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

The following report represents management's discussion and analysis of the financial condition and results of operations of OAO LUKOIL as of September 30, 2009, and for the nine and three months ended September 30, 2009 and 2008, and significant trends that may affect its future performance. It should be read in conjunction with our interim US GAAP consolidated financial statements and notes thereto.

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

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

## Key financial and operational results

| | 9 months of | | Change, % | 3rd quarter of | | Change, % |
|---|---|---|---|---|---|---|
| | **2009** | **2008** | | **2009** | **2008** | |
| Sales (millions of US dollars) | 56,802 | 89,265 | (36.4) | 21,941 | 32,375 | (32.2) |
| Net income attributable to OAO LUKOIL (millions of US dollars) | 5,285 | 10,765 | (50.9) | 2,056 | 3,472 | (40.8) |
| EBITDA (millions of US dollars) | 10,237 | 16,703 | (38.7) | 3,703 | 5,664 | (34.6) |
| Taxes other than income taxes, excise and export tariffs (millions of US dollars) | (13,745) | (27,466) | (50.0) | (5,745) | (10,938) | (47.5) |
| Basic and diluted earning per share of common stock attributable to OAO LUKOIL (US dollars) | 6.24 | 12.85 | (51.4) | 2.43 | 4.09 | (40.6) |
| Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE) | 604,378 | 599,877 | 0.8 | 202,648 | 203,760 | (0.5) |
| Crude oil production by the Group including our share in equity affiliates (thousands of tonnes) | 73,278 | 71,185 | 2.9 | 24,645 | 24,179 | 1.9 |
| Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters) | 10,937 | 12,784 | (14.4) | 3,581 | 4,382 | (18.3) |
| Refined products produced by our subsidiaries and affiliated refineries (thousands of tonnes) | 44,409 | 39,416 | 12.7 | 15,641 | 13,957 | 12.1 |

During the nine months of 2009, our net income was $5,285 million, which is $5,480 million, or 50.9%, less than in the same period of 2008.

Such decrease in our net income is mainly explained by a two-fold decrease in prices for hydrocarbons in the nine months of 2009, compared to the respective period of 2008.

## Business overview

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

The Group was established in accordance with Presidential Decree 1403, issued on November 17, 1992. Under this decree, on April 5, 1993, the Government of the Russian Federation transferred to the Company 51% of the voting shares of fifteen enterprises. Under Government Resolution 861 issued on September 1, 1995, a further nine enterprises were transferred to the Group during 1995. Since 1995, the Group has carried out a share exchange program to increase its shareholding in each of 24 founding subsidiaries to 100%. From formation, the Group has expanded substantially through consolidation of interests, acquisition of new companies and establishment of new businesses. Now LUKOIL is a global energy company operating through its subsidiaries in 36 countries on four continents.

LUKOIL is one of the world's largest energy companies in terms of hydrocarbon reserves. The Company's proved reserves as of January 1, 2009 amounted to 19.3 billion BOE and comprised of 14.5 billion BOE of crude oil and 29.3 trillion cubic feet of gas.

Our operations are divided into three main business segments:

- **Exploration and Production** – which includes our exploration, development and production operations relating to crude oil and natural gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, Uzbekistan, the Middle East, South America, and Northern and Western Africa.

- **Refining, Marketing and Distribution** – which includes refining and transport operations, marketing and trading of crude oil, natural gas and refined products.

- **Chemicals** – which includes processing and trading of petrochemical products.

Other businesses include a power generation business, banking, finance and other activities. Each of our three main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the "Domestic crude oil and refined products prices" section on page 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 refining crude oil and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 20 "Segment information" to our interim consolidated financial statements.

## Changes in the Group structure

During the nine months of 2009, we acquired 23.6% of share capital of OAO RITEK ("RITEK") for $235 million raising our share to 98.4%. During October and November 2009, we acquired the remaining share in this company, increasing the Group's ownership to 100%. RITEK is a crude oil producing company operating in European Russia and Western Siberia.

In June 2009, a Group company entered into an agreement with Total to acquire a 45% interest in the TRN refinery in The Netherlands. The transaction was finalized in September 2009 in the amount of approximately $600 million. The Group will provide crude oil and market refined products in line with its equity stake in the refinery. The refinery has the flexibility to process Urals blend crude oil as well as significant volumes of straight-run fuel oil and vacuum gasoil, which will allow to integrate the plant into the Group's crude oil supply and refined products marketing operations. The plant has an annual topping capacity of 7.9 million tonnes and a hydro-cracking unit with an annual capacity of approximately 3.4 million tonnes. The plant has a Nelson complexity index of 9.8. This acquisition was made in accordance with the Company's plans to develop its refining capacity in Europe.

In the first quarter of 2009, the Group acquired 100% interests in OOO Smolenskneftesnab, OOO IRT Investment, OOO PM Invest and OOO Retaier House for $238 million. These are holding companies, which between them own 96 petrol stations and plots of land in Moscow, the Moscow region and other regions of central European Russia. This acquisition was made in order to expand the Group's presence on the most advantageous retail market in the Russian Federation.

In the fourth quarter of 2008, the Group acquired a 100% interest in ZAO Association Grand and OOO Mega Oil M for $493 million. ZAO Association Grand and OOO Mega Oil M are holding companies, owning 181 petrol stations in Moscow, the Moscow region and other regions of central European Russia. This acquisition was made in order to expand the Group's presence on the most advantageous retail markets in the Russian Federation.

In July 2008, a Group company signed an agreement to acquire a 100% interest in the Akpet group for $555 million. The transaction was finalized in November 2008. The amended agreement provided for three payments of purchase consideration: the first payment in amount of $250 million was paid at the date of finalization, the second payment in amount of $150 million was paid in April 2009, and the remaining amount was paid in October 2009. The Akpet group operates 689 petrol filling stations on the basis of dealer agreements and owns eight refined product terminals, five LNG storage tanks, three jet fuel terminals and a lubricant production plant in Turkey.

In June 2008, a Group company signed an agreement with ERG S.p.A. to establish a joint venture to operate the ISAB refinery complex in Priolo, Italy. In December 2008, the Group completed the acquisition of a 49% stake in the joint venture for €1.45 billion (approximately $1.83 billion) and paid €600 million (approximately $762 million) as a first installment. The remaining amount was paid in February 2009. The seller has a put option, the effect of which would be to increase the Group's stake in the company operating the ISAB refinery complex up to 100%. The agreement states that each partner will be responsible for procuring crude oil and marketing refined products in line with its equity stake in the joint venture. The ISAB refinery complex has the flexibility to process Urals blend crude oil, and the Group integrated its share of the ISAB refinery complex capacity into its crude oil supply and refined products marketing operations. The ISAB refinery complex has an annual refining capacity of 16 million tonnes. The ISAB refinery complex also includes three jetties and storage tanks totaling 3,700 thousand cubic meters.

In March 2008, a Group company entered into an agreement to acquire 75 petrol stations and storage facilities in Bulgaria for approximately $367 million. The transaction was finalized in the second quarter of 2008.

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

In March 2008, a Group company entered into an agreement with a related party, whose management and directors include members of the Group's management and Board of Directors, to acquire a 64.31% interest in OAO UGK TGK-8 ("TGK-8") for approximately $2,117 million. The purchase consideration partly consisted of 23.55 million shares of common stock of the Company (at a market value of approximately $1,620 million). The transaction was finalized in May 2008. From May 2008 to June 2009, a Group company acquired the remaining interest in TGK-8 for a total of $1,202 million, increasing the Group's ownership to 100%. TGK-8 is one of the major gas consumers in the Southern Federal District with an annual consumption of 6 billion cubic meters per year. Its power plants are located in Astrakhan, Volgograd and Rostov regions, Krasnodar and Stavropol Districts, and the Republic of Dagestan of the Russian Federation with total productive capacity of 3.6 GW. By purchasing TGK-8 LUKOIL expects significant synergies through natural gas supplies from the Company's gas fields located in the Northern Caspian and in Astrakhan region, which will allow the Company to reach efficient gas price. This acquisition is made in accordance with the Company's plans to develop its electric power business.

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

## Operational highlights

### Hydrocarbon production

We undertake exploration for, and production of, crude oil and natural gas in Russia and internationally. In Russia our major oil producing subsidiaries are LUKOIL-Western Siberia, LUKOIL-Komi and LUKOIL-Perm. Also we have a consolidated joint venture with ConocoPhillips, Narianmarneftegaz, in the Northern Timan-Pechora region. Exploration and production outside of Russia is performed by our 100% subsidiary LUKOIL-Overseas, that has stakes in PSA's and other projects in Kazakhstan, Azerbaijan, Uzbekistan, Saudi Arabia, Columbia, Ghana and Cote d'Ivoire.

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

| | 9 months of | | 3rd quarter of | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Daily production of hydrocarbons, including the Company's share in equity affiliates (thousand BOE per day), including: | 2,214 | 2,189 | 2,203 | 2,215 |
| - crude oil | 1,978 | 1,915 | 1,974 | 1,935 |
| - natural and petroleum gas* | 236 | 274 | 229 | 280 |
| Hydrocarbon extraction expenses (US dollar per BOE) | 3.39 | 4.16 | 3.67 | 4.29 |
| | (millions of US dollars) | | | |
| Sales of gas and crude oil | 15,322 | 21,447 | 5,904 | 7,708 |
| Hydrocarbon extraction expenses | 1,989 | 2,421 | 722 | 850 |
| Exploration expenses | 188 | 273 | 119 | 188 |
| Mineral extraction tax | 3,790 | 10,242 | 1,720 | 4,080 |

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

**Crude oil production.** In the nine months of 2009, we increased our total daily crude oil production by 3.3%, compared to the same period of 2008. We produced (including the Company's share in equity affiliates) 540.0 million barrels, or 73.3 million tonnes.

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

| (thousands of tonnes) | 9 months of 2009 | Change to 2008 | | 9 months of 2008 |
|---|---|---|---|---|
| | | Total, % | Organic change | |
| Western Siberia | 39,896 | (6.0) | (2,547) | 42,443 |
| Timan-Pechora | 16,216 | 33.9 | 4,108 | 12,108 |
| Ural region | 8,900 | 3.6 | 309 | 8,591 |
| Volga region | 2,175 | (4.5) | (103) | 2,278 |
| Other in Russia | 1,602 | (2.0) | (32) | 1,634 |
| Crude oil produced in Russia | 68,789 | 2.6 | 1,735 | 67,054 |
| Crude oil produced internationally | 2,625 | 12.0 | 281 | 2,344 |
| **Total crude oil produced by consolidated subsidiaries** | **71,414** | **2.9** | **2,016** | **69,398** |
| **Our share in crude oil produced by equity affiliates:** | | | | |
| in Russia | 227 | 1.3 | 3 | 224 |
| outside Russia | 1,637 | 4.7 | 74 | 1,563 |
| **Total crude oil produced** | **73,278** | **2.9** | **2,093** | **71,185** |

The main oil producing region of the Company is Western Siberia where we produced 55.9% of our crude oil in Russia in the nine months of 2009 (61.2% in the nine months of 2008). In 2009, the Western Siberian producing assets continued to mature resulting in a production decline and water cut increase. A significant impact on our production in the period was caused by a lack of sufficient power generating capacities to meet the growing demand for extra power from a wide range of oil producers in Western Siberia as they faced the need to scale up pumping operations supporting crude oil production.

In line with its strategy the Company is developing new oil fields in the Northern Timan-Pechora and Caspian regions in order to compensate for the decrease in crude oil production in the traditional regions. In August 2008, we began commercial production on the Yuzhnoye Khylchuyu oil field, located in the Timan-Pechora region. We produced 5.1 million tonnes from this field in the nine months of 2009. This oil field is developed within our strategic partnership with ConocoPhillips. In December 2009, we plan to begin production on the Yu. Korchagin field in the Caspian Sea. The maximum annual production from this field is expected to be 2.3 million tonnes of oil and gas condensate, and 1.2 billion cubic meters of gas.

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

| | 9 months of | | | |
|---|---|---|---|---|
| | 2009 | | 2008 | |
| | (thousand of barrels) | (thousand of tonnes) | (thousand of barrels) | (thousand of tonnes) |
| Crude oil purchases in Russia | 1,840 | 251 | 1,136 | 155 |
| Crude oil purchases internationally | 117,001 | 15,962 | 49,639 | 6,772 |
| **Total crude oil purchased** | **118,841** | **16,213** | **50,775** | **6,927** |

| | 3rd quarter of | | | |
|---|---|---|---|---|
| | 2009 | | 2008 | |
| | (thousand of barrels) | (thousand of tonnes) | (thousand of barrels) | (thousand of tonnes) |
| Crude oil purchases in Russia | 1,349 | 184 | 674 | 92 |
| Crude oil purchases internationally | 40,043 | 5,463 | 21,939 | 2,993 |
| **Total crude oil purchased** | **41,392** | **5,647** | **22,613** | **3,085** |

The increase in volumes of crude oil purchased internationally resulted from increased refining and trading. In the nine months of 2009, we purchased 8,520 thousand tonnes in order to process at our and at third party refineries (including 4,029 thousand tonnes at the ISAB refinery complex and 169 thousand tonnes at the TRN refinery complex), compared to 3,211 thousand tonnes in the nine months of 2008.

**Gas production.** In the nine months of 2009, we produced 10,937 million cubic meters of gas available for sale (including our share in equity affiliates), a decrease of 14.4%, compared to the same period of 2008.

Our major gas production field is the Nakhodkinskoe gas field, where we produced 4,208 million cubic meters of natural gas in the nine months of 2009, compared to 6,407 million cubic meters in the nine months of 2008. The 34.3% decrease in gas production from this field resulted from the decrease of purchases of our gas by OAO Gazprom ("Gazprom"), the Russian gas monopoly.

In the nine months of 2009, our share in production from the Shakh-Deniz field in Azerbaijan was 377 million cubic meters, compared to 388 million cubic meters in the nine months of 2008. Our production from the Khauzak gas field in Uzbekistan was 1,936 million cubic meters of natural gas, compared to 1,621 million cubic meters in the nine months of 2008.

### Refining, marketing and trading

**Refining.** We own and operate four refineries located in European Russia and three refineries located outside of Russia – in Bulgaria, Ukraine and Romania. In August 2005, we closed our refinery in Odessa, Ukraine to commence a wide-scale upgrade. In April 2008, we put it back into operation after the completion of the upgrade. The annual capacity of the Odessa refinery amounts to 2.8 million tonnes. At the end of 2008, we acquired 49% interest in the ISAB refinery complex, which has an annual refining capacity of 16 million tonnes. In September 2009, we acquired a 45% interest in the TRN refinery, which has an annual capacity of 7.9 million tonnes.

Compared to the nine months of 2008, production at our consolidated and affiliated refineries increased by 12.7%. Russian refineries increased their production by 0.9%. In the nine months of 2009, the production of our international refineries including our share of production at the ISAB refinery complex and the TRN refinery increased by 61.1%, notwithstanding the fact that the production at our Romanian refinery was 15.0% lower due to overhaul performed at the refinery in January-February 2009.

In the nine months of 2009, our share of refined products produced at the ISAB refinery complex amounted to 4,572 thousand tonnes, while our share in production of the TRN refinery amounted to 371 thousand tonnes.

We are continuously improving the refined products mix at our refineries in order to produce more profitable products of higher quality. At our Russian refineries we produced 5,417 and 5,452 thousand tonnes of Euro 4 and Euro 5 diesel fuel in the nine months of 2009 and 2008, respectively. In the nine months of 2009 and 2008, our production of Euro 3 gasoline amounted to 3,512 and 3,022 thousand tonnes, respectively.

Along with our own production of refined products we refined crude oil at third party refineries. In Russia we processed crude oil at third party refineries primarily to supply our network in the Ural region and for export sales. To supply our retail networks in Eastern Europe we refined crude oil in Belarus and Serbia. Refined products processed in Belarus are used for supplying our local retail network and for wholesale export.

The following table summarizes key figures for our refining activities.

| | **9 months of** | | **3rd quarter of** | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| | (millions of US dollars) | | | |
| Own refining expenses | 670 | 849 | 235 | 294 |
| Refining expenses at third party and affiliated refineries | 493 | 297 | 165 | 121 |
| Capital expenditures | 617 | 716 | 196 | 257 |
| | (thousand barrels per day) | | | |
| Refinery throughput at the Group's and affiliated refineries | 1,229 | 1,119 | 1,268 | 1,178 |
| Refinery throughput at third party refineries | 75 | 109 | 46 | 107 |
| **Total refinery throughput** | **1,304** | **1,228** | **1,314** | **1,285** |
| | (thousand of tonnes) | | | |
| Refined products produced at the Group's refineries in Russia* | 32,024 | 31,730 | 11,194 | 10,983 |
| Refined products produced at the Group's and affiliated refineries outside Russia | 12,385 | 7,686 | 4,447 | 2,974 |
| **Total refined products produced at the Group's and affiliated refineries** | **44,409** | **39,416** | **15,641** | **13,957** |
| Refined products produced at third party refineries in Russia | 1,426 | 2,187 | 183 | 679 |
| Refined products produced at third party refineries outside Russia | 1,074 | 1,589 | 345 | 558 |
| **Total refined products produced at third party refineries** | **2,500** | **3,776** | **528** | **1,237** |

* Excluding mini refineries.

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

The Group retails its refined products in 25 countries through 6.5 thousand petrol stations. Most of the stations operate under the LUKOIL brand. We continuously develop our retail business and LUKOIL brand by expanding our retail network.

The table below summarizes figures for our trading activities.

| | 9 months of | | 3rd quarter of | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| | (millions of US dollars) | | | |
| Retail sales | 9,483 | 14,095 | 3,738 | 5,388 |
| Wholesale sales | 28,597 | 49,026 | 11,044 | 17,643 |
| **Total refined products sales** | **38,080** | **63,121** | **14,782** | **23,031** |
| | (thousand of tonnes) | | | |
| Refined products purchased in Russia | 350 | 1,223 | 133 | 400 |
| Refined products purchased internationally | 29,482 | 28,569 | 9,099 | 8 291 |
| **Total refined products purchased** | **29,832** | **29,792** | **9,232** | **8 691** |

**Exports of crude oil and refined products from Russia.** In the nine months of 2009, our export of crude oil from Russia was 10.3% more than in the nine months of 2008, and we exported 46.2% of our total domestic crude oil production (43.0% in the nine months of 2008). This increase resulted from the commencement of production on the Yuzhnoye Khylchuyu oil field by our joint venture with ConocoPhillips, crude oil from which we export from Russia.

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

| | 9 months of | | | |
|---|---|---|---|---|
| | 2009 | | 2008 | |
| | (thousand of barrels) | (thousand of tonnes) | (thousand of barrels) | (thousand of tonnes) |
| Exports of crude oil using Transneft export routes | 182,671 | 24,921 | 196,525 | 26,811 |
| Exports of crude oil bypassing Transneft | 50,232 | 6,853 | 14,594 | 1,991 |
| **Total crude oil exports** | **232,903** | **31,774** | **211,119** | **28,802** |

| | 3rd quarter of | | | |
|---|---|---|---|---|
| | 2009 | | 2008 | |
| | (thousand of barrels) | (thousand of tonnes) | (thousand of barrels) | (thousand of tonnes) |
| Exports of crude oil using Transneft export routes | 53,890 | 7,352 | 61,990 | 8,457 |
| Exports of crude oil bypassing Transneft | 18,970 | 2,588 | 8,415 | 1,148 |
| **Total crude oil exports** | **72,860** | **9,940** | **70,405** | **9,605** |

In the nine months of 2009, the crude oil exported through our own export infrastructure was 6,608 thousand tonnes or over five times more than in the nine months of 2008. This was due to export of crude oil produced from the Yuzhnoye Khylchuyu oil field (5.1 million tonnes, in the nine months of 2009) through our export terminal in Varandey.

In the nine months of 2009, we exported from Russia 21.3 million tonnes of refined products, an increase of 10.5%, compared to the same period of 2008. We export from Russia primarily diesel fuel, fuel oil and gasoil. These products account for approximately 92% of our refined products export volumes.

## Main macroeconomic factors affecting our results of operations

### Changes in the price of crude oil and refined products

The price at which we sell crude oil and refined products is the primary driver of our revenues. During the nine months of 2009, the Brent crude oil price fluctuated between $39 and $74 per barrel and reached its peak of $74.8 in the beginning of August 2009.

In the nine months of 2008, the crude oil prices were the highest ever in real terms. Starting from July 2008, crude oil prices began to descend and by the end of the year crude oil price dropped by more than $100 per barrel down to $37 per barrel driven by the world economic downturn. During the nine months of 2009, the crude oil price stabilized around $60 per barrel. Expectations for economic recovery help to resist the negative impact of fundamental factors. However, in order to support the price, significant strengthening of industry demand is required, which will help to liquidate record-high hydrocarbon stocks that put downward pressure on crude oil prices.

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

| | 9 months of | | Change, | 3rd quarter of | | Change, |
|---|---|---|---|---|---|---|
| | 2009 | 2008 | % | 2009 | 2008 | % |
| | (in US dollars per barrel, except for figures in percent) | | | | | |
| Brent crude | 57.32 | 111.11 | (48.4) | 68.08 | 115.09 | (40.8) |
| Urals crude (CIF Mediterranean)* | 56.80 | 108.06 | (47.4) | 67.88 | 113.55 | (40.2) |
| Urals crude (CIF Rotterdam)* | 56.72 | 108.18 | (47.6) | 67.76 | 113.32 | (40.2) |
| | (in US dollars per metric tonne, except for figures in percent) | | | | | |
| Fuel oil 3.5% (FOB Rotterdam) | 316.13 | 529.65 | (40.3) | 395.29 | 606.45 | (34.8) |
| Diesel fuel 10 ppm (FOB Rotterdam) | 505.15 | 1,017.77 | (50.4) | 569.84 | 1,054.59 | (46.0) |
| High-octane gasoline (FOB Rotterdam) | 546.74 | 962.16 | (43.2) | 641.92 | 995.67 | (35.5) |

Source: Platts.

* 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 respective periods of 2009 and 2008.

| | 9 months of | | Change, | 3rd quarter of | | Change, |
|---|---|---|---|---|---|---|
| | 2009 | 2008 | % | 2009 | 2008 | % |
| | (in US dollars per metric tonne, except for figures in percent) | | | | | |
| Fuel oil | 144.44 | 276.16 | (47.7) | 172.00 | 314.22 | (45.3) |
| Diesel fuel | 438.97 | 813.45 | (46.0) | 456.27 | 841.47 | (45.8) |
| High-octane gasoline (Regular) | 552.11 | 832.05 | (33.6) | 747.07 | 882.83 | (15.4) |
| High-octane gasoline (Premium) | 596.17 | 915.48 | (34.9) | 771.87 | 1,017.69 | (24.2) |

Source: InfoTEK (excluding VAT).

## Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenue is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, ruble inflation and movements of exchange rates can significantly affect the results of our operations. In particular, the real devaluation of the ruble against the US dollar generally causes our costs to decrease in US dollar terms, and vice versa. The appreciation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 16.6% in the nine months of 2009, compared to the same period of 2008. The period-end ruble-dollar exchange rate exceeded the opening rate by 2.4%.

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

| | 9 months of | | 3rd quarter of | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| Ruble inflation (CPI), % | 8.2 | 10.7 | 0.6 | 1.7 |
| Change of the ruble-dollar exchange rate, % | (2.4) | (2.9) | 3.8 | (7.6) |
| Average exchange rate for the period (ruble to US dollar) | 32.48 | 24.05 | 31.33 | 24.25 |
| Exchange rate at the end of the period (ruble to US dollar) | 30.09 | 25.25 | – | – |

## Tax burden

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

| | | 9 months of | | Change, % |
|---|---|---|---|---|
| | | **2009** | **2008** | |
| Export tariffs on crude oil | $/tonne | 157.05 | 379.00 | (58.6) |
| Export tariffs on refined products | | | | |
| Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils | $/tonne | 118.12 | 267.64 | (55.9) |
| Liquid fuels (fuel oil) | $/tonne | 63.62 | 144.20 | (55.9) |
| Excise on refined products | | | | |
| Straight-run gasoline | RUR/tonne | 3,900.00 | 2,657.00 | 46.8 |
| High-octane gasoline | RUR/tonne | 3,629.00 | 3,629.00 | – |
| Low-octane gasoline | RUR/tonne | 2,657.00 | 2,657.00 | – |
| Diesel fuel | RUR/tonne | 1,080.00 | 1,080.00 | – |
| Motor oils | RUR/tonne | 2,951.00 | 2,951.00 | – |
| Mineral extraction tax | | | | |
| Crude oil | RUR/tonne | 2,139.57 | 3,806.10 | (43.8) |
| Natural gas | RUR/1,000 $m^3$ | 147.00 | 147.00 | – |

| | | 3rd quarter of 2009 | 3rd quarter of 2008 | Change, % |
|---|---|---|---|---|
| Export tariffs on crude oil | $/tonne | 224.25 | 462.95 | (51.6) |
| Export tariffs on refined products | | | | |
| Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils | $/tonne | 163.40 | 324.19 | (49.6) |
| Liquid fuels (fuel oil) | $/tonne | 88.01 | 174.64 | (49.6) |
| Excise on refined products | | | | |
| Straight-run gasoline | RUR/tonne | 3,900.00 | 2,657.00 | 46.8 |
| High-octane gasoline | RUR/tonne | 3,629.00 | 3,629.00 | – |
| Low-octane gasoline | RUR/tonne | 2,657.00 | 2,657.00 | – |
| Diesel fuel | RUR/tonne | 1,080.00 | 1,080.00 | – |
| Motor oils | RUR/tonne | 2,951.00 | 2,951.00 | – |
| Mineral extraction tax | | | | |
| Crude oil | RUR/tonne | 2,662.89 | 4,012.22 | (33.6) |
| Natural gas | RUR/1,000 $m^3$ | 147.00 | 147.00 | – |

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

| | | 9 months of 2009 | 9 months of 2008 | Change, % |
|---|---|---|---|---|
| Excise on refined products | | | | |
| Straight-run gasoline | $/tonne | 120.07 | 110.50 | 8.7 |
| High-octane gasoline | $/tonne | 111.73 | 150.92 | (26.0) |
| Low-octane gasoline | $/tonne | 81.80 | 110.50 | (26.0) |
| Diesel fuel | $/tonne | 33.25 | 44.91 | (26.0) |
| Motor oils | $/tonne | 90.85 | 122.73 | (26.0) |
| Mineral extraction tax | | | | |
| Crude oil | $/tonne | 65.87 | 158.29 | (58.4) |
| Natural gas | $/1,000 $m^3$ | 4.53 | 6.11 | (26.0) |

| | | 3rd quarter of 2009 | 3rd quarter of 2008 | Change, % |
|---|---|---|---|---|
| Excise on refined products | | | | |
| Straight-run gasoline | $/tonne | 124.49 | 109.58 | 13.6 |
| High-octane gasoline | $/tonne | 115.84 | 149.67 | (22.6) |
| Low-octane gasoline | $/tonne | 84.81 | 109.58 | (22.6) |
| Diesel fuel | $/tonne | 34.47 | 44.54 | (22.6) |
| Motor oils | $/tonne | 94.20 | 121.71 | (22.6) |
| Mineral extraction tax | | | | |
| Crude oil | $/tonne | 85.00 | 165.48 | (48.6) |
| Natural gas | $/1,000 $m^3$ | 4.69 | 6.06 | (22.6) |

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

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

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

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

**Natural gas extraction tax rate.** The mineral extraction tax on natural gas production is calculated using a flat rate. The current rate of 147 rubles per thousand cubic meters of natural gas extracted has been in effect since January 1, 2006.

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

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

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

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

**Crude oil and refined products exported to CIS countries**, other than Ukraine and Belarus, are not subject to export duties. Crude oil exported from Russia to Belarus is subject to export duties calculated in 2009 with the application of a coefficient 0.356 (0.335 in 2008) to the regular export duty rate set by the Russian government.

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

**Income tax.** Before 2009, operations in the Russian Federation were subject to an income tax rate up to 24%. The Federal income tax rate was 6.5% and the regional income tax rate varied from 13.5% to 17.5% at the discretion of the individual regional administrations. Starting on January 1, 2009, the Federal income tax rate was decreased to 2.0% and the regional income tax rate varies between 13.5% and 18.0%. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

## Transportation of crude oil and refined products in Russia

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

Transportation of crude oil produced in Russia to refineries and export destinations is performed primarily through the trunk oil pipeline system of state-owned OAO AK Transneft ("Transneft"). Access to the Transneft crude oil export pipeline network is allocated quarterly, based on recent volumes produced and delivered through the pipeline and proposed export destinations. The crude oil transported by Transneft is Urals blend – a mix of crude oils of various qualities. Therefore Russian companies that produce crude oil of a higher quality, cannot obtain benefits from selling it using Transneft's pipeline. Alternative access to international markets bypassing Transneft's export routes can be obtained through railroad transport, by tankers, and by the export infrastructure of oil producing companies. Our own export infrastructure includes the Vysotsk terminal in the Leningrad region, the Varandey terminal in the Nenetsky Autonomous District and the Svetly terminal in the Kaliningrad region. We use the offshore ice-resistant terminal in Varandey with annual capacity of 12 million tonnes to export crude oil produced by our joint venture with ConocoPhillips located in Northern Timan-Pechora. Through the Svetly terminal we export crude oil primarily produced by OOO LUKOIL-Kaliningradmorneft, our subsidiary operating in the Kaliningrad region, and refined products. Its annual capacity is 6 million tonnes. We use the Vysotsk terminal to export refined products. In the future we expect to use the terminal to export both crude oil and refined products, depending on market conditions. Currently it has a capacity of 12 million tonnes per year and it can be expanded up to 15 million tonnes per year.

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

As the activities of the above mentioned companies fall under the scope of natural monopolies, the fundamentals of their tariff policies are defined by the state authorities to ensure the balance of interests of the state and all participants in the transportation process. Transportation tariffs of natural monopolies are set by the Federal Service for Tariffs of the Russian Federation ("FST"). The tariffs are dependent on transport destination, delivery volume, distance of transportation, and several other factors. Changes in the tariffs depend on inflation forecasts by the Ministry of Economic Development of the Russian Federation, the investment needs of owners of the transport infrastructure, other macroeconomic factors, and compensation of economically reasonable expense, incurred by entities of the natural monopolies. Tariffs are revised by the FST at least annually.

## Nine months ended September 30, 2009, compared to nine months ended September 30, 2008

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

| | 9 months of | |
|---|---|---|
| | 2009 | 2008 |
| | (millions of US dollars) | |
| **Revenues** | | |
| Sales (including excise and export tariffs) | 56,802 | 89,265 |
| **Costs and other deductions** | | |
| Operating expenses | (5,015) | (5,882) |
| Cost of purchased crude oil, gas and products | (21,475) | (31,956) |
| Transportation expenses | (3,594) | (4,048) |
| Selling, general and administrative expenses | (2,398) | (2,832) |
| Depreciation, depletion and amortization | (3,001) | (2,098) |
| Taxes other than income taxes | (4,569) | (11,124) |
| Excise and export tariffs | (9,176) | (16,342) |
| Exploration expense | (188) | (273) |
| Gain (loss) on disposals and impairments of assets | 15 | (210) |
| **Income from operating activities** | **7,401** | **14,500** |
| Interest expense | (503) | (259) |
| Interest and dividend income | 105 | 113 |
| Equity share in income of affiliates | 270 | 462 |
| Currency translation loss | (337) | (165) |
| Other non-operating income (expense) | 37 | (115) |
| **Income before income taxes** | **6,973** | **14,536** |
| Current income taxes | (1,430) | (3,899) |
| Deferred income taxes | (123) | 205 |
| **Total income tax expense** | **(1,553)** | **(3,694)** |
| **Net income** | **5,420** | **10,842** |
| Less: net income attributable to noncontrolling interests | (135) | (77) |
| **Net income attributable to OAO LUKOIL** | **5,285** | **10,765** |
| Basic and diluted earning per share of common stock attributable to OAO LUKOIL (in US dollars) | 6.24 | 12.85 |

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

## Sales revenues

| Sales breakdown | 9 months of 2009 | 9 months of 2008 |
|---|---|---|
| | (millions of US dollars) | |
| Crude oil | | |
| Export and sales on international markets other than CIS | 13,199 | 19,065 |
| Export and sales to CIS | 1,189 | 1,288 |
| Domestic sales | 472 | 559 |
| | **14,860** | **20,912** |
| Refined products | | |
| Export and sales on international markets | | |
| Wholesale | 25,905 | 42,326 |
| Retail | 6,496 | 9,656 |
| Domestic sales | | |
| Wholesale | 2,692 | 6,700 |
| Retail | 2,987 | 4,439 |
| | **38,080** | **63,121** |
| Petrochemicals | | |
| Export and sales on international markets | 432 | 1,089 |
| Domestic sales | 338 | 730 |
| | **770** | **1,819** |
| Gas and gas products | | |
| Export and sales on international markets | 792 | 689 |
| Domestic sales | 367 | 808 |
| | **1,159** | **1,497** |
| Other | | |
| Export and sales on international markets | 765 | 945 |
| Domestic sales | 1,168 | 971 |
| | **1,933** | **1,916** |
| **Total sales** | **56,802** | **89,265** |

| Sales volumes | 9 months of 2009 | 9 months of 2008 |
|---|---|---|
| Crude oil | (thousands of barrels) | |
| Export and sales on international markets other than CIS | 236,774 | 178,962 |
| Export and sales to CIS | 29,056 | 19,608 |
| Domestic sales | 14,462 | 12,095 |
| | **280,292** | **210,665** |
| Crude oil | (thousands of tonnes) | |
| Export and sales on international markets other than CIS | 32,302 | 24,415 |
| Export and sales to CIS | 3,964 | 2,675 |
| Domestic sales | 1,973 | 1,650 |
| | **38,239** | **28,740** |
| Refined products | (thousands of tonnes) | |
| Export and sales on international markets | | |
| Wholesale | 56,405 | 49,948 |
| Retail | 5,975 | 6,180 |
| Domestic sales | | |
| Wholesale | 7,322 | 10,185 |
| Retail | 4,520 | 4,390 |
| | **74,222** | **70,703** |
| **Total sales volume of crude oil and refined products** | **112,461** | **99,443** |

**Realized average sales prices**

| | 9 months of 2009 | | 9 months of 2008 | |
|---|---|---|---|---|
| | ($/barrel) | ($/tonne) | ($/barrel) | ($/tonne) |
| Average realized price international | | | | |
| Oil (excluding CIS) | 55.74 | 408.60 | 106.53 | 780.86 |
| Oil (CIS) | 40.93 | 300.02 | 65.70 | 481.55 |
| Refined products | | | | |
| Wholesale | | 459.26 | | 847.41 |
| Retail | | 1,087.19 | | 1,562.61 |
| Average realized price within Russia | | | | |
| Oil | 32.66 | 239.41 | 46.23 | 338.86 |
| Refined products | | | | |
| Wholesale | | 367.65 | | 657.86 |
| Retail | | 660.85 | | 1,011.05 |

During the nine months of 2009, our revenues decreased by $32,463 million, or by 36.4%, compared to the same period of 2008. Our revenues from crude oil sales decreased by $6,052 million, or by 28.9%, and revenues from sales of refined products decreased by $25,041 million, or by 39.7%. The decrease in sales was due to the two-fold decrease in hydrocarbon prices, compared to the nine months of 2008. Moreover, the devaluation of the ruble against the US dollar also seriously affected our average realized prices in Russia.

At the same time, we increased crude oil production and trading, which raised our crude oil sales by 33.1% in terms of volumes. The increase in crude oil production was attributable to commencement of production on the Yuzhnoye Khylchuyu oil field in August 2008, from which we produced about 5.1 million tonnes in the nine months of 2009.

We also increased our refined product sales outside of Russia in terms of volumes by 11.1%, mainly due to commencement of processing at the ISAB and the TRN refinery complexes. In the nine months of 2009, our share of production at these refineries amounted to 4.6 million tonnes and 0.4 million tonnes, respectively.

Sales of crude oil and refined products on international markets, including the CIS, accounted for 87.7% of the total sales volume in the nine months of 2009 (in the nine months of 2008 – 83.7%).

*Sales of crude oil*

The 28.9% decrease in our total crude oil sales revenues was attributable primarily to a decrease in our international crude oil sales revenues (excluding CIS). This sales revenue, which accounted for approximately 88.8% of our total crude oil sales revenue in the nine months of 2009 and 91.2% in the nine months of 2008, decreased by 30.8% due to a decrease in sales prices by 47.7%. At the same time, the volume of international crude oil sales increased by 32.3% due to increased crude oil export from Russia and trading.

*Sales of refined products*

In the nine months of 2009, our revenue from the wholesale of refined products outside Russia decreased by $16,421 million, or by 38.8%, compared to the same period of 2008, due to decreased average realized price by 45.8%. At the same time, commencement of crude oil refining at the ISAB and the TRN refinery complexes led to an increase in volumes sold by 12.9%.

In the nine months of 2009, our revenue from international retail sales decreased by $3,160 million, or by 32.7%, compared to the same period of 2008, mainly due to a decrease in average retail prices by 30.4%.

In the nine months of 2009, our revenue from the wholesale of refined products on the domestic market decreased by $4,008 million, or by 59.8%, compared to the same period of the previous year, due to a decrease in the average realized price by 44.1%, and a decrease in volumes sold by 2,863 thousand tonnes, or by 28.1%. The decrease in volume sold was a result of decreased domestic purchases and increased refined product exports from Russia.

In the nine months of 2009, our revenue from retail sales in Russia decreased by $1,452 million, or by 32.7%, compared to the same period of 2008, due to a decrease in prices. In the nine months of 2009, retail sales revenue was 52.6% of total refined products sales in Russia (in the nine months of 2008 – 39.9%).

*Sales of petrochemical products*

In the nine months of 2009, our revenue from sales of petrochemical products decreased by $1,049 million, or by 57.7%, compared to the same period of 2008. This resulted from a decrease in prices by 45.1% and a decrease in sales volumes by 22.9%. The decrease in volumes resulted from a temporary shutdown of our petrochemical plant Karpatnaftochim Ltd., Ukraine. In May 2008, this plant was stopped for modernization and construction of a chlorine and caustic production line. Besides, the overall negative situation on the world petrochemical markets led to a decrease in sales volumes.

*Sales of gas and gas products*

In the nine months of 2009, sales of gas and gas refined products amounted to $1,159 million, which is 22.6% less than in the nine months of 2008. Gas products sales revenue decreased by $265 million, or by 27.5%, compared to the same period of 2008. This was primarily a result of decrease in prices. Natural gas sales revenue amounted to $443 million – a decrease of 14.1%, compared to the same period of 2008. Decrease in domestic sales volumes and selling prices were partly compensated by an increase in selling price in Uzbekistan.

Our major purchaser of natural gas produced in the Russian Federation is Gazprom. In the nine months of 2009, we sold 4,208 million cubic meters of natural gas to Gazprom (6,063 million cubic meters in the nine months of 2008). The average realized price decreased by 26.0% to $32.6 per 1,000 cubic meters as a result of the ruble devaluation.

*Sales of other products*

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

In the nine months of 2009, our other sales increased by $17 million, or by 0.9%. The increase in other sales due to structural changes (acquisition of TGK-8 in May 2008) was offset by a decrease in other sales outside of Russia primarily through retail stations and transportation services, and effect of devaluation of the ruble in Russia.

During the nine months of 2009, sales of goods and other products from our retail stations amounted to $419 million, a decrease of $60 million from the level of the nine months of 2008. This was mainly because of an overall decrease of such sales outside of Russia as a result of the adverse macroeconomic environment.

## Operating expenses

Operating expenses include the following:

| | 9 months of | |
|---|---|---|
| | **2009** | **2008** |
| | (millions of US dollars) | |
| Hydrocarbon extraction expenses | 1,989 | 2,421 |
| Own refining expenses | 670 | 849 |
| Refining expenses at third party and affiliated refineries | 493 | 297 |
| Excise included in the processing fee paid to third party refineries | 44 | 90 |
| Expenses for crude oil transportation to refineries | 709 | 823 |
| Petrochemical expenses | 90 | 187 |
| Other operating expenses | 1,285 | 1,344 |
| | **5,280** | **6,011** |
| Change in operating expenses in crude oil and refined products inventory originating within the Group* | (265) | (129) |
| **Total operating expenses** | **5,015** | **5,882** |

* The change in operating expenses in crude oil and refined products inventory originating within the Group includes extraction and refining expenses related to crude oil and refined products produced by the Group during the reporting period, but not sold to third party.

Compared to the nine months of 2008, operating expenses decreased by $867 million, or by 14.7%, which is mainly explained by general decrease in operating expenses in Russia due to the ruble devaluation. At the same time, refining expenses at third party and affiliated refineries increased significantly due to the commencement of refining crude oil at the ISAB complex at the end of 2008 and at the TRN refinery in September 2009.

*Hydrocarbon extraction expenses*

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

In the nine months of 2009, our extraction expenses decreased by $432 million, or by 17.8%, compared to the same period of 2008, despite increased crude oil production by 2.9% and an increase in expenses for power supply. The decrease was mainly a result of the effect of the real ruble devaluation against the US dollar and a cost cutting program implemented in the fourth quarter of 2008. Our average hydrocarbon extraction cost decreased from $4.16 to $3.39 per BOE, or by 18.5%, compared to the same period of 2008.

*Own refining expenses*

In the nine months of 2009, our refining expenses decreased by $179 million, or by 21.1%, compared to the same period of 2008.

Refining expenses at our domestic refineries decreased by 20.1%, or by $122 million, mainly as a result of the devaluation of the ruble against the US dollar and cost cutting program implemented in the fourth quarter of 2008.

Refining expenses at our international refineries decreased by 23.5%, or by $57 million. This resulted from a decrease in the cost of power supply at our refinery in Bulgaria. In the first half of 2009, we produced energy from our own resources, while, in 2008, we purchased gas for this purpose from third party.

*Refining expenses at third party and affiliated refineries*

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

In the nine months of 2009, refining expenses at third party and affiliated refineries increased by 66.0%, compared to the same period of 2008, due to commencement of crude oil refining at the ISAB refinery complex and the TRN refinery.

*Petrochemical operating expenses*

In the nine months of 2009, operating expenses of our petrochemical companies decreased by $97 million, or by 51.9%, compared to the same period of 2008, due to a general decrease of production volumes. Also, in May 2008, we stopped our petrochemical plant Karpatnaftochim Ltd., Ukraine, for modernization and construction of a chlorine and caustic production line.

*Expenses for crude oil transportation to refineries*

Expenses for crude oil transportation to refineries decreased in the nine months of 2009 by $114 million, or by 13.9%, compared to the same period of 2008, due to a decrease in transportation tariffs in Russia (see Transportation expenses below), and change in crude oil supply structure – an increase in portion of purchased crude oil.

*Other operating expenses*

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

In the nine months of 2009, our other operating expenses decreased by $59 million, or by 4.4%, compared to the same period of 2008. The structural increase of other operating expenses by $109 million was compensated by the devaluation of the ruble against the US dollar, and a decrease in expenses related to other sales through petrol stations and transportation services outside of Russia.

### Cost of purchased crude oil, gas and products

Cost of purchased crude oil, gas and products decreased by $10,481 million in the nine months of 2009, or by 32.8%, compared to the same period of 2008, due to a decrease in international crude oil and refined products prices. The effect of decreased prices was partly compensated by an increase in crude oil purchases.

Cost of purchased crude oil, gas and products includes the result of hedging of international crude oil and refined products sales. In the nine months of 2009, we recognized a $525 million expense from hedging, compared to an expense of $96 million in the nine months of 2008.

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

### Transportation expenses

In the nine months of 2009, our transportation expenses decreased by $454 million, or by 11.2%, compared to the same period of 2008. This was primarily due to a decrease in freight rates and railway transportation tariffs in Russia. Ruble denominated transportation tariffs in Russia increased in the nine months of 2009, but this increase was offset by the ruble devaluation.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed in the nine months of 2009, compared to the same period of the previous year, as follows: crude oil pipeline tariffs increased by 3.5%, railway tariffs for refined products transportation decreased by 14.6%, crude oil and refined products freight rates decreased by 39.8% and 48.0%, respectively.

### Selling, general and administrative expenses

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

In the nine months of 2009, our selling, general and administrative expenses decreased by $434 million, or by 15.3%, compared to the same period of 2008. The decrease was primarily due to the devaluation of the ruble. At the same time, the structural changes in the Group in 2008 led to a $58 million increase in these expenses in the nine months of 2009.

### Depreciation, depletion and amortization

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

Our depreciation, depletion and amortization expenses increased by $903 million, or by 43.0%, compared to the same period of 2008. The increase was a result of the Company's capital expenditures and the corresponding increase in depreciable assets, in particular due to putting in production the Yuzhnoe Khylchuyu oil field. Moreover, the decrease of our proved reserves in 2008 and increase of crude oil production resulted in an increase in depreciation of our oil and gas producing assets.

### Exploration expenses

During the nine months of 2009, exploration expense decreased by $85 million, or by 31.1%, compared to the same period of 2008. Dry hole costs decreased by $54 million to $114 million.

In the nine months of 2009, we charged to expense the cost of a dry well in Saudi Arabia totaling $58 million. Also, we expensed dry hole costs related to our project in Azerbaijan in the amount of $9 million. During the nine months of 2008, dry hole costs in Russia amounted to $19 million, primarily relating to Western Siberia.

In the nine months of 2008, we charged to expense the costs of three dry wells in Saudi Arabia totaling $113 million. Also, we expensed dry hole costs related to our projects in Kazakhstan and Columbia in amount of $20 million and $27 million, respectively.

### Interest expense

In the nine months of 2009, interest expense amounted to $503 million, which is twice more than in the respective period of the previous year. This was a result of the termination of interest capitalization related to certain assets in Timan-Pechora after completion of their construction and a general increase in our indebtedness and cost of borrowings (see Liquidity and capital resources – Financing activities).

### Equity share in income of affiliates

The Group has investments in equity method affiliates and corporate joint ventures. These companies are primarily engaged in crude oil exploration, production, marketing and distribution operations in the Russian Federation, crude oil production and marketing in Kazakhstan and refining operations in Europe.

Compared to the nine months of 2008, our share in income of affiliates decreased by $192 million, or by 41.6%, due to an overall decrease in profitability of our affiliates because of the adverse macroeconomic environment as a consequence of the economic downturn.

### Taxes other than income taxes

| | 9 months of | |
|---|---|---|
| | **2009** | **2008** |
| | (millions of US dollars) | |
| **In Russia** | | |
| Mineral extraction taxes | 3,751 | 10,242 |
| Social security taxes and contributions | 277 | 366 |
| Property tax | 311 | 276 |
| Other taxes | 63 | 108 |
| **Total in Russia** | **4,402** | **10,992** |
| **International** | | |
| Mineral extraction taxes | 39 | – |
| Social security taxes and contributions | 48 | 59 |
| Property tax | 24 | 24 |
| Other taxes | 56 | 49 |
| **Total internationally** | **167** | **132** |
| **Total** | **4,569** | **11,124** |

In the nine months of 2009, taxes other than income taxes decreased by 58.9%, or by $6,555 million, compared to the same period of 2008, mainly due to a decrease in mineral extraction taxes in Russia. This is explained by a decrease in the tax rate resulting from the low level of crude oil prices. Moreover, the change in the tax rate calculation effective from January 1, 2009 led to approximately $570 million decrease in the extraction taxes. An effect from the application of the zero tax rate for crude oil produced in Timan-Pechora and Western Siberia led to approximately $630 million reduction.

### Excise and export tariffs

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

| | 9 months of 2009 | 9 months of 2008 |
|---|---|---|
| | (millions of US dollars) | |
| **In Russia** | | |
| Excise tax and sales taxes on refined products | 559 | 745 |
| Crude oil export tariffs | 4,268 | 9,356 |
| Refined products export tariffs | 1,623 | 3,040 |
| **Total in Russia** | **6,450** | **13,141** |
| **International** | | |
| Excise tax and sales taxes on refined products | 2,603 | 2,963 |
| Crude oil export tariffs | 64 | 60 |
| Refined products export tariffs | 59 | 178 |
| **Total internationally** | **2,726** | **3,201** |
| **Total** | **9,176** | **16,342** |

In spite of an increase in crude oil and refined products export volumes, export tariffs decreased by $6,620 million, or by 52.4%, compared to the same period of 2008, due to the decrease in tariff rates in Russia because of the crude oil prices decline. The decrease in excises in Russia was due to the ruble devaluation. Despite the changes in the Group structure, which resulted in $86 million of excise increase, our international excises decreased due to a decrease in volumes sold.

### Income taxes

In the nine months of 2009, our total income tax expense decreased by $2,141 million, or by 58.0%, compared to the same period of 2008, due to the decrease in income before income tax by $7,563 million, or by 52.0%.

In the nine months of 2009, our effective income tax rate was 22.3%, compared to 25.4% in the nine months of 2008, which is higher than the maximum statutory rate for the Russian Federation (20% in the nine months of 2009 and 24% in the nine months of 2008).

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

| | 9 months of | |
|---|---|---|
| | **2009** | **2008** |
| | (millions of US dollars) | |
| **Net income attributable to OAO LUKOIL** | **5,285** | **10,765** |
| Add back: | | |
| Income tax expense | 1,553 | 3,694 |
| Depreciation and amortization | 3,001 | 2,098 |
| Interest expense | 503 | 259 |
| Interest and dividend income | (105) | (113) |
| **EBITDA** | **10,237** | **16,703** |

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.

## Three months ended September 30, 2009, compared to three months ended September 30, 2008

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

| | 3rd quarter of | |
|---|---|---|
| | **2009** | **2008** |
| | (millions of US dollars) | |
| **Revenues** | | |
| Sales (including excise and export tariffs) | 21,941 | 32,375 |
| **Costs and other deductions** | | |
| Operating expenses | (1,907) | (2,204) |
| Cost of purchased crude oil, gas and products | (8,203) | (10,837) |
| Transportation expenses | (1,238) | (1,494) |
| Selling, general and administrative expenses | (878) | (1,042) |
| Depreciation, depletion and amortization | (998) | (771) |
| Taxes other than income taxes | (1,976) | (4,372) |
| Excise and export tariffs | (3,769) | (6,566) |
| Exploration expense | (119) | (188) |
| Gain (loss) on disposals and impairments of assets | 3 | (19) |
| **Income from operating activities** | **2,856** | **4,882** |
| Interest expense | (169) | (95) |
| Interest and dividend income | 40 | 39 |
| Equity share in income of affiliates | 88 | 180 |
| Currency translation loss | (213) | (198) |
| Other non-operating (expense) income | (24) | 3 |
| **Income before income taxes** | **2,578** | **4,811** |
| Current income taxes | (593) | (1,459) |
| Deferred income taxes | 73 | 94 |
| **Total income tax expense** | **(520)** | **(1,365)** |
| **Net income** | **2,058** | **3,446** |
| Less: (net income) net loss attributable to noncontrolling interests | (2) | 26 |
| **Net income attributable to OAO LUKOIL** | **2,056** | **3,472** |
| Basic and diluted earning per share of common stock attributable to OAO LUKOIL (in US dollars) | 2.43 | 4.09 |

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

## Sales revenues

| Sales breakdown | 3rd quarter of 2009 | 2008 |
|---|---|---|
| | (millions of US dollars) | |
| Crude oil | | |
| Export and sales on international markets other than CIS | 4,924 | 6,866 |
| Export and sales to CIS | 408 | 420 |
| Domestic sales | 429 | 229 |
| | **5,761** | **7,515** |
| Refined products | | |
| Export and sales on international markets | | |
| Wholesale | 9,997 | 15,070 |
| Retail | 2,506 | 3,520 |
| Domestic sales | | |
| Wholesale | 1,047 | 2,573 |
| Retail | 1,232 | 1,868 |
| | **14,782** | **23,031** |
| Petrochemicals | | |
| Export and sales on international markets | 158 | 285 |
| Domestic sales | 162 | 249 |
| | **320** | **534** |
| Gas and gas products | | |
| Export and sales on international markets | 298 | 267 |
| Domestic sales | 148 | 293 |
| | **446** | **560** |
| Other | | |
| Export and sales on international markets | 255 | 339 |
| Domestic sales | 377 | 396 |
| | **632** | **735** |
| **Total sales** | **21,941** | **32,375** |

| Sales volumes | 3rd quarter of 2009 | 2008 |
|---|---|---|
| Crude oil | (thousands of barrels) | |
| Export and sales on international markets other than CIS | 72,553 | 61,440 |
| Export and sales to CIS | 8,891 | 7,360 |
| Domestic sales | 13,231 | 5,395 |
| | **94,675** | **74,195** |
| Crude oil | (thousands of tonnes) | |
| Export and sales on international markets other than CIS | 9,898 | 8,382 |
| Export and sales to CIS | 1,213 | 1,004 |
| Domestic sales | 1,805 | 736 |
| | **12,916** | **10,122** |
| Refined products | (thousands of tonnes) | |
| Export and sales on international markets | | |
| Wholesale | 18,517 | 16,751 |
| Retail | 2,051 | 2,125 |
| Domestic sales | | |
| Wholesale | 2,462 | 3,400 |
| Retail | 1,716 | 1,728 |
| | **24,746** | **24,004** |
| **Total sales volume of crude oil and refined products** | **37,662** | **34,126** |

**Realized average sales prices**

| | 3rd quarter of | | | |
|---|---|---|---|---|
| | 2009 | | 2008 | |
| | ($/barrel) | ($/tonne) | ($/barrel) | ($/tonne) |
| Average realized price international | | | | |
| Oil (excluding CIS) | 67.87 | 497.46 | 111.74 | 819.02 |
| Oil (CIS) | 45.91 | 336.49 | 57.12 | 418.68 |
| Refined products | | | | |
| Wholesale | | 539.86 | | 899.64 |
| Retail | | 1,222.21 | | 1,656.66 |
| Average realized price within Russia | | | | |
| Oil | 32.46 | 237.92 | 42.51 | 311.60 |
| Refined products | | | | |
| Wholesale | | 425.28 | | 757.18 |
| Retail | | 718.16 | | 1,080.29 |

During the third quarter of 2009, our revenues decreased by $10,434 million, or by 32.2%, compared to the same period of 2008. Our revenues from crude oil sales decreased by $1,754 million, or by 23.3%, and our revenues from sales of refined products decreased by $8,249 million, or by 35.8%. The decrease in sales was due to a significant decrease in hydrocarbon prices, compared to the third quarter of 2008. Moreover, the devaluation of the ruble against the US dollar in 2009 also seriously affected our average realized prices in Russia.

At the same time, we increased crude oil production and trading, which raised our crude oil sales by 27.6% in terms of volumes. Increase in production was mainly attributable to the commencement of production from the Yuzhnoye Khylchuyu oil field, where we produced 1.9 million tonnes in the third quarter of 2009.

We also increased our refined product sales outside of Russia in terms of volumes by 9.0%, mainly due to commencement of production at the ISAB refinery complex and the TRN refinery. In the third quarter of 2009, our share of production at these refineries amounted to 1.6 and 0.4 million tonnes, respectively.

Sales of crude oil and refined products on international markets, including the CIS, accounted for 84.1% of the total sales volume in the third quarter of 2009 (in the third quarter of 2008 – 82.8%).

*Sales of crude oil*

The 23.3% decrease in our total crude oil sales revenue was attributable primarily to a decrease in our international crude oil sales revenues (excluding CIS). This sales revenue, which accounted for approximately 85.5% of our total crude oil sales revenue in the third quarter of 2009 and 91.4% in the third quarter of 2008, decreased by 28.3% due to a decrease in sales prices by 39.3%. At the same time, the volume of international crude oil sales increased by 18.1% due to increased crude oil export from Russia and an increase in trading. Also, in the third quarter of 2009, we doubled our domestic sales in order to take benefit from current market conditions.

*Sales of refined products*

In the third quarter of 2009, our revenue from the wholesale of refined products outside Russia decreased by $5,073 million, or by 33.7%, compared to the same period of 2008, due to decreased average realized price by 40.0%. At the same time, commencement of crude oil refining at the ISAB and the TRN refinery complexes led to an increase in volumes sold by 10.5%.

In the third quarter of 2009, our revenue from international retail sales decreased by $1,014 million, or by 28.8%, compared to the same period of 2008, mainly due to a decrease in average retail prices by 26.2%.

In the third quarter of 2009, our revenue from the wholesale of refined products on the domestic market decreased by $1,526 million, or by 59.3%, compared to the same period of the previous year, due to a decrease in the average realized price by 43.8%, and a decrease in volumes sold by 938 thousand tonnes, or by 27.6%. The decrease in volume sold was a result of increased refined product exports from Russia.

In the third quarter of 2009, our revenue from retail sales in Russia decreased by $636 million, or by 34.0%, compared to the same period of 2008, due to a decrease in prices. Revenue from retail sales was 54.1% of total refined products sales in Russia in the third quarter of 2009 (in the third quarter of 2008 – 42.1%).

*Sales of petrochemical products*

In the third quarter of 2009, our revenue from sales of petrochemical products decreased by $214 million, or by 40.1%, compared to the same period of 2008. This resulted from a decrease in prices by 32.2% and a decrease in sales volumes by 11.4%, which is explained by the overall negative situation on the world petrochemical markets.

*Sales of gas and gas products*

In the third quarter of 2009, sales of gas and gas refined products amounted to $446 million, which is 20.4% less than in the third quarter of 2008. Gas products sales revenue decreased by $62 million, or by 17.4%, compared to the same period of 2008. This was primarily a result of decrease in prices. Natural gas sales revenue amounted to $135 million – a decrease of 28.2%, compared to the same period of 2008. Decrease in domestic sales volumes and selling price were partly compensated by an increase in selling price in Uzbekistan.

Our major purchaser of natural gas produced in the Russian Federation is Gazprom. In the third quarter of 2009, we sold 1,258 million cubic meters of natural gas to Gazprom (2,019 million cubic meters in the third quarter of 2008). The average realized price decreased by 22.2% to $34.0 per 1,000 cubic meters as a result of the ruble devaluation.

*Sales of other products*

In the third quarter of 2009, our other sales decreased by $103 million, or by 14.0%, which mainly resulted from a decrease in transportation services provided outside of Russia. The structural increase of such sales related to TGK-8 was mitigated by ruble devaluation.

## Operating expenses

Operating expenses include the following:

| | 3rd quarter of 2009 | 3rd quarter of 2008 |
|---|---|---|
| | (millions of US dollars) | |
| Hydrocarbon extraction expenses | 722 | 850 |
| Own refining expenses | 235 | 294 |
| Refining expenses at third party and affiliated refineries | 165 | 121 |
| Excise included in the processing fee paid to third party refineries | 8 | 26 |
| Expenses for crude oil transportation to refineries | 244 | 286 |
| Petrochemical expenses | 36 | 46 |
| Other operating expenses | 470 | 512 |
| | **1,880** | **2,135** |
| Change in operating expenses in crude oil and refined products inventory originating within the Group* | 27 | 69 |
| **Total operating expenses** | **1,907** | **2,204** |

* The change in operating expenses in crude oil and refined products inventory originating within the Group includes extraction and refining expenses related to crude oil and refined products produced by the Group during the reporting period, but not sold to third parties.

Compared to the third quarter of 2008, operating expenses decreased by $297 million, or by 13.5%, which is mainly explained by a general decrease of our operating expenses in Russia due to the ruble devaluation. At the same time, refining expenses at third party and affiliated refineries increased due to the commencement of crude oil refining at the ISAB refinery complex and the TRN refinery.

*Hydrocarbon extraction expenses*

In the third quarter of 2009, our extraction expenses decreased by $128 million, or by 15.1%, compared to the same period of 2008, despite increased crude oil production by 1.7% and an increase in expenses for power supply. The decrease was mainly a result of the effect of the real ruble devaluation against the US dollar. Our average hydrocarbon extraction cost decreased from $4.29 to $3.67 per BOE, or by 14.4%, compared to the same period of 2008.

*Own refining expenses*

In the third quarter of 2009, refining expenses decreased by $59 million, or by 20.1%, compared to the same period of 2008.

Refining expenses at our domestic refineries decreased by 18.2%, or by $39 million, mainly as a result of the devaluation of the ruble against the US dollar.

Refining expenses at our international refineries decreased by 25.0%, or by $20 million. This resulted mainly from a decrease in the cost of power supply at our refinery in Bulgaria. In the third quarter of 2009, we produced energy from our own resources, while, in the third quarter of 2008, we purchased gas for this purpose from third parties.

*Refining expenses at third party and affiliated refineries*

In the third quarter of 2009, refining expenses at third party and affiliated refineries increased by 36.4%, compared to the same period of 2008, due to commencement of crude oil refining at the ISAB refinery complex and at the TRN refinery. Nevertheless, in the third quarter of 2009, refining expenses at third party refineries in Russia were lower than in the respective period of 2008 due to decrease in volumes refined.

*Petrochemical operating expenses*

In the third quarter of 2009, operating expenses of our petrochemical companies decreased by $10 million, or by 21.7%, compared to the same period of 2008, due the ruble devaluation and decrease of production volumes.

*Expenses for crude oil transportation to refineries*

Expenses for crude oil transportation to refineries decreased in the third quarter of 2009 by $42 million, or by 14.7%, compared to the same period of 2008, due to a decrease in transportation tariffs in Russia, and change in crude oil supply structure – an increase in portion of purchased crude oil.

*Other operating expenses*

In the third quarter of 2009, our other operating expenses decreased by $42 million, or by 8.2%, compared to the same period of 2008, despite the increase in such expenses due to the changes in Group structure in amount of $23 million. The decrease was primarily because of the ruble devaluation.

**Cost of purchased crude oil, gas and products**

Cost of purchased crude oil, gas and products decreased by $2,634 million in the third quarter of 2009, or by 24.3%, compared to the same period of 2008, due to a decrease in international crude oil and refined products prices. The effect of decreased prices was partly compensated by an increase in crude oil purchases.

Cost of purchased crude oil, gas and products includes the result of hedging of international crude oil and refined products sales. In the third quarter of 2009, we recognized a $17 million gain from hedging, compared to a gain of $623 million in the third quarter of 2008.

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

**Transportation expenses**

In the third quarter of 2009, our transportation expenses decreased by $256 million, or by 17.1%, compared to the same period of 2008. This was primarily due to a decrease in freight rates and railway transportation tariffs in Russia. Ruble denominated transportation tariffs in Russia significantly increased compared to the third quarter of 2008, however, this increase was offset by the ruble devaluation.

### Selling, general and administrative expenses

In the third quarter of 2009, our selling, general and administrative expenses decreased by $164 million, or by 15.7%, compared to the same period of 2008. The decrease was primarily a result of the ruble devaluation and our cost cutting program. At the same time, the structural changes in the Group in 2008 led to a $13 million increase in these expenses in the third quarter 2009.

### Depreciation, depletion and amortization

Our depreciation, depletion and amortization expenses increased by $227 million, or by 29.4%, compared to the same period of 2008. The increase was a result of the Company's capital expenditures and the corresponding increase in depreciable assets, in particular due to putting in production the Yuzhnoe Khylchuyu oil field. Moreover, the decrease of our proved reserves in 2008 and increase of crude oil production resulted in an increase in depreciation of our oil and gas producing assets.

### Exploration expenses

During the third quarter of 2009, exploration expense decreased by $69 million, or by 36.7%, compared to the respective period of 2008. Dry hole costs decreased from $143 million in the third quarter of 2008 to $91 million in the third quarter of 2009.

In the third quarter of 2009, we charged to expense the costs of a dry well totaling $58 million related to our project in Saudi Arabia. Dry hole write-offs in Russia amounted to $5 million and mostly related to our projects in Western Siberia.

In the third quarter of 2008, we charged to expense the costs of three dry wells totaling $105 million related to our project in Saudi Arabia. Other dry hole write-offs related to our projects in Kazakhstan and Columbia and amounted to $7 million and $27 million, respectively.

### Interest expense

In the third quarter of 2009, interest expense amounted to $169 million, which is 77.9%, more than in the respective period of the previous year. This was a result of the termination of interest capitalization related to certain assets in Timan-Pechora after completion of their construction and a general increase in our indebtedness and cost of borrowings (see Liquidity and capital resources – Financing activities).

### Equity share in income of affiliates

Compared to the third quarter of 2008, our share in income of affiliates decreased by $92 million, or by 51.1%, due to an overall decrease in profitability of our affiliates because of the adverse macroeconomic environment as a consequence of the economic downturn.

### Taxes other than income taxes

| | 3rd quarter of 2009 | 2008 |
|---|---|---|
| | (millions of US dollars) | |
| **In Russia** | | |
| Mineral extraction taxes | 1,704 | 4,080 |
| Social security taxes and contributions | 76 | 98 |
| Property tax | 114 | 96 |
| Other taxes | 25 | 43 |
| **Total in Russia** | **1,919** | **4,317** |
| **International** | | |
| Mineral extraction taxes | 16 | – |
| Social security taxes and contributions | 17 | 19 |
| Property tax | 9 | 9 |
| Other taxes | 15 | 27 |
| **Total internationally** | **57** | **55** |
| **Total** | **1,976** | **4,372** |

In the third quarter of 2009, taxes other than income taxes decreased by 54.8%, or by $2,396 million, compared to the same period of 2008, mainly due to a decrease in mineral extraction taxes in Russia. This is explained by a decrease in the tax rate resulting from the low level of crude oil prices.

### Excise and export tariffs

| | 3rd quarter of 2009 | 2008 |
|---|---|---|
| | (millions of US dollars) | |
| **In Russia** | | |
| Excise tax and sales taxes on refined products | 207 | 272 |
| Crude oil export tariffs | 1,898 | 3,723 |
| Refined products export tariffs | 696 | 1,361 |
| **Total in Russia** | **2,801** | **5,356** |
| **International** | | |
| Excise tax and sales taxes on refined products | 923 | 1,085 |
| Crude oil export tariffs | 24 | 60 |
| Refined products export tariffs | 21 | 65 |
| **Total internationally** | **968** | **1,210** |
| **Total** | **3,769** | **6,566** |

In spite of an increase in crude oil and refined products export volumes, export tariffs decreased by $2,570 million, or by 49.3%, compared to the same period of 2008, due to the decrease in tariff rates in Russia because of the crude oil prices decline. The decrease in excises in Russia was due to the ruble devaluation. Despite the changes in the Group structure, which resulted in $32 million of excise increase, our international excises decreased due to a decrease in volumes sold.

### Income taxes

In the third quarter of 2009, our total income tax expense decreased by $845 million, or by 619%, compared to the same period of 2008, due to the decrease in income before income tax by $2,233 million, or by 46.4%.

In the third quarter of 2009, our effective income tax rate was 20.2%, compared to 28.4% in the third quarter of 2008, which is higher than the maximum statutory rate for the Russian Federation (20% in the third quarter of 2009 and 24% in the third quarter of 2008).

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

| | 3rd quarter of | |
|---|---|---|
| | **2009** | **2008** |
| | (millions of US dollars) | |
| **Net income attributable to OAO LUKOIL** | **2,056** | **3,472** |
| Add back: | | |
| Income tax expense | 520 | 1,365 |
| Depreciation and amortization | 998 | 771 |
| Interest expense | 169 | 95 |
| Interest and dividend income | (40) | (39) |
| **EBITDA** | **3,703** | **5,664** |

## Liquidity and capital resources

| | 9 months of | |
|---|---|---|
| | 2009 | 2008 |
| | (millions of US dollars) | |
| Net cash provided by operating activities | 6,073 | 10,943 |
| Net cash used in investing activities | (6,720) | (9,703) |
| Net cash (used in) provided by financing activities | (115) | 86 |

**Operating activities**

Our primary source of cash flow is funds generated from our operations. During the nine months of 2009, cash generated by operating activities was $6,073 million, or 44.5% less than in the same period of 2008, mainly due to the decrease in sales revenues. Besides, in the nine months of 2009, our operating cash inflows were affected by an increase of working capital by $2,255 million, compared to January 1, 2009. This was mainly caused by:

- a $1,387 million net increase in trade accounts receivable and payable
- an increase in inventory of $1,306 million, resulting mainly from increased hydrocarbons prices

At the same time, the negative effect from the above mentioned factors was partly offset by a $305 million decrease in tax accounts payable and a $133 million net decrease in other assets and liabilities

**Investing activities**

The decrease in cash used in investing activities resulted from a decrease in cash spent on capital expenditures. In the nine months of 2009, our capital expenditures decreased by $3,070 million, or by 39.9%, compared to the same period of 2008 (for a detailed analysis of capital expenditures see a later section).

At the same time, in the nine months of 2009, payments for acquisitions increased by 8.9%, compared to the same period of 2008. In the nine months of 2009, we paid the remaining amount of $1,066 million for the acquisition of a 49% stake in the ISAB refinery complex, we paid $127 million for the remaining interests in TGK-8. We also made a payment of approximately $600 million within the acquisition of 45% interest in the TRN refinery, settled a $150 million liability within the acquisition of Akpet and paid $225 million for increasing our share in RITEK. Other acquisitions refer to advances for downstream assets in Russia.

In the nine months of 2008, we made a final payment of $157 million for the acquisition of upstream assets in Uzbekistan (SNG Holdings Ltd.), $64 million for the increase of our share in the share capital of our refinery in Nizhny Novgorod. We also paid $198 million as the cash part of the consideration of the TGK-8 acquisition. The other payments were related to planned acquisitions of marketing assets in Russia and outside of Russia.

**Financing activities**

In the nine months of 2009, net movements of short-term and long-term debt generated an inflow of $582 million, compared to an inflow of $884 million in the nine months of 2008.

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

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

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

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

In November 2009, we completed the issuance of a dual-tranche bond offering worth $1.5 billion, consisting of $900 million of 6.375% notes due 2014 and $600 million of 7.250% notes due in 2019. Yields to maturity for each tranche are 6.500% and 7.375%, respectively.

### Analysis of capital expenditures

| | 9 months of | | 3rd quarter of | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| | (millions of US dollars) | | | |
| **Capital expenditures*** | | | | |
| Exploration and production | | | | |
| Russia | 2,939 | 5,439 | 1,040 | 1,760 |
| International | 529 | 712 | 187 | 298 |
| Total exploration and production | 3,468 | 6,151 | 1,227 | 2,058 |
| Refining, marketing and distribution | | | | |
| Russia | 575 | 914 | 232 | 364 |
| International | 384 | 525 | 120 | 186 |
| Total refining, marketing and distribution | 959 | 1,439 | 352 | 550 |
| Chemicals | | | | |
| Russia | 9 | 16 | 3 | 6 |
| International | 80 | 77 | 25 | 42 |
| Total chemicals | 89 | 93 | 28 | 48 |
| Other | 167 | 87 | 36 | 39 |
| **Total capital expenditures** | **4,683** | **7,770** | **1,643** | **2,695** |
| **Acquisitions of subsidiaries and minority shareholding interest**** | | | | |
| Exploration and production | | | | |
| Russia | 225 | – | 28 | – |
| International | – | 257 | – | – |
| Total exploration and production | 225 | 257 | 28 | – |
| Refining, marketing and distribution | | | | |
| Russia | 210 | 500 | 4 | – |
| International | 1,821 | 379 | 256 | – |
| Total refining, marketing and distribution | 2,031 | 879 | 260 | – |
| Other | 137 | 3,189*** | – | 1,019 |
| Less cash acquired | (9) | (167) | – | (23) |
| **Total acquisitions** | **2,384** | **4,158** | **288** | **996** |

* Including non-cash transactions and prepayments.

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

*** Including $1,969 million of non-cash part of consideration for acquisition of TGK-8.

During the nine months of 2009, our capital expenditures, including non-cash transactions, amounted to $4,683 million, which is 39.7% less than in the nine months of 2008. The decrease was in compliance with our plan to reduce capital expenditures in 2009 because of the economic downturn. Capital expenditures in our exploration and production segment decreased by $2,683 million, or by 43.6%, compared to the same period of 2008. The exploration and production capital expenditures in new regions decreased by $991 million mainly due to commencement of commercial production on the Yuzhnoye Khylchuyu oil field. In the traditional exploration and production region of Western Siberia and European Russia capital expenditures decreased by $824 million and $691 million, respectively. The decrease in the capital expenditures in our international exploration projects (excluding the Caspian region) amounted to $177 million and was primarily related to our projects in Kazakhstan and Saudi Arabia.

The table below shows our exploration and production capital expenditures in promising new production regions. In December 2009, we plan to begin production on the Yu. Korchagin field in the Caspian Sea. The maximum annual production from the field is expected to be 2.3 million tonnes of oil and gas condensate, and 1.2 billion cubic meters of gas.

| | 9 months of | | 3rd quarter of | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| | (millions of US dollars) | | (millions of US dollars) | |
| Northern Timan-Pechora | 307 | 1,366 | 74 | 472 |
| Yamal | 106 | 133 | 24 | 78 |
| Caspian region* | 438 | 343 | 230 | 122 |
| **Total** | **851** | **1,842** | **328** | **672** |

* Russian and international projects.