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

The following report represents discussion and analysis of the financial condition of OAO LUKOIL as of March 31, 2012 and results of it's operations for the first quarter of 2012, compared to the first quarter of 2011, as well as significant factors that may affect its future performance. It should be read in conjunction with our interim US GAAP consolidated financial statements and notes thereto.

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

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

Key financial and operational results

	3 months of		Change, %
	2012	**2011**	
Sales (millions of US dollars)	35,261	29,626	19.0
Net income attributable to OAO LUKOIL (millions of US dollars)	3,789	3,517	7.7
EBITDA (millions of US dollars)	5,346	5,343	0.1
Taxes other than income taxes, excise and export tariffs (millions of US dollars)	(9,055)	(7,436)	21.8
Earning per share of common stock attributable to OAO LUKOIL (US dollars):			
Basic	4.90	4.50	8.9
Diluted	4.79	4.41	8.8
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	200,040	199,277	0.4
Daily hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	2,198	2,214	(0.7)
Crude oil and natural gas liquids produced by the Group including our share in equity affiliates (thousands of barrels)	169,014	171,973	(1.7)
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	5,272	4,640	13.6
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes)	15,043	14,572	3.2

During the first quarter of 2012, our net income was $3,789 million, which is $272 million, or 7.7%, more than in the same period of 2011.

The increase in our net income was mainly due to an increase in hydrocarbon prices in the first quarter of 2012, compared to the respective period of 2011. Moreover, our net income was supported by a decrease of income tax expenses due to currency translation losses reported by Russian subsidiaries. At the same time, our results were affected by increased extraction tax and export duty expenses.

Business overview

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

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

LUKOIL is one of the world's largest energy companies in terms of hydrocarbon reserves that amounted to 17.3 billion BOE as of January 1, 2012 and comprised of 13.4 billion barrels of crude oil and 23.2 trillion cubic feet of gas.

Our operations are divided into four main business segments:

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

Each of our four main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the "Domestic crude oil and refined products prices" section on page 7, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of crude oil refining and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 19 "Segment information" to the interim consolidated financial statements.

Changes in the Group structure

In January 2012, the Group was offered to acquire a 20% stake in the joint venture operating the ISAB refining complex for €400 million (approximately $526 million) that would increase Group's ownership in it from 60% to 80%. The transaction is subject to approval of certain regulatory authorities and is expected to be completed in the second quarter of 2012. This is a partial exercise of ERG S.p.A. option to sell in full its stake in the joint venture established in 2008. In April 2011, the Group acquired an 11% stake in for €241 million (approximately $342 million).

In April 2011, LUKOIL and OAO "ANK Bashneft" ("Bashneft") signed an agreement to establish a joint venture and to stipulate conditions for the development of two fields named after R. Trebs and A. Titov located in Northern Timan-Pechora region. According to the agreement, in the end of December 2011, the Company purchased a 25.1% interest in OOO "Bashneft-Polus", a Bashneft subsidiary, in favor of which the license and mineral rights for R.Trebs and A.Titov fields were re-issued, for approximately $153 million. In its turn, the joint venture purchased from a Group company 29 exploration wells located in the license area for $60 million. The agreement also envisages the exploitation of the Group's infrastructure, including the oil export terminal in Varandey and the energy centre of the Yuzhnoye Khylchuyu field. The total recoverable oil reserves located within the license areas of R.Trebs and A.Titov fields are 140.1 million tonnes.

According to the information available to the Company, in May 2012, state authorities cancelled the order to transfer the mineral rights for the development of the fields named after R.Trebs and A.Titov to the joint venture and the license was returned to Bashneft. Bashneft and the Company are discussing further cooperation opportunities within the project. The Company reserves the right to contest this decision by the law. Management does not believe that this matter will have a material adverse effect on the Group's financial condition.

Operational highlights

Hydrocarbon production

We undertake exploration for, and production of, crude oil and natural gas in Russia and internationally. In Russia our major oil producing subsidiaries are OOO LUKOIL-Western Siberia, OOO LUKOIL-Komi and OOO LUKOIL-Perm. Also we have a consolidated joint venture with ConocoPhillips, OOO Narianmarneftegaz, 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, Iraq, Saudi Arabia, Columbia, Ghana, Vietnam and Cote d'Ivoire.

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

	3 months of	
	2012	2011
	(thousand BOE per day)	
Daily production of hydrocarbons, including the Company's share in equity affiliates, including:	2,198	2,214
- crude oil and natural gas liquids[1]	1,857	1,911
- natural gas[2]	341	303
	(US dollar per BOE)	
Hydrocarbon extraction expenses	4.70	4.70
- in Russia	4.73	4.73
- outside Russia	4.33	4.22
	(millions of US dollars)	
Hydrocarbon extraction expenses	906	900
- in Russia	838	846
- outside Russia	68	54
Exploration expenses	43	28
- in Russia	26	12
- outside Russia	17	16
Mineral extraction tax	3,140	2,465
- in Russia	3,118	2,441
- outside Russia	22	24

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

Crude oil production. In the first quarter of 2012, we produced 22.4 million tonnes (165.4 million barrels) of crude oil compared to 22.8 million tonnes (168.6 million barrels) in the same period of 2011 (including the Company's share in equity affiliates).

The following table represents our crude oil production in the first quarter of 2012 and 2011 by major regions.

(thousands of tonnes)	3 months of 2012	Change to 2011: Total, %	Change to 2011: Change in structure	Change to 2011: Organic change	3 months of 2011
Western Siberia	12,284	0.9	–	108	12,176
Timan-Pechora	3,945	(16.2)	–	(763)	4,708
Ural region	3,314	6.5	–	203	3,111
Volga region	822	10.8	–	80	742
Other in Russia	467	(2.7)	–	(13)	480
Crude oil produced in Russia	20,832	(1.8)	–	(385)	21,217
Crude oil produced internationally	853	(1.6)	–	(14)	867
Total crude oil produced by consolidated subsidiaries	**21,685**	**(1.8)**	**–**	**(399)**	**22,084**
Our share in crude oil produced by equity affiliates:					
in Russia	95	8.0	–	7	88
outside Russia	615	(7.4)	–	(49)	664
Total crude oil produced	**22,395**	**(1.9)**	**–**	**(441)**	**22,836**

The main oil producing region for the Company is Western Siberia where we produced 56.6% of our crude oil in the first quarter of 2012 (55.1% in the first quarter of 2011).

The continuing trend of increasing water cut at our Yuzhnoye Khylchuyu oilfield was the main reason for the production decrease in Russia.

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

	3 months of			
	2012		2011	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	1,092	149	718	98
Crude oil purchases internationally	25,560	3,487	28,418	3,877
Total crude oil purchased	**26,652**	**3,636**	**29,136**	**3,975**

Significant part of our crude oil purchases is for processing. In the first quarter of 2012, we purchased 2,575 thousand tonnes of crude oil to process at our and at third party refineries, compared to 2,939 thousand tonnes in the first quarter of 2011. Our purchases for trading remained relatively flat to the first quarter of 2011.

Production of gas and natural gas liquids. In the first quarter of 2012, we produced 5,272 million cubic meters (31.0 million BOE) of gas available for sale (including our share in equity affiliates), that is 13.6% more than in the first quarter of 2011.

Our major gas production field is the Nakhodkinskoe field, where we produced 2,152 million cubic meters of natural gas in the first quarter of 2012 (2,126 million cubic meters in the first quarter of 2011). Our international natural gas production increased by 48.9%, mostly due to growth of our production in Uzbekistan by 70.2%. We produced 233 million cubic meters of gas from the Gissar field (commercial production commenced in December 2011), and increased production from the Khauzak field by 244 million cubic meters, or by 35.9%.

In the first quarter of 2012, production of natural gas liquids at the Group gas processing plants in Western Siberia, Ural and Volgograd regions of Russia was 3.6 million BOE, compared to 3.4 million BOE in the first quarter of 2011.

Refining, marketing and trading

Refining. We own and operate four refineries located in European Russia and three refineries located outside of Russia – in Bulgaria, Ukraine and Romania. Moreover, we have a 60% stake in the ISAB refinery complex in Italy (49% before April 1, 2011) and a 45% interest in the Zeeland Refinery in the Netherlands.

Compared to the first quarter of 2011, the total volume of refined products produced by the Group (including our share in equity affiliates production) increased by 3.2%. Our consolidated refineries decreased their production by 2.5%. Production volumes of our Russian refineries increased by 0.7%, while production of our international refineries' decreased by 21.7% due to scheduled overhauls. At the same time, our share of production of ISAB and Zeeland Refinery increased by 33.5% that resulted from the increase of Group's share in the ISAB refinery.

We invested, and continue to invest, significant resources in our refineries aiming at taking the leading position in Russia in producing ecological fuel of high quality standards. In December 2011, we completed construction of a delayed-coking unit with annual capacity of 1 million tonnes at our Volgograd refinery increasing refining depth to 88%.

The share of Euro-4 and Euro-5 gasoline exceeds 99% and the share of Euro-4 and Euro-5 diesel exceeds 70% of our total domestic production. We will be able to increase the share of Euro-4 and Euro-5 diesel to 97% of our total domestic diesel production after the launch of the new fuel hydrorefining unit at Volgograd refinery scheduled for the second half of 2012.

Along with our own production of refined products we can refine crude oil at third party refineries depending on market conditions and other factors. In 2011, we began processing our crude oil at a third party refinery in Kazakhstan. In 2012, we restarted processing operations in Belarus.

The following table summarizes key figures for our refining activities.

	3 months of 2012	3 months of 2011
	(millions of US dollars)	
Refining expenses at the Group refineries	315	336
- in Russia	240	250
- outside Russia	75	86
Refining expenses at ISAB and Zeeland Refinery	240	166
Refining expenses at third party refineries	23	3
Capital expenditures	294	125
- in Russia	116	85
- outside Russia	178	40
	(thousand barrels per day)	
Refinery throughput at the Group refineries	1,011	1,052
- in Russia	893	898
- outside Russia	118	154
Refinery throughput at ISAB and Zeeland Refinery [(1)] [(2)]	246	186
Refinery throughput at third party refineries	51	8
Total refinery throughput	**1,308**	**1,246**
	(thousands of tonnes)	
Refined products produced at the Group refineries	11,947	12,253
- in Russia	10,566	10,490
- outside Russia	1,381	1,763
Production of ISAB and Zeeland Refinery [(1)]	3,096	2,319
Refined products produced at third party refineries	589	95
Total refined products produced	**15,632**	**14,667**

[(1)] Group's share.
[(2)] Including refined product processed.

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

The Group retails its refined products in 26 countries through nearly 5.7 thousand petrol stations. Most of the stations operate under the LUKOIL brand.

The table below summarizes figures for our trading activities.

	3 months of 2012	3 months of 2011
	(thousands of tonnes)	
Retail sales	3,504	3,269
Wholesale sales	23,959	20,672
Total refined products sales	**27,463**	**23,941**
Refined products purchased in Russia	258	419
Refined products purchased internationally	13,189	11,081
Total refined products purchased	**13,447**	**11,500**

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

	3 months of			
	2012		2011	
	(thousands of barrels)	(thousands of tonnes)	(thousands of barrels)	(thousands of tonnes)
Exports of crude oil using Transneft export routes	58,853	8,029	52,329	7,139
Exports of crude oil bypassing Transneft.............................	6,377	870	11,281	1,539
Total crude oil exports..	**65,230**	**8,899**	**63,610**	**8,678**

In the first quarter of 2012, our export of crude oil from Russia increased by 2.5%, compared to the same period of 2011, and we exported 42.7% of our total domestic crude oil production (40.9% in the first quarter of 2011).

All the volume of crude oil exported bypassing Transneft was routed through our own export infrastructure. The reduction of export through our own export infrastructure was mainly caused by a decrease in production from Yuzhnoye Khylchuyu oilfield (530 thousand tonnes in the first quarter of 2012 compared to 1,300 thousand tonnes in the first quarter of 2011).

In the first quarter of 2012, we exported from Russia 6.3 million tonnes of refined products, an increase of 11.1%, compared to the respective period of 2011. Primarily, we export from Russia diesel fuel, fuel oil and gasoil. These products account for approximately 88% of our refined products export volumes.

In the first quarter of 2012, our revenue from export of crude oil and refined products from Russia both to Group companies and third parties amounted to $6,866 million and $4,997 million, respectively ($5,991 million for crude oil and $4,045 million for refined products in the first quarter of 2011).

Main macroeconomic factors affecting our results of operations

Changes in the price of crude oil and refined products

The price at which we sell crude oil and refined products is the primary driver of the Group's revenues. During the first quarter of 2012, the Brent crude oil price fluctuated between $108 and $128 per barrel and reached its peak of $128.2 in the beginning of March of 2012.

The increase of crude oil prices between the periods considered was generally due to instability in the Middle East.

Substantially all the crude oil the Group exports is Urals blend. The following table shows the average crude oil and refined product prices in the first quarter of 2012 and 2011.

	3 months of 2012	3 months of 2011	Change, %
	(in US dollars per barrel, except for figures in percent)		
Brent crude	118.60	105.43	12.5
Urals crude (CIF Mediterranean) [(1)]	117.02	102.67	14.0
Urals crude (CIF Rotterdam) [(1)]	116.87	102.55	14.0
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam)	686.05	558.36	22.9
Diesel fuel 10 ppm (FOB Rotterdam)	1,011.11	912.02	10.9
High-octane gasoline (FOB Rotterdam)	1,061.60	922.24	15.1

Source: Platts.

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

Domestic crude oil and refined products prices

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

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

The table below represents average domestic wholesale prices of refined products in the first quarter of 2012 and 2011.

	3 months of 2012	3 months of 2011	Change, %
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil	307.20	270.95	13.4
Diesel fuel	836.58	781.50	7.0
High-octane gasoline (Regular)	777.52	744.92	4.4
High-octane gasoline (Premium)	814.34	788.01	3.3

Source: InfoTEK (excluding VAT).

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenue is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, ruble inflation and movements of exchange rates can significantly affect the results of our operations. In particular, the appreciation of the ruble against the US dollar generally causes our costs to increase in US dollar terms, and vice versa. The appreciation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 0.5% in the first quarter of 2012, compared to the first quarter of 2011, and didn't impact our results significantly.

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

	3 months of	
	2012	**2011**
Ruble inflation (CPI), %	1.5	3.8
Change of the ruble-dollar exchange rate, %	8.9	6.7
Average exchange rate for the period (ruble to US dollar)	30.26	29.27
Exchange rate at the end of the period (ruble to US dollar)	29.33	28.43

Tax burden

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

		3 months of		Change, %
		2012(1)	**2011**(1)	
Export tariffs on crude oil	\$/tonne	400.96	342.91	16.9
Export tariffs on refined products				
Middle distillates (jet fuel), diesel fuel and gasoils	\$/tonne	264.60	234.40	12.9
Light distillates				
gasoline	\$/tonne	360.84	234.40	53.9
straight-run gasoline	\$/tonne	360.84	234.40	53.9
Liquid fuels (fuel oil)	\$/tonne	264.60	151.02	75.2
Mineral extraction tax				
Crude oil	RUR/tonne	5,283.37	4,090.91	29.1
Natural gas	RUR/1,000 m^3	251.00	237.00	5.9

(1) Average values.

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

		3 months of		Change, %
		2012(1)	**2011**(1)	
Mineral extraction tax				
Crude oil	\$/tonne	174.58	139.77	24.9
Natural gas	\$/1,000 m^3	8.29	8.10	2.3

(1) Average values.

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

Crude oil extraction tax rate. The base rate is 446 rubles per metric tonne extracted (419 rubles in 2011) and it is adjusted depending on the international market price of Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals blend international market price for a tax period is less than or equal to \$15.00 per barrel. Each \$1.00 per barrel increase in the international Urals blend price over the threshold (\$15.00 per barrel) results in an increase of the tax rate by \$1.61 per tonne extracted (or \$0.22 per barrel extracted using a conversion factor of 7.33).

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

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

The Group produces crude oil from several greenfields in the Caspian Sea. In the first quarter of 2012, the amount of incentive was relatively insignificant, but we expect it to become sizable as the production volumes grow.

Natural gas extraction tax rate. The mineral extraction tax on natural gas production is calculated using a flat rate. In 2011, the rate was 237 rubles. On January 1, 2012, the rate was raised to 251 rubles per thousand cubic meters.

Crude oil export duty rate is calculated on a progressive scale. The rate is zero when the average Urals blend international market price is less than or equal to approximately $15.00 per barrel ($109.50 per metric tonne). If the Urals blend price is between $15.00 and $20.00 per barrel ($146.00 per metric tonne), each $1.00 per barrel increase in the Urals blend price over $15.00 results in an increase of the crude oil export duty rate by $0.35 per barrel exported. If the Urals blend price is between $20.00 and $25.00 per barrel ($182.50 per metric tonne), each $1.00 per barrel increase in the Urals blend price over $20.00 results in an increase of the crude oil export duty rate by $0.45 per barrel exported. Each $1.00 per barrel increase in the Urals blend price over $25.00 per barrel results in an increase of the crude oil export duty rate no more than by $0.65 per barrel exported. Starting from October 1, 2011, the maximum increase of export duty rate is $0.60 per barrel for each $1.00 per barrel increase in the Urals blend price.

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

A special export duty regime is in place for certain greenfields. Effective from December 2010, the list of the oilfields where the reduced rate applies also includes our Yu. Korchagin and V. Filanovsky oilfields located in the Caspian Sea.

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

	Before October 1st, 2011	**After October 1st, 2011**
Multiplier for:		
Light distillates (except for gasolines), middle distillates (jet fuel), diesel fuel and gasoils	0.670	0.660
Gasolines(1)	0.467	0.900
Liquid fuels (fuel oil)	0.467	0.660
Motor and other oils	0.467	0.660
Other products	0.467	0.660

(1) Starting from May 2011, a coefficient for gasoline export duty rate is set at 0.9.

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

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

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

Starting from 2011, excise rates on refined products in Russia were increased and tied to the ecological class of fuel. Excise tax rates for the first quarter of 2012 and 2011 are listed below:

		3 months of 2012	3 months of 2011	Change, %
Gasoline				
Below Euro-3	RUR/tonne	7,725.00	5,995.00	28.9
Euro-3	RUR/tonne	7,382.00	5,672.00	30.1
Euro-4 and -5	RUR/tonne	6,822.00	5,143.00	32.6
Diesel fuel				
Below Euro-3	RUR/tonne	4,098.00	2,753.00	48.9
Euro-3	RUR/tonne	3,814.00	2,485.00	53.5
Euro-4 and -5	RUR/tonne	3,562.00	2,247.00	58.5
Motor oils	RUR/tonne	6,072.00	4,681.00	29.7
Straight-run gasoline	RUR/tonne	7,824.00	6,089.00	28.5

		3 months of 2012	3 months of 2011	Change, %
Gasoline				
Below Euro-3	$/tonne	255.25	204.82	24.6
Euro-3	$/tonne	243.92	193.78	25.9
Euro-4 and -5	$/tonne	225.42	175.71	28.3
Diesel fuel				
Below Euro-3	$/tonne	135.41	94.06	44.0
Euro-3	$/tonne	126.02	84.90	48.4
Euro-4 and -5	$/tonne	117.70	76.77	53.3
Motor oils	$/tonne	200.63	159.93	25.4
Straight-run gasoline	$/tonne	258.52	208.03	24.3

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

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

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

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

Transportation of crude oil and refined products in Russia

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

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

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

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

Three months ended March 31, 2012, compared to three months ended March 31, 2011

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

	3 months of	
	2012	**2011**
	(millions of US dollars)	
Revenues		
Sales (including excise and export tariffs)	35,261	29,626
Costs and other deductions		
Operating expenses	(2,215)	(2,138)
Cost of purchased crude oil, gas and products	(16,368)	(12,845)
Transportation expenses	(1,605)	(1,420)
Selling, general and administrative expenses	(829)	(825)
Depreciation, depletion and amortization	(1,095)	(1,059)
Taxes other than income taxes	(3,478)	(2,822)
Excise and export tariffs	(5,577)	(4,614)
Exploration expense	(43)	(28)
Loss on disposals and impairments of assets	(9)	(3)
Income from operating activities	**4,042**	**3,872**
Interest expense	(161)	(173)
Interest and dividend income	66	45
Equity share in income of affiliates	181	169
Currency translation loss	(86)	(65)
Other non-operating (expense) income	(22)	222
Income before income taxes	**4,020**	**4,070**
Current income taxes	(487)	(331)
Deferred income taxes	120	(308)
Total income tax expense	**(367)**	**(639)**
Net income	**3,653**	**3,431**
Net loss attributable to noncontrolling interests	136	86
Net income attributable to OAO LUKOIL	**3,789**	**3,517**
Earning per share of common stock attributable to OAO LUKOIL (in US dollars):		
Basic	4.90	4.50
Diluted	4.79	4.41

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

Sales revenues

Sales breakdown	3 months of	
	2012	2011
	(millions of US dollars)	
Crude oil		
Export and sales on international markets other than CIS	6,804	6,587
Export and sales to CIS	501	536
Domestic sales	383	423
	7,688	**7,546**
Refined products		
Export and sales on international markets		
Wholesale	19,523	14,532
Retail	2,402	2,461
Domestic sales		
Wholesale	1,652	1,537
Retail	1,973	1,491
	25,550	**20,021**
Petrochemicals		
Export and sales on international markets	276	277
Domestic sales	52	239
	328	**516**
Gas and gas products		
Export and sales on international markets	601	388
Domestic sales	271	235
	872	**623**
Sales of energy and related services	**438**	**546**
Other		
Sales on international markets	197	207
Domestic sales	188	167
	385	**374**
Total sales	**35,261**	**29,626**

Sales volumes	3 months of	
	2012	2011
Crude oil	(thousands of barrels)	
Export and sales on international markets other than CIS	58,567	64,753
Export and sales to CIS	8,767	9,874
Domestic sales	6,773	8,466
	74,107	**83,093**
Crude oil	(thousands of tonnes)	
Export and sales on international markets other than CIS	7,990	8,834
Export and sales to CIS	1,196	1,347
Domestic sales	924	1,155
	10,110	**11,336**
Refined products	(thousands of tonnes)	
Export and sales on international markets		
Wholesale	21,648	18,248
Retail	1,476	1,604
Domestic sales		
Wholesale	2,311	2,424
Retail	2,028	1,665
	27,463	**23,941**
Total sales volume of crude oil and refined products	**37,573**	**35,277**

Realized average sales prices		**3 months of**	
		2012	**2011**
Average realized price international			
Oil (excluding CIS)	($/barrel)	116.18	101.72
Oil (CIS)	($/barrel)	57.10	54.31
Refined products			
Wholesale	($/tonne)	901.87	796.33
Retail	($/tonne)	1,626.90	1,534.19
Average realized price within Russia			
Oil	($/barrel)	56.47	49.93
Refined products			
Wholesale	($/tonne)	714.89	633.93
Retail	($/tonne)	973.02	895.86

During the first quarter of 2012, our revenues increased by $5,635 million, or by 19.0%, compared to the same period of 2011. Our revenues from crude oil sales increased by $142 million, or by 1.9%. Our revenues from sales of refined products increased by $5,529 million, or by 27.6%. In the first quarter of 2012, the increase in sales revenue was due to increase in hydrocarbon prices, compared to the respective period of 2011.

Sales of crude oil

Our total crude oil sales revenues increased by $142 million, or by 1.9%, due to growth of crude oil prices. At the same time, following the increase of throughput on third party and affiliated refineries and decrease of crude oil production, sales volumes decreased by 10.8%, or by 1,226 thousand tonnes.

In the first quarter of 2012, revenue from export of crude oil from Russia both to the Group companies and third parties amounted to $6,866 million.

Sales of refined products

Our revenue from the wholesale of refined products outside of Russia increased by $4,991 million, or by 34.3%, due to an increase of the average realized price by 13.3% and wholesales volumes by 3,400 thousand tonnes, or by 18.6%, compared to the first quarter of 2011.

Our revenue from international retail sales decreased by $59 million, or by 2.4%. Our average prices increased by 6.0%, but sales volumes decreased by 128 thousand tonnes, or by 8.0%, mainly as a result of restructuring of our retail network in the USA and cold winter in Europe.

Compared to the first quarter of 2011, our revenue from the wholesale of refined products on the domestic market increased by $115 million, or by 7.5%, due to an increase in the average realized price by 12.8%, while our sales volumes decreased by 113 thousand tonnes, or by 4.7%, as a result of the increase of domestic retail sales.

Our revenue from retail sales in Russia increased by $482 million, or by 32.3%. Domestic retail volumes increased by 21.8% following significant increase of domestic demand. Average retail prices in Russia increased by 8.6%, compared to the first quarter of 2011.

In the first quarter of 2012, our revenue from export of refined products from Russia both to Group companies and third parties amounted to $4,997 million.

Sales of petrochemical products

In the first quarter of 2012, our revenue from sales of petrochemical products decreased by $188 million, or by 36.4%. That was mainly a result of a decrease in domestic sales volumes by 150 thousand tonnes, or by 73.7%, as a consequence of a fire on our petrochemical plant in Stavropol, Russia. International sales volumes increased by 7 thousand tonnes, or by 3.2%. Our realized prices decreased by 5.6%.

Sales of gas and gas products

Sales of gas and gas refined products increased by $249 million, or by 40.0%, in the first quarter of 2012. Gas products wholesales revenue increased by $88 million, or by 36.8%, primarily as a result of an increase in sales volumes and prices. Retail gas products revenue decreased by $4 million, or by 3.0%.

The increase in natural gas sales revenue by $165 million, or by 65.1%, mostly related to the international segment. Outside of Russia, sales volumes increased by 46.6% mainly as a result of the increased production in Uzbekistan, while realized prices also increased by 41.4%.

Domestic sales of energy and related services

We sell substantially all our energy and related services domestically. International sales are relatively insignificant.

In the first quarter of 2012, our revenue from sales of electricity, heat and related services decreased by $108 million, or by 19.8%, due to the reduction of resale operations.

Sales of other products

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

In the first quarter of 2012, other sales increased by $11 million, or by 2.9%.

Operating expenses

Operating expenses include the following:

	3 months of	
	2012	**2011**
	(millions of US dollars)	
Hydrocarbon extraction expenses	906	900
Own refining expenses	315	336
Refining expenses at third parties and affiliated refineries	263	169
Expenses for crude oil transportation to refineries	287	232
Power generation and distribution expenses	178	188
Petrochemical expenses	74	74
Other operating expenses	192	239
Total operating expenses	**2,215**	**2,138**

The method of allocation of operating expenses above differs from the approach used in preparing the data for Note 19 “Segment information” to our interim consolidated financial statements. Expenditures in the segment reporting are grouped depending on the segment to which a particular company belongs. Operating expenses for the purposes of this analysis are grouped based on the nature of the costs incurred.

In the first quarter of 2012, our operating expenses increased by $77 million, or by 3.6%. The growth of expenses as a result of increased throughput on third parties and affiliated refineries abroad was partially offset by lower expenses of our own refineries and lower other operating expenses.

Hydrocarbon extraction expenses

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

Our extraction expenses were on the same level as in the first quarter of 2011. Our average hydrocarbon extraction cost remained flat versus the first quarter of 2011 and amounted to $4.70 per BOE.

Own refining expense

Our own refining expenses decreased by $21 million, or by 6.3%, compared to the first quarter of 2011.

Refining expenses at our domestic refineries decreased by 4.0%, or by $10 million, mainly as a result of decreased energy costs. At the same time, our expenses were affected by increased consumption and cost of additives.

Refining expenses at our international refineries decreased by 12.8%, or by $11 million, following a decrease in refining volumes.

Refining expenses at third party and affiliated refineries

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

In the first quarter of 2012, refining expenses at third party and affiliated refineries increased by $94 million, or by 55.6%, mainly as a result of increased throughput by 55.1%. This was due to the increase of our share in ISAB from 49% to 60% since April, 2011 and commencement of processing on third-party facilities in Belorussia in the first quarter of 2012.

Expenses for crude oil transportation to refineries

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

Expenses for crude oil transportation to refineries in the first quarter of 2012 increased by $55 million, or by 23.7%. This was mainly due to increase in volumes of own crude oil supplies to our refineries outside of Russia and commencement of processing operations on third-party facilities in Belorussia in the first quarter of 2012.

Petrochemical expenses

Operating expenses of our petrochemical plants remained flat to the first quarter of 2011. The increase of expenses on our Ukrainian plant Karpatneftekhim resulted from the growth of production was offset by decreased expenses of our plant in Stavropol due to a decrease of production as a result of a fire.

Other operating expenses

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

In the first quarter of 2012, other operating expenses decreased by $47 million, or by 19.7%, mainly due to decrease in transportation services provided abroad and in non-petroleum sales and services of our retail segment.

Cost of purchased crude oil, gas and products

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

Cost of purchased crude oil, gas and products increased by $3,523 million in the first quarter of 2012, or by 27.4%, due to an increase in crude oil and refined products prices and an increase in volumes of refined products purchased.

In the first quarter of 2012, we recognized a $452 million loss on hedging, compared to an $827 million loss in the first quarter of 2011.

Transportation expenses

Our transportation expenses increased by $185 million, or by 13.0%. This increase was primarily related to Russia and resulted from increased tariffs and change in supply directions.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed to the first quarter of 2011 as follows: crude oil pipeline tariffs increased by 7.4%, railway tariffs for refined products transportation decreased by 1.2%, crude oil freight rates decreased by 17.2%, and refined products freight rates increased by 13.6%.

Equity share in income of affiliates

The Group has investments in equity method affiliates and corporate joint ventures. These companies are primarily engaged in crude oil exploration, production, marketing and distribution operations in the Russian Federation, crude oil production and marketing in Kazakhstan and refining operations in Europe. Our largest affiliates are Turgai Petroleum and Tengizchevroil, exploration and production companies operating in Kazakhstan, and ISAB and Zeeland Refinery.

In the first quarter of 2012, our share in income of affiliates increased by $12 million, or by 7.1%.

Taxes other than income taxes

	3 months of	
	2012	2011
	(millions of US dollars)	
In Russia		
Mineral extraction taxes	3,118	2,441
Social security taxes and contributions	148	152
Property tax	126	129
Other taxes	17	18
Total in Russia	**3,409**	**2,740**
International		
Mineral extraction taxes	22	24
Social security taxes and contributions	23	25
Property tax	5	19
Other taxes	19	14
Total internationally	**69**	**82**
Total	**3,478**	**2,822**

In the first quarter of 2012, taxes other than income taxes increased by 23.2%, or by $656 million. This was mainly due to an increase in mineral extraction taxes in Russia as a result of the rise of the tax rate following the increase of international crude oil prices.

In the first quarter of 2012, application of decreased rate for depleted oilfields and zero rate for the fields with extra heavy crude oil and the greenfields led to $376 million tax reduction ($262 million in the first quarter of 2011).

Excise and export tariffs

	3 months of	
	2012	2011
	(millions of US dollars)	
In Russia		
Excise tax and sales taxes on refined products	459	373
Crude oil export tariffs	2,845	2,456
Refined products export tariffs	1,458	945
Total in Russia	**4,762**	**3,774**
International		
Excise tax and sales taxes on refined products	674	769
Crude oil export tariffs	79	71
Refined products export tariffs	62	–
Total internationally	**815**	**840**
Total	**5,577**	**4,614**

Export tariffs increased by $972 million, or by 28.0%, in the first quarter of 2012. The effect of increased crude oil and refined products tariff rates was supported by increase in export volumes by 2.5% and 11.1%, respectively, compared to the first quarter of 2011.

Other non-operating (expense) income

Other non-operating income for the first quarter of 2011 included the effect of recalculation of the extraction tax incentive by certain Group companies for prior periods in total amount of $240 million.

Income taxes

In the first quarter of 2012, our total income tax expense decreased by $272 million, or by 42.6%. At the same time, our income before income tax decreased by $50 million, or by 1.2%.

In the first quarter of 2012, our effective income tax rate was 9.1%, compared to 15.7% in the first quarter of 2011, while the maximum statutory rate for the Russian Federation is 20%. The low level of our effective income tax rate in the periods considered was caused by tax deductible currency translation losses reported by Russian subsidiaries.

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

	3 months of	
	2012	**2011**
	(millions of US dollars)	
Net income	**3,789**	**3,517**
Add back:		
Income tax expense	367	639
Depreciation and amortization	1,095	1,059
Interest expense	161	173
Interest and dividend income	(66)	(45)
EBITDA	**5,346**	**5,343**

EBITDA is a non-US GAAP financial measure. EBITDA is defined as net income before interest, taxes and depreciation and amortization. The Company believes that EBITDA provides useful information to investors because it is an indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions and other investments and our ability to incur and service debt. While depreciation and amortization are considered as operating costs under US GAAP, these expenses primarily represent the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. The EBITDA calculation is commonly used as a basis for some investors, analysts and credit rating agencies to evaluate and compare the periodic and future operating performance and value of companies within the oil and gas industry. EBITDA should not be considered in isolation as an alternative to net income, operating income or any other measure of performance under US GAAP. EBITDA does not include our need to replace our capital equipment over time.

Liquidity and capital resources

	3 months of 2012	2011
	(millions of US dollars)	
Net cash provided by operating activities	3,880	3,715
Net cash used in investing activities	(2,517)	(3,446)
Net cash used in financing activities	(137)	(190)

Operating activities

Our primary source of cash flow is funds generated from our operations. During the first quarter of 2012, cash generated from operating activities was $3,880 million, which is 4.4% more than in the first quarter of 2011, mainly due to the increase in sales revenues. On the other hand, our operating cash flows were affected by an increase in working capital by $1,131 million, compared to January 1, 2012.

The increase of working capital was mainly caused by:

- $540 million increase in inventory
- $1,569 million net increase in trade accounts receivable and payable

At the same time, this negative effect was partially offset by a $619 million net decrease in other taxes receivable and payable and a $348 million net decrease in other assets and liabilities.

Investing activities

The decrease in cash used in investing activities mainly resulted from a decrease in payments for acquisitions.

In the first quarter of 2011, we made an advance payment of $1,778 million for expected acquisition of certain upstream assets, while in the first quarter of 2012 we didn't make significant acquisitions.

Capital expenditures increased by $719 million, or by 42.2%, compared to the first quarter of 2011.

Financing activities

In the first quarter of 2012, net movements of short-term and long-term debt generated an inflow of $13 million, compared to an outflow of $148 million in the first quarter of 2011.

In the first quarter of 2012, we purchased Company's stock worth $128 million.

Analysis of capital expenditures

	3 months of 2012	2011
	(millions of US dollars)	
Capital expenditures[1]		
Exploration and production		
Russia	1,629	1,161
International	373	232
Total exploration and production	2,002	1,393
Refining, marketing and distribution		
Russia	172	171
International	179	56
Total refining, marketing and distribution	351	227
Chemicals		
Russia	6	7
International	4	7
Total chemicals	10	14
Power generation and distribution	57	50
Other	42	38
Total capital expenditures	**2,462**	**1,722**
Acquisitions of subsidiaries and associates[2]		
Exploration and production		
Russia	52	18
International	10	1,760
Total exploration and production	62	1,778
Refining, marketing and distribution		
Russia	2	–
International	3	–
Total refining, marketing and distribution	5	–
Power generation and distribution	–	–
Other	–	–
Less cash acquired	(1)	–
Total acquisitions	**66**	**1,778**

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

Our capital expenditures, including non-cash transactions, amounted to $2,462 million, which is 43.0% more than in the first quarter of 2011.

Capital expenditures in exploration and production segment increased by $609 million, or by 43.7%. In Russia, this was due to development of the V. Filanovsky oilfield on the Caspian seashore and production drilling in Western Siberia. In our international projects, we increased investments in developing our projects in Iraq and Uzbekistan.

The increase in our refining, marketing and distribution capital expenditures was mainly due to construction of a heavy residue processing complex at our Bulgarian refinery.

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

	3 months of 2012	2011
	(millions of US dollars)	
Northern Timan-Pechora	54	53
Yamal	179	130
Caspian region[1]	350	84
Ghana	5	8
Cote d'Ivoire	14	4
Iraq	143	31
Uzbekistan	149	124
Total	**894**	**434**

(1) Russian and international projects.