

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 PJSC LUKOIL as of June 30, 2015 and the results of its operations for the three and six month periods ended June 30, 2015 and 2014, 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 PJSC 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

	2 nd quarter of		Change,	1 st half of		Change,
	2015	2014	%	2015	2014	%
	(millions of US dollars)					
Sales.....	28,104	38,205	(26.4)	51,294	73,886	(30.6)
Net income attributable to LUKOIL.....	1,005	2,389	(57.9)	1,695	4,122	(58.9)
Adjusted net income attributable to LUKOIL ⁽¹⁾	1,249	2,389	(47.7)	2,019	4,642	(56.5)
EBITDA	3,563	5,437	(34.5)	6,379	9,432	(32.4)
Adjusted EBITDA ⁽¹⁾	3,807	5,437	(30.0)	6,703	9,952	(32.6)
Taxes other than income taxes, excise and export tariffs..	(4,973)	(8,747)	(43.1)	(10,145)	(17,680)	(42.6)
Earning per share of common stock attributable to LUKOIL (US dollars):						
Basic	1.33	3.16	(57.9)	2.25	5.46	(58.9)
Diluted	1.32	3.10	(57.5)	2.23	5.35	(58.4)
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE).....	216,342	210,444	2.8	429,529	409,740	4.8
Daily hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	2,377	2,313	2.8	2,373	2,264	4.8
Crude oil and natural gas liquids produced by the Group including our share in equity affiliates (thousands of barrels)	187,041	182,202	2.7	370,009	351,876	5.2
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	4,979	4,799	3.8	10,114	9,833	2.9
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes)	14,713	15,709	(6.3)	28,793	31,094	(7.4)

⁽¹⁾Adjusted for loss on disposal of assets and dry hole write-offs.

In the first half of 2015, net income attributable to LUKOIL decreased by \$2,427 million, or by 58.9%, while our EBITDA decreased by \$3,053 million, or by 32.4%, compared to the first half of 2014. In the first half of 2015, our net income was significantly affected by a sharp decrease in the hydrocarbon prices. Moreover, in the first half of 2015 our net income was affected by dry hole write-off related to exploration project in Romania in the amount of \$244 million and by a loss on expected disposal of our share in Caspian Investment Resources Ltd. in the amount of \$80 million. At the same time, our net income for the first half of 2014 was affected by a loss on the expected disposal of assets in the amount of \$358 million and write-offs related to our exploration projects in Africa in the total amount of \$162 million.

Business overview

The primary activities of 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.

LUKOIL was established in accordance with Presidential Decree No. 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 No. 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 34 countries on four continents.

In July 2015, the Company changed its legal form to PJSC (Public Joint Stock Company) following the requirements of the amended Russian Civil Code.

LUKOIL is one of the world's largest energy companies in terms of hydrocarbon reserves that amounted to 17.6 billion BOE as of January 1, 2015 and comprised of 13.6 billion barrels of crude oil and 23.9 trillion cubic feet of gas.

Our operations are divided into four main business segments:

- **Exploration and Production** – which includes our exploration, development and production operations relating to crude oil and gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, Uzbekistan, the Middle East, Northern and Western Africa, Norway and Romania.
- **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 9, 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 analyse either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 19 “Segment information” to our interim consolidated financial statements.

Changes in Group structure

On April 15, 2014, a Group company entered into a contract with a Sinopec group company, to sell the Group's 50% interest in Caspian Investment Resources Ltd., an exploration and production company operating in Kazakhstan. On June 3, 2015, a Group company made a substitute transaction with a Sinopec group company for the sale at a price of \$1,067 million. The transaction's closing was subject to requisite governmental consents and approvals and was completed on August 20, 2015.

In April 2015, in line with the strategy to optimize downstream portfolio a Group company sold 100% of interest in LUKOIL Ukraine, a distribution company operating in Ukraine, to AMIC Energy Management GmbH. Also, in December 2014, Group companies sold 100% of shares in LUKOIL Slovakia s.r.o., LUKOIL Hungary Ltd. and LUKOIL Czech Republic s.r.o. to Slovnaft Česká Republica, Spol. s.r.o. and Norm Benzinkút Kft at the price of €98 million (approximately \$123 million).

In March 2015, a Group company closed a transaction to enter a project to develop the Etinde block offshore the Republic of Cameroon in the Gulf of Guinea. The Etinde project is being executed under the production sharing agreement. The project partners are LUKOIL (30% interest), New Age (African Global Energy) Ltd (30% interest, operator), Bowleven Plc (20% interest), and state-owned Societe Nationale des Hydrocarbures of Cameroon (20% interest). The license to develop the Etinde area was issued on July 29, 2014 and is valid for 20 years.

In December 2014, LUKOIL sold to Rosneft its 20% share in National oil consortium (“NOC”), established by Russian oil companies in 2008 within development of economic cooperation between Russia and Venezuela. In 2010, NOC and PDVSA, Venezuelan state-owned oil company, established a joint venture, PetroMiranda, to develop the “Junin-6” block in the Orinoko river basin.

West Qurna-2 project

On December 12, 2009, a consortium of a Group company and Statoil won the tender for development of the West Qurna-2 field in Iraq, one of the largest crude oil fields discovered in the world, with estimated recoverable oil reserves of 12.9 billion barrels (1.8 billion tonnes). The service agreement for West Qurna-2 field development and production was signed on January 31, 2010 and then ratified by the Ministry cabinet of the Iraq Republic. After Statoil withdrew from the West Qurna-2 project in May 2012, the parties of the project are Iraq’s state-owned South Oil Company and a consortium of contractors, consisting of a Group company (75% interest) and Iraq’s state-owned North Oil Company (25% interest).

The Group launched the “Mishrif Early Oil” stage on the West Qurna-2 field and reached the planned production of 120 thousand barrels per day in March 2014. According to the service agreement, costs are compensated after this level of production is achieved and maintained during any 90 days within a 120-day period. In June 2014, we met this term and from the second quarter of 2014 started to receive cost compensation.

Accounting for the cost compensation within the West Qurna-2 project in the Group consolidated statement of comprehensive income is as follows. The crude oil sales revenue is recognized after the Iraqi party has approved the actual invoice for the spending quarter. The invoice total amount depends on crude oil production volumes and the market prices for crude oil during the period. Subsequently, crude oil purchases are recognized based on actual crude oil shipments by the Iraqi party against its debt for cost compensation. Then this crude oil is either sold to third parties or supplied to the Group refineries and the respective sales revenues are recognized.

In the first half of 2015, the Group accrued revenue from the West Qurna-2 project in the total amount of \$1,535 million, consisting of cost recovery of \$1,475 million and remuneration fee of \$60 million, compared to the revenue of \$1,179 million in the first half of 2014. This revenue was classified as crude oil sales revenue. Attributable amount of 4,412 thousand tonnes, or 30,260 thousand barrels, of crude oil was included in Group’s crude oil production for the first half of 2015 (1,781 thousand tonnes, or 12,218 thousand barrels in the first half of 2014) that represented approximately 52% of total production from the field (65% in the first half of 2014). In the first half of 2015, we received 4,769 thousand tonnes of crude oil from the Iraqi party as a debt settlement within the cost compensation. This crude oil at cost of \$1,683 million was recognized in *Cost of purchased crude oil, gas and products*. Subsequently, we sold this crude oil to third party customers or delivered to our refineries. During the first half of 2015, the cost compensation increased the Group’s EBITDA by \$1,072 million (\$1,017 million in the first half of 2014).

The project’s target production level is 1.2 million barrels per day and the total term of the contract is 25 years.

The Group is exposed to political, economic and legal risks due to its operations in Iraq. Management monitors the risks associated with the projects in Iraq and believes that there is no adverse effect on the Group’s financial position that can be reasonably estimated at present.

Sectorial sanctions against the Russian companies

In July-September 2014, the United States (“US”), the European Union (“EU”) and other countries imposed a number of sectorial sanctions on Russian entities, including LUKOIL. These sanctions prohibit the US and the EU companies and individuals from the provision of goods, services or technology (except for financial services to LUKOIL) that can be used on the territory of the Russian Federation in deepwater exploration and production of crude oil, exploration and production of crude oil in Arctic offshore and shale projects. The Company considers these sanctions in its activities, continuously monitors them and analyses the effect of the sanctions on the Company’s financial position and results of operations.

Operational highlights

Hydrocarbon production

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

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
Crude oil and natural gas liquids production⁽¹⁾	(thousand BOE per day)			
Consolidated subsidiaries				
Western Siberia	926	970	934	976
Timan-Pechora	339	306	332	308
Ural region	320	308	316	308
Volga region.....	140	135	140	135
Other in Russia.....	37	38	37	37
Total in Russia.....	1,762	1,757	1,759	1,764
Iraq ⁽²⁾	177	134	167	67
Other outside Russia.....	61	61	62	62
Total outside Russia.....	238	195	229	129
Total consolidated subsidiaries	2,000	1,952	1,988	1,893
Our share in equity affiliates				
in Russia	15	10	15	9
outside Russia.....	40	40	41	42
Total share in equity affiliates.....	55	50	56	51
Total crude oil and natural gas liquids	2,055	2,002	2,044	1,944
Natural gas production available for sale⁽³⁾				
Consolidated subsidiaries				
Western Siberia	173	185	177	186
Timan-Pechora	13	15	12	14
Ural region	18	16	22	18
Volga region.....	6	6	6	6
Total in Russia.....	210	222	217	224
Total outside Russia.....	103	81	103	87
Total consolidated subsidiaries	313	303	320	311
Share in equity affiliates				
in Russia	1	1	1	1
outside Russia.....	8	7	8	8
Total share in production of equity affiliates.....	9	8	9	9
Total natural gas available for sale.....	322	311	329	320
Total daily hydrocarbon production	2,377	2,313	2,373	2,264
				(US dollar per BOE)
Hydrocarbon extraction expenses	4.76	6.13	4.50	5.70
- in Russia	3.98	5.65	3.60	5.46
- outside Russia	9.11	9.46	9.73	7.90
				(millions of US dollars)
Hydrocarbon extraction expenses	1,003	1,259	1,884	2,270
- in Russia	712	1,015	1,283	1,957
- outside Russia.....	291	244	601	313
Exploration expenses	309	64	388	269
- in Russia	35	38	85	123
- outside Russia	274	26	303	146
Mineral extraction tax	2,361	3,070	4,285	6,169
- in Russia	2,358	3,055	4,276	6,136
- outside Russia.....	3	15	9	33

⁽¹⁾ Natural gas liquids produced at the Group gas processing plants.

⁽²⁾ Compensation oil that represented approximately 52% of production from the West Qurna-2 field in the first half of 2015 and 65% in the first half of 2014.

⁽³⁾ Including petroleum gas sold to third parties.

We undertake exploration for, and production of, crude oil and natural gas in Russia and internationally. In Russia, our major oil producing subsidiaries are LUKOIL-Western Siberia, LUKOIL-Komi and LUKOIL-PERM. Currently, the Group is restructuring its international upstream segment that includes stakes in PSA's and other projects in Kazakhstan, Azerbaijan, Uzbekistan, Romania, Iraq, Saudi Arabia, Egypt, Ghana, Cote d'Ivoire, Norway, Cameroon and Nigeria.

Crude oil production. In the first half of 2015, we produced (including the Company's share in equity affiliates) 49.6 million tonnes, or 363.4 million barrels, of crude oil.

The following table represents our crude oil production in the first half of 2015 and 2014 by major regions.

(thousands of tonnes)	Change to 2014				1st half of 2014
	1st half of 2015	Total, %	Change in structure	Organic change	
Western Siberia.....	22,402	(4.2)	–	(975)	23,377
Timan-Pechora.....	8,316	8.0	–	619	7,697
Ural region.....	7,425	3.4	–	241	7,184
Volga region.....	3,383	3.8	–	123	3,260
Other in Russia.....	935	(0.4)	–	(4)	939
Crude oil produced in Russia.....	42,461	0.0	–	4	42,457
Iraq ⁽¹⁾	4,412	147.7	–	2,631	1,781
Other outside of Russia.....	1,473	–	–	–	1,473
Crude oil produced internationally.....	5,885	80.9	–	2,631	3,254
Total crude oil produced by consolidated subsidiaries.....	48,346	5.8	–	2,635	45,711
Our share in crude oil produced by equity affiliates:					
in Russia.....	350	69.1	–	143	207
outside Russia.....	942	(3.0)	–	(29)	971
Total crude oil produced.....	49,638	5.9	–	2,749	46,889

⁽¹⁾ Compensation oil that represented approximately 52% of production from the West Qurna-2 field in the first half of 2015 and 65% in the first half of 2014.

The main oil producing region for the Company is Western Siberia where we produced 46.3% of our crude oil in the first half of 2015 (51.1% in the first half of 2014).

Crude oil production in Western Siberia continued to decline due to natural depletion of reserves and an increase in water cut. Nevertheless, this was compensated for by the development of greenfields, successful employment of new technologies and an increase in drilling footage.

The increase in our international production was a result of commencement of commercial production at the West Qurna-2 oilfield in Iraq in the second quarter of 2014 (for details see p. 3).

The increase in our share in crude oil produced by equity affiliates in Russia was due to the commencement of production at the Trebs and Titov oilfields by Bashneft-Polus, where the Group holds a 25.1% interest.

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			
	2015	2014		
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Purchases in Russia.....	4,618	630	1,129	154
Purchases for trading internationally.....	40,938	5,585	32,809	4,476
Purchases for refining internationally.....	20,898	2,851	21,719	2,963
The West Qurna-2 compensation crude oil.....	18,303	2,497	–	–
Total crude oil purchased.....	84,757	11,563	55,657	7,593

	1 st half of			
	2015		2014	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Purchases in Russia.....	6,854	935	3,262	445
Purchases for trading internationally.....	78,761	10,745	56,199	7,667
Purchases for refining internationally	37,947	5,177	38,497	5,252
The West Qurna-2 compensation crude oil.....	34,957	4,769	–	–
Total crude oil purchased.....	158,519	21,626	97,958	13,364

A significant part of our crude oil purchases is for refining. Compared to the first half of 2014, our purchases for refining at international refineries remained relatively unchanged. At the same time, our purchases for trading increased significantly compared to the first half of 2014. Moreover, in the first half of 2015, the Group received 4.8 million tonnes of compensation crude from Iraq's state-owned South Oil Company as cost compensation within the West Qurna-2 project (in the first half of 2014, the Group did not receive compensation crude oil yet).

Production of gas and natural gas liquids. During the first half of 2015, we produced 10,114 million cubic meters (59.5 million BOE) of gas available for sale (including our share in equity affiliates), that is 2.9% more than in the first half of 2014.

Our major gas production field is the Nakhodkinskoe field, where we produced 3,731 million cubic meters of natural gas in the first half of 2015 (4,131 million cubic meters in the first half of 2014). The decrease of production from the field was due to a revision of the development plan. Our international gas production increased by 17.8%, compared to the first half of 2014, largely resulting from the increase in production in Uzbekistan and Azerbaijan.

In the first half of 2015, the output of natural gas liquids at the Group gas processing plants in Western Siberia, Ural and Volgograd regions of Russia was 6.6 million BOE, compared to 7.2 million BOE in the first half of 2014.

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.

Compared to the first half of 2014, the total volume of refined products produced by the Group (including our share in production at the Zeeland refinery) decreased by 7.4%. Production volumes decreased by 10.9% at our Russian refineries and increased by 0.5% internationally. In Russia, the decrease was a result of amendments in the tax legislation that decreased the refining margins.

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

The following table summarizes key figures for our refining activities.

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
	(thousand barrels per day)			
Refinery throughput at the Group refineries	1,164	1,269	1,141	1,247
- in Russia	827	902	818	912
- outside Russia ⁽¹⁾	337	367	323	335
Refinery throughput at the Zeeland refinery ⁽¹⁾	90	34	96	60
Refinery throughput at third party refineries	17	41	17	29
Total refinery throughput	1,271	1,344	1,254	1,336
	(thousands of tonnes)			
Production of the Group refineries in Russia	9,758	10,743	19,194	21,547
Production of the Group refineries outside Russia	3,847	4,543	7,225	8,059
Production of the Zeeland refinery	1,108	423	2,374	1,488
Refined products produced by the Group including our share in the Zeeland refinery	14,713	15,709	28,793	31,094
Refined products produced at third party refineries	206	463	406	648
Total refined products produced	14,919	16,172	29,199	31,742
	(millions of US dollars)			
Refining expenses at the Group refineries	385	518	717	998
- in Russia	192	272	330	502
- outside Russia	193	246	387	496
Refining expenses at the Zeeland refinery	38	33	79	90
Refining expenses at third party refineries	10	19	19	26
Capital expenditures	336	799	694	1,198
- in Russia	244	613	520	814
- outside Russia	92	186	174	384

⁽¹⁾ 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 23 countries through nearly 5.1 thousand petrol stations (including franchisees). Most of the stations operate under the LUKOIL brand.

The table below summarizes figures for our trading activities.

	2 nd quarter of		1 st half of	
	2015	2014 ⁽¹⁾	2015	2014 ⁽¹⁾
	(thousands of tonnes)			
Retail sales	4,818	4,928	9,131	9,347
Wholesale sales	26,275	24,132	51,472	47,886
Total refined products sales	31,093	29,060	60,603	57,233
Refined products purchased in Russia	508	382	893	819
Refined products purchased internationally	18,165	14,532	33,771	29,210
Total refined products purchased	18,673	14,914	34,664	30,029

⁽¹⁾ From the first quarter of 2015, our international volumes of small wholesales are included in retail sales. Figures for 2014 were adjusted accordingly.

In April 2015, in line with the strategy to optimize its downstream operations, a Group company sold 100% of the Group's interest in LUKOIL Ukraine, a distribution company operating in Ukraine. Also, in December 2014, Group companies sold 100% of shares in LUKOIL Slovakia, LUKOIL Hungary and LUKOIL Czech Republic that together operated approximately 140 petrol stations.

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:

	2 nd quarter of			
	2015			2014
	(thousands of barrels)	(thousands of tonnes)	(thousands of barrels)	(thousands of tonnes)
Exports of crude oil to Customs Union	7,029	959	6,692	913
Exports of crude oil beyond Customs Union	59,292	8,089	47,550	6,487
Total crude oil exports	66,321	9,048	54,242	7,400
Exports of refined products.....		5,144		6,122

	1 st half of			
	2015			2014
	(thousands of barrels)	(thousands of tonnes)	(thousands of barrels)	(thousands of tonnes)
Exports of crude oil to Customs Union	14,183	1,935	13,480	1,839
Exports of crude oil beyond Customs Union	119,926	16,361	94,381	12,876
Total crude oil exports	134,109	18,296	107,861	14,715
Exports of refined products.....		10,403		12,446

Following the amendments in tax legislation in the Russian oil industry, we increased our exports of crude oil and decreased the refined products exports. During the first half of 2015, the volume of our crude oil exports from Russia increased by 24.3%, and we exported 43.1% of our domestic crude oil production (34.7% – in the first half of 2014), including 794 thousand tonnes of crude oil purchased from our affiliates and third parties (161 thousand tonnes in the first half of 2014). The volume of our refined products exports from Russia decreased by 16.4% compared to the first half of 2014. Primarily, we export from Russia diesel fuel, fuel oil and gasoil. These products accounted for approximately 81% of our exported refined products volumes.

Substantially, we use Transneft infrastructure to export our crude oil. Nevertheless, during the second quarter and the first half of 2015, we exported 1,865 thousand tonnes and 3,689 thousand tonnes, respectively, through our own infrastructure (1,483 thousand tonnes and 3,131 thousand tonnes during the second quarter and the first half of 2014, respectively) that represented approximately 20% of our total crude oil export in each of the periods considered. All the volume of crude oil exported that bypassed Transneft was routed beyond the Customs Union.

In the first half of 2015, the Company exported 765 thousand tonnes of light crude oil through the Eastern Siberia – Pacific Ocean pipeline. This allowed us to preserve the premium quality of crude oil and thus increased the efficiency of exports, compared to exports to traditional Western markets.

During the first half of 2015, our revenue from export of crude oil and refined products from Russia both to Group companies and third parties amounted to \$6,928 million and \$4,114 million, respectively (\$10,590 million for crude oil and \$9,337 million for refined products in the first half of 2014).

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. Compared to the first half of 2014, crude oil price dropped nearly two-fold and in the second quarter of 2015, the price for the Brent crude oil fluctuated between \$45 and \$66 per barrel and reached its maximum of \$66.7 in the middle of May.

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 first half of 2015 and 2014.

	2 nd quarter of		Change,	1 st half of		Change,
	2015	2014	%	2015	2014	%
	(in US dollars per barrel, except for figures in percent)					
Brent crude.....	61.88	109.67	(43.6)	57.84	108.93	(46.9)
Urals crude (CIF Mediterranean) ⁽¹⁾	62.25	108.04	(42.4)	57.68	107.42	(46.3)
Urals crude (CIF Rotterdam) ⁽¹⁾	61.21	107.30	(43.0)	56.83	106.76	(46.8)
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam).....	323.50	579.13	(44.1)	299.51	575.19	(47.9)
Diesel fuel 10 ppm (FOB Rotterdam)	579.97	922.01	(37.1)	554.66	923.37	(39.9)
High-octane gasoline (FOB Rotterdam).....	671.00	1,021.17	(34.3)	608.90	989.69	(38.5)

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 first half of 2015 and 2014.

	2 nd quarter of		Change,	1 st half of		Change,
	2015	2014	%	2015	2014	%
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil.....	140.83	285.11	(50.6)	120.21	271.34	(55.7)
Diesel fuel.....	548.89	800.33	(31.4)	498.62	803.55	(37.9)
High-octane gasoline (Regular)	607.04	866.02	(29.9)	525.44	837.70	(37.3)
High-octane gasoline (Premium)	627.02	892.76	(29.8)	546.92	867.65	(37.0)

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, a depreciation of the ruble against the US dollar generally causes our costs to decrease in US dollar terms, and vice versa. The appreciation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 29.3% in the first half of 2015, compared to the first half of 2014, while the nominal ruble depreciation against the US dollar was 39.1%, compared to the first half of 2014.

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

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
Ruble inflation (CPI), %	1.0	2.4	8.5	4.8
Average exchange rate for the period (ruble to US dollar)	52.65	35.00	57.40	34.98
Exchange rate at the end of the period (ruble to US dollar)	55.52	33.63	55.52	33.63

Tax burden

Starting from January 1, 2015, the method for calculation of certain tax and duty rates applied to oil companies in Russian Federation is amended. The mineral extraction tax rate increases significantly along with simultaneous decrease of export duty rates and excises.

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

		2 nd quarter of		Change, %
		2015	2014	
Export tariffs on crude oil	\$/tonne	130.41	382.63	(65.9)
Export tariffs on refined products				
Light and middle distillates	\$/tonne	62.56	252.52	(75.2)
Fuel oil	\$/tonne	99.08	252.52	(60.8)
Gasoline	\$/tonne	101.68	344.33	(70.5)
Straight-run gasoline	\$/tonne	110.80	344.33	(67.8)
Diesel fuel	\$/tonne	62.56	248.65	(74.8)
Mineral extraction tax				
Crude oil	RUR/tonne	7,072.91	6,135.44	15.3
Crude oil	\$/tonne ⁽¹⁾	134.33	175.30	(23.4)

⁽¹⁾ Translated to US dollars using average exchange rate for the period.

		1 st half of		Change, %
		2015	2014	
Export tariffs on crude oil	\$/tonne	130.30	386.65	(66.3)
Export tariffs on refined products				
Light and middle distillates	\$/tonne	62.48	255.16	(75.5)
Fuel oil	\$/tonne	99.00	255.16	(61.2)
Gasoline	\$/tonne	101.59	347.94	(70.8)
Straight-run gasoline	\$/tonne	110.71	347.94	(68.2)
Diesel fuel	\$/tonne	62.48	251.94	(75.2)
Mineral extraction tax				
Crude oil	RUR/tonne	6,954.05	6,107.12	13.9
Crude oil	\$/tonne ⁽¹⁾	121.16	174.59	(30.6)

⁽¹⁾ Translated to US dollars using average exchange rate for the period.

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-dollar 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 in the tax rate by \$1.80 per tonne extracted (or \$0.25 per barrel extracted using a conversion factor of 7.33) above the base rate.

During the first half of 2015, the base rate was 766 rubles per metric tonne extracted (493 rubles in the first half of 2014).

The crude oil extraction tax rate varies depending on the development, depletion and complexity 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, the Nenetsky Autonomous District and some other regions, depending on the period and volume of production.

The Group produces crude oil in the Caspian Sea, extra-heavy crude oil in Timan-Pechora and benefits from the application of a zero extraction tax rate.

Natural gas extraction tax rate. The mineral extraction tax on natural gas produced by independent producers in Russia was calculated using a flat rate until July 1, 2014. The rate was 471 rubles per thousand cubic meters during the first half of 2014.

Starting from July 1, 2014, the base rate amounts to 35 rubles per thousand cubic meters and is adjusted depending on average wholesale natural gas price in Russia, share of gas production in total hydrocarbon production of particular taxpayer, and complexity of particular gas field. In the first half of 2015, actual average natural gas extraction tax rate calculated for our major gas field – Nakhodkinskoe in Western Siberia amounted to 149.86 rubles per thousand cubic meters.

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 in 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 in 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 resulted in an increase in the crude oil export duty rate no more than by \$0.65 per barrel exported. From January 1, 2014 to December 31, 2014, the maximum increase in export duty rate was reduced to \$0.59 per barrel for each \$1.00 per barrel increase in the Urals blend price. From January 1, 2015 to December 31, 2015, the maximum increase in export duty rate is \$0.42 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 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 is applied includes our Yu. Korchagin and V. Filanovsky oilfields located in the Caspian Sea and extra-heavy crude oil fields in Timan-Pechora.

Export duty rates on refined products are to be calculated by multiplying the current crude oil export duty rate by a coefficient according to the table below.

	From January 1, 2015 to December 31, 2015	From January 1, 2014 to December 31, 2014
Multiplier for:		
Light and middle distillates.....	0.48	0.66
Diesel fuel.....	0.48	0.65
Gasolines.....	0.78	0.90
Straight-run gasoline.....	0.85	0.90
Fuel oil.....	0.76	0.66

Crude oil and refined products exports from Russia are subject to two steps of customs declaration and duties payments: temporary and complete. Temporary declaration is submitted based on preliminary exports volumes and the duty is paid in rubles translated from US dollars as at the date of the temporary declaration. Complete declaration is submitted after receiving the actual data on the exported volumes, but not later than six months after the date of the temporary declaration. The final amount of the export duty is adjusted depending on the actual volumes, US dollar exchange rate as at the date of the complete declaration (except for pipeline deliveries when the exchange rate as at the temporary declaration date is used) and the export duty rate. If temporary and complete declarations are submitted in the different reporting periods, the final amount of the export duty is adjusted in the period of submission of the complete declaration. The high volatility of the ruble-dollar exchange rates may lead to significant value of such adjustments.

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 first half of 2015 and 2014 are listed below. Translation to the US dollars was made using average exchange rate for the period.

		2 nd quarter of		Change,	1 st half of		Change,
		2015	2014	%	2015	2014	%
Gasoline							
Below Euro-3.....	RUR/tonne	7,300.00	11,110.00	(34.3)	7,300.00	11,110.00	(34.3)
Euro-3	RUR/tonne	7,300.00	10,725.00	(31.9)	7,300.00	10,725.00	(31.9)
Euro-4	RUR/tonne	7,300.00	9,916.00	(26.4)	7,300.00	9,916.00	(26.4)
Euro-5	RUR/tonne	5,530.00	6,450.00	(14.3)	5,530.00	6,450.00	(14.3)
Diesel fuel							
Below Euro-3.....	RUR/tonne	3,450.00	6,446.00	(46.5)	3,450.00	6,446.00	(46.5)
Euro-3	RUR/tonne	3,450.00	6,446.00	(46.5)	3,450.00	6,446.00	(46.5)
Euro-4	RUR/tonne	3,450.00	5,427.00	(36.4)	3,450.00	5,427.00	(36.4)
Euro-5	RUR/tonne	3,450.00	4,767.00	(27.6)	3,450.00	4,767.00	(27.6)
Motor oils.....	RUR/tonne	6,500.00	8,260.00	(21.3)	6,500.00	8,260.00	(21.3)
Straight-run gasoline.....	RUR/tonne	11,300.00	11,252.00	0.4	11,300.00	11,252.00	0.4

		2 nd quarter of		Change,	1 st half of		Change,
		2015	2014	%	2015	2014	%
Gasoline							
Below Euro-3.....	\$/tonne	138.64	317.43	(56.3)	127.18	317.61	(60.0)
Euro-3	\$/tonne	138.64	306.43	(54.8)	127.18	306.60	(58.5)
Euro-4	\$/tonne	138.64	283.32	(51.1)	127.18	283.48	(55.1)
Euro-5	\$/tonne	105.02	184.29	(43.0)	96.35	184.39	(47.7)
Diesel fuel							
Below Euro-3.....	\$/tonne	65.52	184.17	(64.4)	60.11	184.28	(67.4)
Euro-3	\$/tonne	65.52	184.17	(64.4)	60.11	184.28	(67.4)
Euro-4	\$/tonne	65.52	155.06	(57.7)	60.11	155.15	(61.3)
Euro-5	\$/tonne	65.52	136.20	(51.9)	60.11	136.28	(55.9)
Motor oils.....	\$/tonne	123.45	236.00	(47.7)	113.25	236.13	(52.0)
Straight-run gasoline.....	\$/tonne	214.61	321.49	(33.2)	196.87	321.67	(38.8)

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.

The Company and its Russian subsidiaries file income tax returns in Russia. A number of Group companies in Russia are paying 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.

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 the state-owned company, Transneft, or by railway transport.

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

In Russia, 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 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, 2015, compared to three and six months ended June 30, 2014

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

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
	(millions of US dollars)			
Revenues				
Sales (including excise and export tariffs)	28,104	38,205	51,294	73,886
Costs and other deductions				
Operating expenses	(2,063)	(2,558)	(3,871)	(4,867)
Cost of purchased crude oil, gas and products	(14,864)	(18,871)	(26,102)	(36,114)
Transportation expenses	(1,310)	(1,557)	(2,613)	(3,110)
Selling, general and administrative expenses	(770)	(1,015)	(1,435)	(1,871)
Depreciation, depletion and amortization	(2,186)	(2,485)	(4,005)	(3,997)
Taxes other than income taxes	(2,606)	(3,408)	(4,745)	(6,854)
Excise and export tariffs	(2,367)	(5,339)	(5,400)	(10,826)
Exploration expense	(309)	(64)	(388)	(269)
(Loss) gain on disposals and impairments of assets	(31)	1	(114)	(414)
Income from operating activities	1,598	2,909	2,621	5,564
Interest expense	(183)	(155)	(352)	(295)
Interest and dividend income	78	63	159	120
Equity share in income of affiliates	23	91	77	273
Currency translation (loss) gain	(183)	2	(220)	(268)
Other non-operating expense	(50)	(39)	(86)	(119)
Income before income taxes	1,283	2,871	2,199	5,275
Current income taxes	(363)	(541)	(701)	(1,346)
Deferred income taxes	96	70	215	208
Total income tax expense	(267)	(471)	(486)	(1,138)
Net income	1,016	2,400	1,713	4,137
Net income attributable to non-controlling interests	(11)	(11)	(18)	(15)
Net income attributable to LUKOIL	1,005	2,389	1,695	4,122
Earning per share of common stock attributable to LUKOIL (in US dollars):				
Basic	1.33	3.16	2.25	5.46
Diluted	1.32	3.10	2.23	5.35

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

Sales revenues

Sales breakdown	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than Customs Union.....	7,175	8,409	13,092	15,367
Export and sales to Customs Union.....	302	460	548	996
Domestic sales.....	710	953	1,312	1,937
	8,187	9,822	14,952	18,300
Refined products				
Export and sales on international markets				
Wholesale.....	12,650	18,230	23,089	35,988
Retail.....	2,879	4,088	5,284	7,649
Domestic sales				
Wholesale.....	1,200	1,861	2,091	3,473
Retail.....	1,641	2,337	2,895	4,429
	18,370	26,516	33,359	51,539
Petrochemicals				
Export and sales on international markets.....	169	234	301	489
Domestic sales.....	116	39	166	171
	285	273	467	660
Gas and gas products				
Export and sales on international markets.....	403	538	849	1,091
Domestic sales.....	178	285	328	583
	581	823	1,177	1,674
Sales of energy and related services				
Export and sales on international markets.....	33	10	73	21
Domestic sales.....	225	307	513	797
	258	317	586	818
Other				
Sales on international markets.....	241	247	425	483
Domestic sales.....	182	207	328	412
	423	454	753	895
Total sales.....	28,104	38,205	51,294	73,886

Sales volumes	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
Crude oil	(thousands of barrels)			
Export and sales on international markets other than Customs Union.....	126,230	79,765	243,847	144,826
Export and sales to Customs Union.....	7,616	8,686	15,129	19,197
Domestic sales.....	18,831	19,043	37,808	39,611
	152,677	107,494	296,784	203,634
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than Customs Union.....	17,221	10,882	33,267	19,758
Export and sales to Customs Union.....	1,039	1,185	2,064	2,619
Domestic sales.....	2,569	2,598	5,158	5,404
	20,829	14,665	40,489	27,781
Refined products	(thousands of tonnes)			
Export and sales on international markets				
Wholesale.....	23,619	21,290	46,566	42,647
Retail.....	2,466	2,575	4,630	4,841
Domestic sales				
Wholesale.....	2,656	2,842	4,906	5,239
Retail.....	2,352	2,353	4,501	4,506
	31,093	29,060	60,603	57,233
Total sales volume of crude oil and refined products.....	51,922	43,725	101,092	85,014

Realized average sales prices	2 nd quarter of		1 st half of		
	2015	2014	2015	2014	
Average realized price international					
Oil (beyond Customs Union)	(\$/barrel)	56.84	105.41	53.69	106.10
Oil (Customs Union)	(\$/barrel)	39.65	52.96	36.22	51.89
Refined products					
Wholesale	(\$/tonne)	535.59	856.21	495.83	843.83
Retail.....	(\$/tonne)	1,167.48	1,588.33	1,141.25	1,580.10
Average realized price within Russia					
Oil.....	(\$/barrel)	37.70	50.07	34.70	48.90
Refined products					
Wholesale	(\$/tonne)	451.81	654.51	426.21	662.85
Retail.....	(\$/tonne)	697.70	993.47	643.19	983.10

During the second quarter of 2015, our revenues decreased by \$10,101 million, or by 26.4%, compared to the second quarter of 2014. Our revenues from crude oil sales decreased by \$1,635 million, or by 16.6%, and our revenues from sales of refined products – by \$8,146 million, or by 30.7%.

During the first half of 2015, our revenues decreased by \$22,592 million, or by 30.6%, compared to the same period of 2014. Our revenues from crude oil sales decreased by \$3,348 million, or by 18.3%. Our revenues from sales of refined products decreased by \$18,180 million, or by 35.3%.

The changes in ruble-nominated revenues against the first half of 2014 were significantly affected by the nominal ruble devaluation by 39.1%.

Sales of crude oil

Our international sales revenue decreased by 14.7%, or by \$1,234 million, and by 14.8%, or by \$2,275 million, compared to the second quarter and the first half of 2014, respectively. Our international sales volumes (beyond the Customs Union) increased by 6,339 thousand tonnes, or by 58.3%, in the second quarter of 2015 and by 13,509 thousand tonnes, or by 68.4%, in the first half of 2015 as a result of the increase in crude oil exports from Russia, increased volumes of crude oil trading and commencement of commercial production from the West Qurna-2 field in March 2014. At the same time, that was offset by the sharp decrease in the international crude oil prices by 46.1% and 49.4%, respectively.

During the second quarter and the first half of 2015, as a result of the ruble devaluation and the drop of international crude oil prices, our realized domestic crude oil price decreased by 24.7% and 29.0%, respectively. The significant increase in exports from Russia was compensated by the decrease in the throughput of the domestic refineries. Thus, our domestic sales volumes decreased relatively insignificantly by 29 thousand tonnes, or by 1.1%, and by 246 thousand tonnes, or by 4.6%, respectively. As a consequence, in the second quarter and the first half of 2015, our domestic sales revenue decreased by 25.5%, or by \$243 million, and by 32.3%, or by \$625 million, respectively.

In the second quarter and the first half of 2015, our revenue from crude oil export from Russia both to the Group companies and third parties amounted to \$3,712 million and \$6,928 million, respectively.

Sales of refined products

Compared to the second quarter and the first half of 2014, our revenue from the wholesale of refined products outside of Russia decreased by \$5,580 million, or by 30.6%, and by \$12,899 million, or by 35.8%, respectively. The decrease in sales prices by 37.4% in the second quarter of 2015 and by 41.2% in the first half of 2015 was partially compensated by the increase in sales volumes by 10.9% and 9.2%, respectively, that resulted from the increase in refined products trading.

During the second quarter and the first half of 2015, our realized retail prices outside of Russia decreased by 26.5% and 27.8%, and sales volumes decreased by 4.2% and 4.4%, that resulted in the decrease of retail revenue by \$1,209 million, or by 29.6%, and by \$2,365 million, or by 30.9%, compared to the second quarter and the first half of 2014, respectively.

During the second quarter and the first half of 2015, our revenue from the wholesale of refined products on the domestic market decreased by 35.5%, or by \$661 million, and by 39.8%, or by \$1,382 million. Our realized prices and sales volumes decreased by 31.0% and 6.5%, respectively, in the second quarter of 2015 and by 35.7% and 6.4%, respectively, in the first half of 2015. The decrease in prices was a result of the ruble devaluation and the decrease in volumes was due to lower production at our domestic refineries.

During the second quarter and the first half of 2015, our revenue from retail sales in Russia decreased by \$696 million, or by 29.8%, and by \$1,534 million, or by 34.6%, respectively. Our average domestic retail prices decreased by 29.8% and by 34.6%, while retail volumes remained unchanged.

In the second quarter and the first half of 2015, our revenue from export of refined products from Russia both to Group companies and third parties amounted to \$2,228 million and \$4,114 million, respectively.

Sales of petrochemical products

In the second quarter of 2015, our revenue from sales of petrochemical products increased by \$12 million, or by 4.4%, largely due to the increase in sales volumes by 56.1% against the background of low productions as a consequence of the fire at our plant in Stavropol region of Russia in the end of the first quarter of 2014. In early April 2015, the production at the plant was resumed. In the first half of 2015, our revenue from sales of petrochemical products decreased by \$193 million, or by 29.2%, largely, due to lower realized prices.

Sales of gas and gas products

Sales of gas and gas refined products decreased by \$242 million, or by 29.4%, compared to the first quarter of 2014 and by \$497 million, or by 29.7%, in the first half of 2015.

During the second quarter of 2015, gas products wholesales revenue decreased by \$101 million, or by 40.8%, and by \$211 million, or by 43.1%, in the first half of 2015. Average realized wholesale prices decreased by 44.2% and sales volumes of gas products increased by 6.0% compared to the second quarter of 2014. Average realized wholesale prices decreased by 47.5% and sales volumes of gas products increased by 8.6% compared to the first half of 2014. Retail gas products revenue decreased by \$83 million, or by 38.1%, in the second quarter of 2015 and by \$160 million, or by 37.8%, in the first half of 2015, due to the decrease in average realized prices.

Natural gas sales revenue decreased by \$58 million, or by 16.1%, in the second quarter of 2015 and by \$126 million, or by 16.6%, in the first half of 2015, also as a result of the decrease in international hydrocarbon prices.

Sales of energy and related services

Our revenue from sales of electricity, heat and related services decreased by \$59 million, or by 18.6%, in the second quarter of 2015 and by \$232 million, or by 28.4%, in the first half of 2015. The decrease in revenue in Russia due to the ruble devaluation was partially offset by the increase in international sales revenue related to the acquisition of ISAB Energy in the third quarter of 2014.

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.

Revenue from other sales decreased by \$31 million, or by 6.8%, in the second quarter of 2015 and by \$142 million, or by 15.9%, in the first half of 2015, largely as a result of the impact of the ruble devaluation on the revenue from sales of other products in Russia. At the same time, since the second quarter of 2014, we increased the volume of rendering crude oil extraction services and since the third quarter of 2014, other sales also included revenue from sales of diamonds.

Operating expenses

Operating expenses include the following:

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
	(millions of US dollars)			
Hydrocarbon extraction expenses	1,003	1,259	1,884	2,270
Own refining expenses	385	518	717	998
Refining expenses at third parties and affiliated refineries.....	48	52	98	116
Expenses for crude oil transportation to refineries	181	270	350	543
Power generation and distribution expenses	176	171	334	361
Petrochemical expenses	46	45	84	111
Other operating expenses	224	243	404	468
Total operating expenses	2,063	2,558	3,871	4,867

The method of allocation of operating expenses above differs from the approach used in preparing the data for Note 19 “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.

Compared to the respective periods of 2014, our operating expenses decreased by \$495 million, or by 19.4%, in the second quarter of 2015, and by \$996 million, or by 20.5%, in the first half of 2015.

The changes in ruble-nominated operating expenses against the first half of 2014 were significantly affected by the nominal ruble devaluation by 39.1%.

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.

Our extraction expenses decreased by \$256 million, or by 20.3%, in the second quarter of 2015 and by \$386 million, or by 17.0%, in the first half of 2015. Our extraction expenses included start-up costs and production expenses related to the West Qurna-2 project in the amount of \$461 million in the first half of 2015 and \$161 million in the first half of 2014. In Russia, the increase in costs was offset by the ruble devaluation.

Our average hydrocarbon extraction expenses decreased from \$6.13 per BOE in the second quarter of 2014 to \$4.76 per BOE in the second quarter of 2015, or by 22.3%, and from \$5.70 per BOE in the first half of 2014 to \$4.50 per BOE in the first half of 2015, or by 21.1%. In Russia, average hydrocarbon extraction expenses decreased by 29.6% to \$3.98 per BOE in the second quarter of 2015 and by 34.1% to \$3.60 per BOE in the first half of 2015 as a result of the ruble devaluation.

Own refining expense

Our own refining expenses decreased by \$133 million, or by 25.7%, in the second quarter of 2015, and by \$281 million, or by 28.2%, in the first half of 2015.

Refining expenses at our domestic refineries decreased by 29.4%, or by \$80 million, in the second quarter of 2015, and by \$172 million, or by 34.3%, in the first half of 2015, as a result of the ruble devaluation and the decrease in production volumes that was partially offset by increased consumption of additives and overhaul costs.

Refining expenses at our refineries outside of Russia decreased by \$53 million, or by 21.5%, in the second quarter of 2015, and by \$109 million, or by 22.0%, in the first half of 2015, largely as a result of depreciation of the euro against the US dollar.

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.

In the second quarter and the first half of 2015, refining expenses at third party and affiliated refineries decreased by 7.7%, or by \$4 million, and by 15.5%, or by \$18 million, respectively, due to the euro depreciation against the US dollar.

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 decreased by \$89 million, or by 33.0%, in the second quarter of 2015 and by \$193 million, or by 35.5%, in the first half of 2015, largely due to the ruble devaluation and the decrease in crude oil refining volumes in Russia.

Petrochemical expenses

During the second quarter of 2015, operating expenses of our petrochemical plants didn't change significantly. The effect of the increase of domestic production volumes after commencement of production at our petrochemical plant in Stavropol region of Russia in April 2015 (the plant's operation was limited since a fire in February 2014) was offset by the ruble devaluation. During the first half of 2015, our petrochemical expenses decreased by \$27 million, or by 24.3%, due to the ruble and the euro devaluation against the US dollar.

Power generation and distribution expenses

During the second quarter of 2015, power generation and distribution expenses increased by \$5 million, or by 2.9%. The decrease of expenses that resulted from the ruble devaluation was outweighed by the cost of maintenance works at one of our Russian power plants in June 2015. At the same time, during the first half of 2015, power generation and distribution expenses decreased by \$27 million, or by 7.5%. The decrease in expenses in Russia due to the ruble devaluation was partially offset by the increase in expenses as a result of the acquisition of ISAB Energy in the third quarter of 2014.

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 \$18 million, or by 7.4%, in the second quarter of 2015, and by \$63 million, or by 13.5%, in the first half of 2015, largely as a result of the ruble devaluation. At the same time, our other operating expenses in the first half of 2015 included expenses related to the production of diamonds that commenced in the third quarter of 2014.

Cost of purchased crude oil, gas and products

Cost of purchased crude oil, gas and products includes the 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 decreased by \$4,007 million, or by 21.2%, in the second quarter of 2015 and by \$10,012 million, or by 27.7%, in the first half of 2015, following the sharp decrease in hydrocarbon prices, that was partially offset by the increase in crude oil and refined products trading volumes. Crude oil purchases in the first half of 2015 also included \$1,683 million related to 4,769 thousand tonnes of compensation crude oil received from Iraq's state-owned South Oil Company within the West Qurna-2 project (in the first half of 2014, we did not receive compensation crude oil yet).

In the second quarter of 2015, we recognized a \$313 million net loss from hedging, compared to a \$182 million net loss in the second quarter of 2014. In the first half of 2015, we recognized a \$462 million net loss from hedging, compared to a net loss of \$109 million in the first half of 2014.

Transportation expenses

In the second quarter of 2015, our transportation expenses decreased by \$247 million, or by 15.9%, compared to the second quarter of the previous year. In the first half of 2015, transportation expenses decreased by \$497 million, or by 16.0%, compared to the first half of 2014. The decrease of expenses as a result of the decrease in tariffs largely due to the ruble devaluation and decreased volume of refined products exports from Russia was partially offset by increased volumes of crude oil exports from Russia and crude oil trading.

Our actual transportation tariffs related to crude oil and refined products deliveries to various exports destinations, weighted by volumes transported, changed to the first half of 2014 as follows: crude oil pipeline tariffs decreased by 30.8%, railway tariffs for refined products transportation decreased by 34.2%.

Selling, general and administrative expenses

Selling, general and administrative expenses include payroll costs (excluding extraction entities', refineries' and power generation entities' 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 decreased by \$245 million, or by 24.1%, in the second quarter of 2015 and by \$436 million, or by 23.3%, in the first half of 2015. Largely, this was due to the devaluation of the ruble and the euro against the US dollar.

Depreciation, depletion and amortization

Our depreciation, depletion and amortization expenses decreased by \$299 million, or by 12.0%, compared to the second quarter of 2014, but stayed flat compared to the first half of 2014. Our depreciation, depletion and amortization expenses for the second quarter and the first half of 2015 included \$649 million and \$1,017 million, respectively, related to the West Qurna-2 field, where we commenced commercial production in the second quarter of 2014. In the first half of 2014, our depreciation, depletion and amortization included \$1,007 million of such expenses, all recognized in the second quarter of 2014.

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 the Netherlands. Currently, our largest affiliates are Turgai Petroleum and Tengizchevroil, exploration and production companies operating in Kazakhstan, the Zeeland refinery in the Netherlands and Bashneft-Polus, an exploration and production company that develops the Trebs and Titov oilfields in Timan-Pechora, Russia.

Our share in income of affiliates decreased by \$68 million, or by 74.7%, compared to the second quarter of 2014, and by \$196 million, or by 71.8%, compared to the first half of 2014, largely as a result of the decrease in income of our upstream affiliates in Kazakhstan.

Taxes other than income taxes

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
(millions of US dollars)				
In Russia				
Mineral extraction taxes	2,358	3,055	4,276	6,136
Social security taxes and contributions	103	133	189	278
Property tax	84	125	155	249
Other taxes	12	23	22	44
Total in Russia	2,557	3,336	4,642	6,707
International				
Mineral extraction taxes	3	15	9	33
Social security taxes and contributions	25	32	49	63
Property tax	7	8	16	17
Other taxes	14	17	29	34
Total internationally	49	72	103	147
Total	2,606	3,408	4,745	6,854

In the second quarter and the first half of 2015, our taxes other than income taxes decreased by \$802 million, or by 23.5%, and by \$2,109 million, or by 30.8%, compared to the respective periods of 2014, which was driven largely by the effect of the decrease in the international crude oil prices and the ruble devaluation on the mineral extraction tax rate. The decrease in social security taxes and contributions, property and other taxes in Russia against the second quarter and the first half of 2014 was mainly due to the ruble devaluation.

In the second quarter and the first half of 2015, application of the reduced rate for crude oil produced from depleted oilfields and the zero rate for crude oil produced from oilfields with extra heavy crude oil and from greenfields led to \$355 million and \$651 million mineral extraction tax reduction, respectively (\$607 million and \$1,191 million in the second quarter and the first half of 2014, respectively).

Excise and export tariffs

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
(millions of US dollars)				
In Russia				
Excise tax on refined products	249	500	447	917
Crude oil export tariffs	957	2,217	2,115	4,765
Refined products export tariffs	382	1,527	1,292	3,153
Total in Russia	1,588	4,244	3,854	8,835
International				
Excise tax and sales taxes on refined products	760	979	1,495	1,800
Crude oil export tariffs	12	51	34	103
Refined products export tariffs	7	65	17	88
Total internationally	779	1,095	1,546	1,991
Total	2,367	5,339	5,400	10,826

Export tariffs decreased by \$2,502 million, or by 64.8%, in the second quarter of 2015 and by \$4,651 million, or by 57.4%, in the first half of 2015, largely, due to nearly three-fold decrease in export duty rates for crude oil and refined products. Compared to the second quarter and the first half of 2014, the volumes of crude oil export beyond the Customs Union increased by 24.7% and 27.1%, while the volumes of the refined products exports decreased by 16.0% and 16.4%, respectively.

Exploration expenses

In the second quarter and the first half of 2015, our exploration expenses increased by \$245 million and by \$119 million that mostly was a result of the increase in the amount of dry hole write-offs, compared to the previous year. In the second quarter of 2015, we charged to expense the costs of dry exploratory well in Romania in the amount of \$244 million. In the first quarter of 2014, we charged to expense the costs of dry exploratory well in Cote d'Ivoire in the amount of \$95 million.

Loss on disposals and impairments of assets

In April 2014, a Group company entered into a contract with a Sinopec group company, to sell the Group's 50% interest in Caspian Investment Resources Ltd. Subsequently, on June 3, 2015, a substitute transaction was made in regard of this sale. In the first quarter of 2014, the Group recognized the loss on this expected disposal in the amount of \$358 million. In the first quarter of 2015, the Group recognized an additional impairment loss related to this transaction amounting to \$80 million.

Also, in the first half of 2014, the Group wrote off signing bonuses related to projects in Sierra Leone and Cote d'Ivoire in the total amount of \$67 million.

Income taxes

The maximum statutory income tax rate in Russia is 20%. Nevertheless, the actual effective income tax rate may be higher due to non-deductible expenses or lower due to certain non-taxable gains. Moreover, quarterly deviations of the effective income tax rates from the maximum statutory rate may happen due to currency translation losses and gains reported by Russian Group companies, that decrease or increase taxable income in the respective periods.

In the second quarter of 2015, our total income tax expense decreased by \$204 million, or by 43.3%, compared to the second quarter of 2014. At the same time, our income before income tax decreased by \$1,588 million, or by 55.3%.

In the first half of 2015, our total income tax expense decreased by \$652 million, or by 57.3%, compared to the first half of 2014, while our income before income tax decreased by \$3,076 million, or by 58.3%.

In the second quarter of 2015, our effective income tax rate was 20.8%, compared to 16.4% in the second quarter of 2014. In the first half of 2015, effective income tax rate was 22.1%, compared to 21.6% in the first half of 2014.

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

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
	(millions of US dollars)			
Net income	1,005	2,389	1,695	4,122
Add back:				
Income tax expense.....	267	471	486	1,138
Depreciation and amortization	2,186	2,485	4,005	3,997
Interest expense.....	183	155	352	295
Interest and dividend income	(78)	(63)	(159)	(120)
EBITDA	3,563	5,437	6,379	9,432
Add back loss on disposal of assets and dry whole related write-offs.....	244	–	324	520
EBITDA adjusted for one-off items	3,807	5,437	6,703	9,952
Including impact of West Qurna-2 project.....	677	1,017	1,072	1,017

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

	1 st half of	
	2015	2014
	(millions of US dollars)	
Net cash provided by operating activities	6,145	7,562
Net cash used in investing activities	(5,307)	(6,928)
Net cash (used in) provided by financing activities	(1,101)	362

Operating activities

Our primary source of cash flow is funds generated from our operations. During the first half of 2015, cash generated from operations decreased by \$1,417 million, or by 18.7%, compared to the first half of 2014, largely, as a result of the decrease in net income. In the first half of 2014, our cash flows from operating activities were negatively affected by an increase of receivables for cost recovery related to commencement of cost compensation within the West Qurna-2 project. Subsequently, after commencement of shipment of compensation crude oil, changes of this receivable do not affect significantly our cash flow from operating activity.

Investing activities

In the first half of 2015, the amount of cash used in investing activities decreased by 23.4% mostly due to the decrease in capital expenditures that resulted from the ruble devaluation.

Our capital expenditures, including non-cash transactions, decreased by 31.1% and amounted to \$5,320 million.

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
	(millions of US dollars)			
Capital expenditures, including non-cash transactions and prepayments				
Exploration and production				
Russia	1,352	2,467	2,523	4,440
International	978	978	1,783	1,730
Total exploration and production	2,330	3,445	4,306	6,170
Refining, marketing and distribution				
Russia	359	681	651	908
International	115	211	224	431
Total refining, marketing and distribution	474	892	875	1,339
Chemicals				
Russia	27	48	56	80
International	–	–	–	–
Total chemicals	27	48	56	80
Power generation and distribution	41	70	49	78
Other	18	35	34	55
Total capital expenditures	2,890	4,490	5,320	7,722

In the first half of 2015, our capital expenditures in the exploration and production segment decreased by \$1,864 million, or by 30.2%. In Russia, capital expenditures decreased mostly due to the effect of ruble devaluation. Outside of Russia, our capital expenditures didn't change significantly compared to the first half of 2014.

The decrease in capital expenditures in domestic refining, marketing and distribution segment in Russia was due to approaching completion of construction of a catalytic cracking unit at our refinery in Nizhny Novgorod. The decrease in the international segment was a result of the completion of the construction of heavy residue processing complex at our Bulgarian refinery.

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

	2 nd quarter of		1 st half of	
	2015	2014	2015	2014
	(millions of US dollars)			
Yamal.....	146	218	238	294
Caspian region ⁽¹⁾	312	473	543	708
Ghana.....	–	149	12	151
Cote d’Ivoire.....	9	2	22	82
Iraq.....	160	425	383	801
Uzbekistan	336	168	496	301
Romania.....	106	54	204	56
Cameroon.....	5	–	130	–
Nigeria	175	–	175	–
Total	1,249	1,489	2,203	2,393

⁽¹⁾ Russian and international projects.

Financing activities

In the first half of 2015, net movements of short-term and long-term debt generated an outflow of \$470 million, compared to an inflow of \$438 million in the first half of 2014.

In the first quarter of 2014, the Company received the loans from Sberbank in the amount of \$500 million maturing in 2021 and bearing interest at twelve month LIBOR plus 2.75% per annum and from Promsvyazbank in the amount of \$300 million maturing in 2019 and bearing interest at three month LIBOR plus 2.75% per annum.