.72	443.09	(14.3)
Export tariffs on refined products				
Middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	250.59	292.37	(14.3)
Light distillates				
gasoline	$/tonne	341.75	398.75	(14.3)
straight-run gasoline	$/tonne	341.75	398.75	(14.3)
Liquid fuels (fuel oil)	$/tonne	250.59	292.37	(14.3)
Mineral extraction tax				
Crude oil	RUR/tonne	4,954.00	4,826.60	2.6
Natural gas	RUR/1,000 m^3	265.00	251.00	5.6

(1) Average values.

		1st half of		Change,
		2013(1)	**2012(1)**	**%**
Export tariffs on crude oil	$/tonne	393.09	422.03	(6.8)
Export tariffs on refined products				
Middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	259.43	278.49	(6.8)
Light distillates				
gasoline	$/tonne	353.79	379.80	(6.8)
straight-run gasoline	$/tonne	353.79	379.80	(6.8)
Liquid fuels (fuel oil)	$/tonne	259.43	278.49	(6.8)
Mineral extraction tax				
Crude oil	RUR/tonne	5,104.08	5,054.99	1.0
Natural gas	RUR/1,000 m^3	265.00	251.00	5.6

(1) Average values.

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

		2nd quarter of		Change,
		2013(1)	**2012(1)**	**%**
Mineral extraction tax				
Crude oil	$/tonne	156.71	155.63	0.7
Natural gas	$/1,000 m^3	8.38	8.09	3.6

(1) Average values.

		1st half of		Change,
		2013(1)	**2012(1)**	**%**
Mineral extraction tax				
Crude oil	$/tonne	164.56	164.99	(0.3)
Natural gas	$/1,000 m^3	8.54	8.19	4.3

(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 is determined by adjusting the base rate depending on the international market price of Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals blend international market price for a tax period is less than or equal to $15.00 per barrel. Each $1.00 per barrel increase in the international Urals blend price over the threshold ($15.00 per barrel) results in an increase of the tax rate by $1.61 per tonne extracted (or $0.22 per barrel extracted using a conversion factor of 7.33) above the base rate.

In the first half of 2013, the base rate was 470 rubles per metric tonne extracted (446 rubles in the first half of 2012).

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

The Group produces crude oil in the Caspian Sea and benefits from application of zero extraction tax rate.

Natural gas extraction tax rate. The mineral extraction tax on natural gas produced by independent producers in Russia is calculated using a flat rate. The rate for 2013 is set at 265 rubles per thousand cubic meters, while in 2012 the rate amounted to 251 rubles.

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 no more than by $0.65 per barrel exported. Starting from October 1, 2011, the maximum increase of export duty rate is $0.60 per barrel for each $1.00 per barrel increase in the Urals blend price.

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

A special export duty regime is in place for certain greenfields. The list of the oilfields where the reduced rate applies 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 refined products are calculated by multiplying the current crude oil export duty rate by a coefficient according to the table below.

Multiplier for:	
Light distillates (except for gasolines), middle distillates (jet fuel), diesel fuel, gasoils, liquid fuels (fuel oil), motor and other oils, other products	0.660
Gasolines	0.900

Crude oil and refined products exported to the member countries of the Custom Union – Belarus and Kazakhstan, are not subject to export duties.

Excise on refined products. The responsibility to pay excises on refined products in Russia is imposed on refined product producers (except for straight-run gasoline). Only domestic sales volumes are subject to excises.

In other countries where the Group operates, excises are paid either by producers or retailers depending on the local legislation.

Excise rates on refined products in Russia are tied to the ecological class of fuel. Excise tax rates for the respective periods of 2013 and 2012 are listed below:

		2nd quarter of 2013	2012	Change, %	1st half of 2013	2012	Change, %
Gasoline							
Below Euro-3	RUR/tonne	10,100.00	7,725.00	30.7	10,100.00	7,725.00	30.7
Euro-3	RUR/tonne	9,750.00	7,382.00	32.1	9,750.00	7,382.00	32.1
Euro-4	RUR/tonne	8,560.00	6,822.00	25.5	8,560.00	6,822.00	25.5
Euro-5	RUR/tonne	5,143.00	6,822.00	(24.6)	5,143.00	6,822.00	(24.6)
Diesel fuel							
Below Euro-3	RUR/tonne	5,860.00	4,098.00	43.0	5,860.00	4,098.00	43.0
Euro-3	RUR/tonne	5,860.00	3,814.00	53.6	5,860.00	3,814.00	53.6
Euro-4	RUR/tonne	4,934.00	3,562.00	38.5	4,934.00	3,562.00	38.5
Euro-5	RUR/tonne	4,334.00	3,562.00	21.7	4,334.00	3,562.00	21.7
Motor oils	RUR/tonne	7,509.00	6,072.00	23.7	7,509.00	6,072.00	23.7
Straight-run gasoline	RUR/tonne	10,229.00	7,824.00	30.7	10,229.00	7,824.00	30.7

		2nd quarter of 2013	2012	Change, %	1st half of 2013	2012	Change, %
Gasoline							
Below Euro-3	$/tonne	325.63	249.08	30.7	325.63	252.13	29.2
Euro-3	$/tonne	314.34	238.02	32.1	314.34	240.93	30.5
Euro-4	$/tonne	275.98	219.97	25.5	275.98	222.66	23.9
Euro-5	$/tonne	165.81	219.97	(24.6)	165.81	222.66	(25.5)
Diesel fuel							
Below Euro-3	$/tonne	188.93	132.13	43.0	188.93	133.75	41.3
Euro-3	$/tonne	188.93	122.98	53.6	188.93	124.48	51.8
Euro-4	$/tonne	159.07	114.85	38.5	159.07	116.26	36.8
Euro-5	$/tonne	139.73	114.85	21.7	139.73	116.26	20.2
Motor oils	$/tonne	242.09	195.78	23.7	242.09	198.18	22.2
Straight-run gasoline	$/tonne	329.79	252.27	30.7	329.79	255.36	29.1

Income tax. 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.

Until January 1, 2012, there were no provisions in the taxation legislation of the Russian Federation to permit the Group to reduce taxable profits of a Group company by offsetting tax losses of another Group company against such profits. Tax losses could be fully or partially used to offset taxable profits in the same company in any of the ten years following the year of loss.

Starting from January 1, 2012, if certain conditions are met, taxpayers are able to pay income tax as a consolidated taxpayers' group ("CTG"). This allows taxpayers to offset taxable losses generated by certain participants of a CTG against taxable profits of other participants of the CTG. Certain Group companies met the legislative requirements and pay income tax as a CTG starting from the first quarter of 2012.

Losses generated by a taxpayer before joining a CTG are not available for offset against taxable profits of other participants of the CTG. However, if a taxpayer leaves a CTG, such losses again become available for offset against future profits generated by the same taxpayer. The expiration period of the losses is extended to take account of any time spent within a CTG when the losses were unavailable for use.

Transportation of crude oil and refined products in Russia

The main Russian crude oil production regions are remote from the main crude oil and refined products markets. Therefore, access by crude oil production companies to the markets is dependent on the extent of diversification of the transport infrastructure and access to it. As a result, transportation cost is an important macroeconomic factor affecting our net income.

Transportation of crude oil produced in Russia to refineries and export destinations is performed primarily through the trunk oil pipeline system of state-owned OAO AK Transneft or by railway transport.

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

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

Three and six months ended June 30, 2013, compared to three and six months ended June 30, 2012

The table below sets forth data from our consolidated statements of comprehensive income for the periods indicated.

	2nd quarter of		1st half of	
	2013	2012	2013	2012
	(millions of US dollars)			
Revenues				
Sales (including excise and export tariffs)	35,053	32,397	68,823	67,658
Costs and other deductions				
Operating expenses	(2,516)	(2,327)	(4,966)	(4,542)
Cost of purchased crude oil, gas and products	(16,462)	(14,416)	(31,565)	(30,784)
Transportation expenses	(1,562)	(1,497)	(3,212)	(3,102)
Selling, general and administrative expenses	(972)	(932)	(1,838)	(1,761)
Depreciation, depletion and amortization	(1,444)	(1,177)	(2,813)	(2,272)
Taxes other than income taxes	(3,396)	(3,461)	(6,779)	(6,939)
Excise and export tariffs	(5,787)	(6,090)	(11,288)	(11,667)
Exploration expense	(75)	(104)	(138)	(147)
Gain on disposals and impairments of assets	17	175	10	166
Income from operating activities	**2,856**	**2,568**	**6,234**	**6,610**
Interest expense	(121)	(160)	(218)	(321)
Interest and dividend income	58	66	119	132
Equity share in income of affiliates	139	163	297	344
Currency translation loss	(257)	(310)	(396)	(396)
Other non-operating income (expense)	168	(45)	181	(67)
Income before income taxes	**2,843**	**2,282**	**6,217**	**6,302**
Current income taxes	(658)	(1,105)	(1,304)	(1,592)
Deferred income taxes	(90)	(68)	(233)	52
Total income tax expense	**(748)**	**(1,173)**	**(1,537)**	**(1,540)**
Net income	**2,095**	**1,109**	**4,680**	**4,762**
Net loss (income) attributable to non-controlling interests	9	(91)	5	45
Net income attributable to OAO LUKOIL	**2,104**	**1,018**	**4,685**	**4,807**
Earning per share of common stock attributable to OAO LUKOIL (in US dollars):				
Basic	2.79	1.34	6.21	6.27
Diluted	2.73	1.32	6.08	6.15

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

Sales revenues

Sales breakdown	2nd quarter of 2013	2nd quarter of 2012	1st half of 2013	1st half of 2012
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS	4,983	5,879	10,082	12,683
Export and sales to CIS	380	347	765	848
Domestic sales	658	264	1,196	647
	6,021	**6,490**	**12,043**	**14,178**
Refined products				
Export and sales on international markets				
Wholesale	20,135	17,359	39,071	36,882
Retail	2,733	2,704	5,176	5,106
Domestic sales				
Wholesale	1,861	1,899	3,782	3,551
Retail	2,267	2,054	4,463	4,027
	26,996	**24,016**	**52,492**	**49,566**
Petrochemicals				
Export and sales on international markets	249	268	472	544
Domestic sales	214	66	460	118
	463	**334**	**932**	**662**
Gas and gas products				
Export and sales on international markets	527	615	1,084	1,216
Domestic sales	259	242	545	513
	786	**857**	**1,629**	**1,729**
Sales of energy and related services	**296**	**249**	**785**	**687**
Other				
Sales on international markets	291	224	551	421
Domestic sales	200	227	391	415
	491	**451**	**942**	**836**
Total sales	**35,053**	**32,397**	**68,823**	**67,658**

Sales volumes	2nd quarter of 2013	2nd quarter of 2012	1st half of 2013	1st half of 2012
Crude oil	(thousands of barrels)			
Export and sales on international markets other than CIS	49,243	55,994	95,437	114,561
Export and sales to CIS	7,990	8,033	15,518	16,800
Domestic sales	14,484	6,634	25,560	13,407
	71,717	**70,661**	**136,515**	**144,768**
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than CIS	6,718	7,639	13,020	15,629
Export and sales to CIS	1,090	1,096	2,117	2,292
Domestic sales	1,976	905	3,487	1,829
	9,784	**9,640**	**18,624**	**19,750**
Refined products	(thousands of tonnes)			
Export and sales on international markets				
Wholesale	24,335	20,115	45,578	41,763
Retail	1,694	1,667	3,163	3,143
Domestic sales				
Wholesale	2,701	2,861	5,330	5,172
Retail	2,225	2,097	4,302	4,125
	30,955	**26,740**	**58,373**	**54,203**
Total sales volume of crude oil and refined products	**40,739**	**36,380**	**76,997**	**73,953**

Realized average sales prices		2nd quarter of		1st half of	
		2013	2012	2013	2012
Average realized price international					
Oil (excluding CIS)	($/barrel)	101.20	104.98	105.64	110.71
Oil (CIS)	($/barrel)	47.59	43.31	49.34	50.50
Refined products					
Wholesale	($/tonne)	827.45	862.93	857.23	883.11
Retail	($/tonne)	1,612.90	1,622.61	1,636.41	1,624.63
Average realized price within Russia					
Oil	($/barrel)	45.41	39.91	46.78	48.27
Refined products					
Wholesale	($/tonne)	689.07	663.59	709.53	686.51
Retail	($/tonne)	1,018.91	979.18	1,037.56	976.15

During the second quarter of 2013, our revenues increased by $2,656 million, or by 8.2%, compared to the same period of 2012. Crude oil sales decreased by $469 million, or by 7.2%, while refined products sales increased by $2,980 million, or by 12.4%, mostly due to the increase in trading volumes.

During the first half of 2013, our revenues increased by $1,165 million, or by 1.7%, compared to the same period of 2012. Our revenues from crude oil sales decreased by $2,135 million, or by 15.1%, because of the decrease both in sales volumes and prices. Our revenues from sales of refined products increased by $2,926 million, or by 5.9%, as a result of the increased trading volumes.

Sales of crude oil

Compared to the respective periods of 2012, our total crude oil sales revenues decreased by $469 million, or by 7.2%, in the second quarter of 2013 as a result of the decrease in sales prices and by $2,135 million, or by 15.1%, in the first half of 2013 as a result of the decrease both in sales prices and volumes.

Our sales volumes outside of Russia decreased by 921 thousand tonnes, or by 12.1%, compared to the second quarter of 2012, and by 2,609 thousand tonnes, or by 16.7%, compared to the first half of 2012, due to decreased export from Russia together with the increased supplies of own crude oil to our overseas refineries. This, along with the decrease in crude oil prices compared to the respective periods of 2012, led to the decrease in our international sales revenue by 15.2%, or by $896 million, and by 20.5%, or by $2,601 million, in the second quarter and the first half of 2013, respectively. At the same time, domestic sales volumes increased by 1,071 thousand tonnes, or by 118.3%, compared to the second quarter of 2012, and by 1,658 thousand tonnes, or by 90.7%, compared to the first half of 2012, due to significant increase of domestic demand. As a result, in the second quarter and the first half of 2013, our domestic sales revenue increased by 149.2%, or by $394 million, and by 84.9%, or by $549 million, respectively.

In the second quarter and the first half of 2013, our revenue from crude oil export from Russia both to the Group companies and third parties amounted to $5,758 million and $11,350 million, respectively.

Sales of refined products

Compared to the same periods of 2012, our revenue from the wholesale of refined products outside of Russia increased by $2,776 million, or by 16.0%, in the second quarter of 2013 and by $2,189 million, or by 5.9%, in the first half of 2013. The main reason for this was the increase in sales volumes by 21.0% compared to the second quarter of 2012 and by 9.1% compared to the first half of 2012 due to the increase in volumes of refined products trading. At the same time, our realized wholesale prices decreased by 4.1% and 2.9%, respectively.

Compared to the second quarter and the first half of 2012, neither our retail volumes nor retail prices outside of Russia changed significantly, therefore, our international retail sales revenue remained on the level of the respective periods of 2012.

Our revenue from the wholesale of refined products on the domestic market decreased by $38 million, or by 2.0%, in the second quarter of 2013 and increased by $231 million, or by 6.5%, in the first half or 2013. Our average realized price increased by 3.8% and 3.4%, respectively. Our sales volumes decreased by 5.6% in the second quarter of 2013, but increased by 3.1% in the first half of 2013.

Our revenue from retail sales in Russia increased by $213 million, or by 10.4%, in the second quarter of 2013 and by $436 million, or by 10.8%, in the first half of 2013. Retail sales volumes increased by 6.1% in the second quarter of 2013 and by 4.3% in the first half of 2013 resulting from the increase in domestic demand for motor fuels. Average retail prices in Russia increased by 4.1%, compared to the second quarter of 2012, and by 6.3%, compared to the first half of 2012.

In the second quarter and the first half of 2013, our revenue from export of refined products from Russia both to Group companies and third parties amounted to $4,354 million and $8,952 million, respectively.

Sales of petrochemical products

Our revenue from sales of petrochemical products increased by $129 million, or by 38.6%, in the second quarter of 2013 and by $270 million, or by 40.8%, in the first half of 2013. That was mainly a result of a sharp increase in domestic sales volumes after resuming the production at our petrochemical plant in Stavropol region of Russia in the end of the third quarter of 2012. At the same time, in the second quarter and the first half of 2013, our international sales volumes decreased by 19.9% and 27.2%, respectively, due to a temporary shutdown at our petrochemical plant Karpatnaftochim Ltd. in Ukraine, which resulted from unfavorable economic conditions.

Sales of gas and gas products

Sales of gas and gas refined products decreased by $71 million, or by 8.3%, in the second quarter of 2013 and by $100 million, or by 5.8%, in the first half of 2013.

Gas products wholesales revenue decreased by $95 million, or by 27.5%, in the second quarter of 2013 and by $124 million, or by 18.5%, in the first half of 2013. Average realized wholesale prices and sales volumes for gas products decreased by 15.1% and 14.1% in the second quarter of 2013 and by 9.7% and 9.7%, in the first half of 2013, respectively.

Retail gas products revenue decreased by $7 million, or by 4.5%, in the second quarter of 2013 and increased by $2 million, or by 0.7%, in the first half of 2013.

Natural gas sales revenue increased by $31 million, or by 8.7%, in the second quarter of 2013 and by $22 million, or by 2.8%, in the first half of 2013.

Sales of energy and related services

Our revenue from sales of electricity, heat and related services increased by $47 million, or by 18.9%, in the second quarter of 2013 and by $98 million, or by 14.3%, in the first half of 2013 due to commissioning of a combined cycle gas turbine unit with a capacity of 410 MW in Krasnodar, Russia in 2012 and consequent increase in volumes of power and capacity generation in 2013.

Sales of other products

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

In the second quarter of 2013, other sales increased by $40 million, or by 8.9%, and in the first half of 2013, they increased by $106 million, or by 12.7%.

Since obtaining control over the ISAB in September 2012, other sales include revenue from processing services, rendered by this refinery complex. In the second quarter and the first half of 2013, the amount of this revenue totaled $53 million and $102 million, respectively.

Operating expenses

Operating expenses include the following:

	2nd quarter of		1st half of	
	2013	**2012**	**2013**	**2012**
	(millions of US dollars)			
Hydrocarbon extraction expenses	1,078	944	2,087	1,850
Own refining expenses	555	363	1,063	678
Refining expenses at third parties and affiliated refineries	83	263	160	526
Cost of processing operations at ISAB	47	–	91	–
Expenses for crude oil transportation to refineries	335	302	673	589
Power generation and distribution expenses	172	139	364	317
Petrochemical expenses	73	84	152	158
Other operating expenses	173	232	376	424
Total operating expenses	**2,516**	**2,327**	**4,966**	**4,542**

The method of allocation of operating expenses above differs from the approach used in preparing the data for Note 20 "Segment information" to our interim consolidated financial statements. Expenditures in the segment reporting are grouped depending on the segment to which a particular company belongs. Operating expenses for the purposes of this analysis are grouped based on the nature of the costs incurred.

Our operating expenses increased by $189 million, or by 8.1%, in the second quarter of 2013 and by $424 million, or by 9.3%, in the first half of 2013.

Hydrocarbon extraction expenses

Our extraction expenses include expenditures related to repairs of extraction equipment, labor costs, expenses on artificial stimulation of reservoirs, fuel and electricity costs, cost of extraction of natural gas liquids, property insurance of extraction equipment and other similar costs.

In the second quarter of 2013, our extraction expenses increased by $134 million, or by 14.2%, and in the first half of 2013, our extraction expenses increased by $237 million, or by 12.8%, as a result of the increase in energy costs triggered by the tariffs growth, repairs and artificial stimulation of reservoirs. Moreover, $18 million of extraction expenses refer to ZAO Samara-nafta, acquired in April 2013. Our average hydrocarbon extraction cost increased from $5.02 per BOE in the second quarter of 2012 to $5.59 per BOE in the second quarter of 2013, or by 11.4%, and from $4.86 per BOE in the first half of 2012 to $5.44 per BOE in the first half of 2013, or by 11.9%.

Own refining expense

Our own refining expenses increased by $192 million, or by 52.9%, in the second quarter of 2013, and by $385 million, or by 56.8%, in the first half of 2013.

Refining expenses at our domestic refineries were stable (increased by 1.0%, or by $3 million, in the second quarter of 2013 and by 4.2%, or by $22 million, in the first half of 2013).

Refining expenses at our international refineries increased by 252.0%, or by $189 million, in the second quarter of 2013, and by 242.0%, or by $363 million, in the first half of 2013. The increase was mainly due to obtaining control over ISAB in September 2012 (see *Refining, marketing and trading* section for details).

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.

In the second quarter and the first half of 2013, refining expenses at third party and affiliated refineries decreased by 68.4%, or by $180 million, and by 69.6%, or by $366 million, respectively due to obtaining control over ISAB in September 2012 (see *Refining, marketing and trading* section for details).

Expenses for crude oil transportation to refineries

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

Our expenses for crude oil transportation to refineries increased by $33 million, or by 10.9%, in the second quarter of 2013 and by $84 million, or by 14.3%, in the first half of 2013 largely due to the increase of supplies of crude oil from Western Siberia to our international refineries, compared to the respective periods of 2012.

Power generation and distribution expenses

Power generation and distribution expenses increased by $33 million, or by 23.7%, in the second quarter of 2013 and by $47 million, or by 14.8%, in the first half of 2013 due to commissioning of a combined cycle gas turbine unit with a capacity of 410 MW in Krasnodar, Russia in 2012 and consequent increase in volumes of power and capacity generation in 2013.

Other operating expenses

Other operating expenses include expenses of the Group's upstream and downstream entities that do not relate to their core activities, namely rendering of transportation and extraction services, costs of other services provided and goods sold by our production and marketing companies, and of non-core businesses of the Group.

Other operating expenses decreased by $59 million, or by 25.4%, in the second quarter of 2013, and by $48 million, or by 11.3%, in the first half of 2013.

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 crude oil and refined products sales.

Cost of purchased crude oil, gas and products increased by $2,046 million, or by 14.2%, in the second quarter of 2013 and by $781 million, or by 2.5%, in the first half of 2013, driven mainly by the increase in the refined products trading volumes.

In the second quarter of 2013, we recognized a $146 million net gain from hedging, compared to a $534 million net gain in the second quarter of 2012. At the same time, in the first half of 2013, we recognized an $81 million net gain from hedging, compared to a net gain of $82 million in the first half of 2012.

Transportation expenses

Our transportation expenses increased by $65 million, or by 4.3%, compared to the second quarter of 2012, and by $110 million, or by 3.5%, compared to the first half of 2012.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed to the first half of 2012 as follows: crude oil pipeline tariffs decreased by 0.8%, railway tariffs for refined products transportation increased by 6.2%, crude oil freight rates increased by 7.0%, and refined products freight rates decreased by 6.7%.

Selling, general and administrative expenses

Selling, general and administrative expenses include payroll costs (excluding extraction entities' and refineries' production staff costs), insurance costs (except for property insurance related to extraction and refinery equipment), costs of maintenance of social infrastructure, movement in bad debt provision and other expenses.

Our selling, general and administrative expenses increased by $40 million, or by 4.3%, in the second quarter of 2013 and by $77 million, or by 4.4%, in the first half of 2013.

Depreciation, depletion and amortization

Our depreciation, depletion and amortization expenses increased by $267 million, or by 22.7%, compared to the second quarter of 2012, and by $541 million, or by 23.8%, compared to the first half of 2012. This was mainly caused by acquisition of ZAO Samara-Nafta, the increase of production from Yu. Korchagin field in the Caspian Sea and the effect of obtaining control over ISAB in September 2012.

Equity share in income of affiliates

The Group has investments in equity method affiliates and corporate joint ventures. These companies are primarily engaged in crude oil exploration, production, marketing and distribution operations in the Russian Federation, crude oil production and marketing in Kazakhstan and refining operations in Europe. Our largest affiliates are Turgai Petroleum and Tengizchevroil, exploration and production companies operating in Kazakhstan, and Zeeland Refinery. Starting from September 2012, we do not include the results of ISAB in equity share in income of affiliates (see *Refining, marketing and trading* section for details).

Our share in income of affiliates decreased by $24 million, or by 14.7%, compared to the second quarter of 2012, and by $47 million, or by 13.7%, compared to the first half of 2012. The main reason for this was a decrease in income of Turgai Petroleum as a result of the decrease in its crude oil production and hydrocarbon prices.

Taxes other than income taxes

	2nd quarter of		1st half of	
	2013	**2012**	**2013**	**2012**
	(millions of US dollars)			
In Russia				
Mineral extraction taxes	3,010	3,108	6,006	6,226
Social security taxes and contributions	141	135	307	283
Property tax	141	125	269	251
Other taxes	33	22	52	39
Total in Russia	**3,325**	**3,390**	**6,634**	**6,799**
International				
Mineral extraction taxes	20	24	37	46
Social security taxes and contributions	30	26	60	49
Property tax	8	6	16	11
Other taxes	13	15	32	34
Total internationally	**71**	**71**	**145**	**140**
Total	**3,396**	**3,461**	**6,779**	**6,939**

In the second quarter of 2013, taxes other than income taxes decreased by 1.9%, or by $65 million, compared to the second quarter of 2012. Compared to the first half of 2012, they decreased by 2.3%, or by $160 million. This was mainly due to lower mineral extraction tax expenses as a result of the increase of the share of production from the fields where either reduced, or zero tax rate was applied, as well as by the decrease in dollar value of mineral extraction tax rate in Russia.

In the second quarter and the first half of 2013, application of the reduced rate for crude oil produced from depleted oilfields and zero rate for crude oil produced from oilfields with extra heavy crude oil and from greenfields led to $436 million and $904 million tax reduction, respectively ($338 million and $714 million in the second quarter and the first half of 2012, respectively). Of this amount, $55 million in the second quarter of 2013 and $112 million in the first half of 2013 refer to the production from the Yu. Korchagin field in the Caspian Sea ($21 million and $38 million in the second quarter and the first half of 2012, respectively).

Excise and export tariffs

	2nd quarter of		1st half of	
	2013	**2012**	**2013**	**2012**
	(millions of US dollars)			
In Russia				
Excise tax on refined products	489	556	925	1,015
Crude oil export tariffs	2,623	3,325	5,107	6,170
Refined products export tariffs	1,592	1,220	3,207	2,678
Total in Russia	**4,704**	**5,101**	**9,239**	**9,863**
International				
Excise tax and sales taxes on refined products	929	811	1,751	1,485
Crude oil export tariffs	59	73	121	152
Refined products export tariffs	95	105	177	167
Total internationally	**1,083**	**989**	**2,049**	**1,804**
Total	**5,787**	**6,090**	**11,288**	**11,667**

Export tariffs decreased by $354 million, or by 7.5%, in the second quarter of 2013 and by $555 million, or by 6.1%, in the first half of 2013, mainly as a result of the decrease in export duty rates and crude oil export volumes. At the same time, this was partially offset by increased refined product export duty as a result of higher volumes of refined product export outside the Customs Union.

The increase in excise tax expense outside of Russia, compared to the respective periods of 2012, was a result of higher volume of sales subject to excises.

Although the excise rates for motor fuels except for Euro-5 gasoline increased compared to the second quarter and the first half of 2012, the increase of the share of Euro-5 motor fuels in our production in Russia let us decrease our excise expenses in the second quarter and the first half of 2013, compared to the respective periods of 2012. In the first half of 2013, all the gasoline produced by the Group in Russia complied with Euro-5 ecological class, while in the first half of 2012 the share of Euro-5 gasoline was much lower.

Other non-operating income (expense)

In the second quarter of 2013, we recognized an income of $200 million related to preliminary results of the revaluation of the Group's 50% interest in ZAO Kama-oil as at the date of acquisition of the remaining 50% interest and obtaining control.

Income taxes

In the second quarter of 2013, our total income tax expense decreased by $425 million, or by 36.2%, compared to the second quarter of 2012. At the same time, our income before income tax increased by $561 million, or by 24.6%.

In the first half of 2013, our total income tax expense decreased by $3 million, or by 0.2%, compared to the first half of 2012, while our income before income tax decreased by $85 million, or by 1.3%.

In the second quarter of 2013, our effective income tax rate was 26.3%, compared to 51.4% in the second quarter of 2012, while in the first half of 2013, our effective income tax rate was 24.7%, compared to 24.4% in the first half of 2012. The maximum statutory rate for the Russian Federation is 20%. In the second quarter of 2012 and 2013, our effective income tax rate was significantly affected by taxable currency translation gains reported by Russian subsidiaries, but the effect of this matter in the second quarter of 2012 was much higher.

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

	2nd quarter of		**1st half of**	
	2013	**2012**	**2013**	**2012**
	(millions of US dollars)			
Net income	**2,104**	**1,018**	**4,685**	**4,807**
Add back:				
Income tax expense	748	1,173	1,537	1,540
Depreciation and amortization	1,444	1,177	2,813	2,272
Interest expense	121	160	218	321
Interest and dividend income	(58)	(66)	(119)	(132)
EBITDA	**4,359**	**3,462**	**9,134**	**8,808**

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

	1st half of 2013	1st half of 2012
	(millions of US dollars)	
Net cash provided by operating activities	7,693	7,031
Net cash used in investing activities	(10,023)	(5,198)
Net cash provided by (used in) financing activities	2,642	(1,100)

Operating activities

Our primary source of cash flow is funds generated from our operations. During the first half of 2013, cash generated from operating activities amounted $7,693 million, which is 9.4% more than in the first half of 2012. Moreover, our cash flow from operating activity was supported by a decrease in working capital by $133 million, compared to January 1, 2013.

Investing activities

In the first half of 2013, the increase in cash used in investing activities mainly resulted from acquisitions of subsidiaries and increase in capital expenditures and acquisition of licenses, as compared to the respective period of the previous year.

Our capital expenditures, including non-cash transactions, amounted to $6,988 million, which was 29.1% higher than in the first half of 2012.

	2nd quarter of 2013	2nd quarter of 2012	1st half of 2013	1st half of 2012
	(millions of US dollars)			
Capital expenditures[1]				
Exploration and production				
Russia	2,045	1,899	3,919	3,533
International	873	423	1,536	796
Total exploration and production	2,918	2,322	5,455	4,329
Refining, marketing and distribution				
Russia	323	265	794	432
International	166	116	325	295
Total refining, marketing and distribution	489	381	1,119	727
Chemicals				
Russia	31	17	34	23
International	1	7	1	11
Total chemicals	32	24	35	34
Power generation and distribution	55	167	176	224
Other	90	57	203	99
Total capital expenditures	**3,584**	**2,951**	**6,988**	**5,413**

(1) Including non-cash transactions and prepayments.

Capital expenditures in exploration and production segment increased by $1,126 million, or by 26.0%, in the first half of 2013, compared to the first half of 2012. In Russia, the increase was due to intense production drilling in Western Siberia and Komi Republic. Internationally, we increased investments in our West Kurnah-2 project in Iraq.

The increase in our refining, marketing and distribution capital expenditures in Russia refers to construction of deep conversion unit at our refinery in Volgograd and construction of catalytic cracking unit at our Nizhny Novgorod refinery.

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

	2nd quarter of 2013	2nd quarter of 2012	1st half of 2013	1st half of 2012
	(millions of US dollars)			
Yamal	95	138	208	317
Caspian region[1]	434	479	878	829
Ghana	1	4	8	9
Cote d'Ivoire	29	10	36	24
Iraq	562	228	1,019	371
Uzbekistan	163	97	259	246
Total	**1,284**	**956**	**2,408**	**1,796**

(1) Russian and international projects.

Also, in the first half of 2013, a Group company paid $835 million as a second 50% installment for the acquisition of the subsoil rights for the site that includes Imilorskoye, West Imilorskoye and Istochnoye fields in Western Siberia. The first 50% payment was made in December 2012.

	2nd quarter of		1st half of	
	2013	2012	2013	2012
	(millions of US dollars)			
Acquisitions of subsidiaries and associates(1)				
Exploration and production				
Russia	2,387	–	2,390	52
International	–	12	–	22
Total exploration and production	2,387	12	2,390	74
Refining, marketing and distribution	–	–	–	–
Russia	69	20	73	22
International	–	32	–	35
Total refining, marketing and distribution	69	52	73	57
Less cash acquired	(15)	(15)	(15)	(16)
Total acquisitions	**2,441**	**49**	**2,448**	**115**

(1) Including prepayments related to acquisitions and non-cash transactions.

In the first half of 2013, the Company spent $2.1 billion for the acquisition of 100% of the shares of ZAO Samara-nafta and $266 million as the final installment within the acquisition of 50% of the shares of ZAO Kama-oil. In the first half of 2012, the Group did not make any significant acquisitions.

Financing activities

In the first half of 2013, net movements of short-term and long-term debt generated an inflow of $2,721 million, compared to an outflow of $198 million in the first half of 2012.

In the second quarter of 2013, a Group company issued two tranches of non-convertible bonds totaling $3 billion. The first tranche totaling $1.5 billion was placed with a maturity of 5 years and a coupon yield of 3.416% per annum. The second tranche totaling $1.5 billion was placed with a maturity of 10 years and a coupon yield of 4.563% per annum. All bonds were placed at face value and have a half year coupon period.

In the first half of 2012, we purchased Company’s stock worth $128 million and in the second quarter of 2012, we spent $740 million for purchase of equity-linked notes.