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

The following report contains a discussion and analysis of the financial position of OAO LUKOIL as of December 31, 2013 and the results of its operations for each of the years ended December 31, 2013, 2012 and 2011, as well as significant factors that may affect its future performance. It should be read in conjunction with our US GAAP consolidated financial statements, including notes and supplementary information on oil and gas exploration and production activities.

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 the 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. *Please see "Forward-looking statement" on page 30 for a discussion of some factors that could cause actual results to differ materially.*

Key financial and operational results

	2013	Change to 2012, %	2012	Change to 2011, %	2011
Sales (millions of US dollars)	141,452	1.6	139,171	4.1	133,650
Net income attributable to OAO LUKOIL (millions of US dollars)	7,832	(28.8)	11,004	6.2	10,357
Adjusted net income attributable to OAO LUKOIL (millions of US dollars)(1)	10,281	(6.6)	11,004	(2.7)	11,312
EBITDA (millions of US dollars)	16,668	(11.9)	18,915	1.7	18,606
Adjusted EBITDA (millions of US dollars)(1)	19,255	1.8	18,915	(2.9)	19,489
Taxes other than income taxes, excise and export tariffs (millions of US dollars)	(36,137)	(1.0)	(36,502)	3.9	(35,135)
Earning per share of common stock attributable to OAO LUKOIL (US dollars):					
Basic	10.38	(28.3)	14.47	8.8	13.30
Diluted	10.18	(28.2)	14.17	8.7	13.04
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	803,825	1.2	794,332	0.5	790,674
Daily hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	2,202	1.5	2,170	0.2	2,166
Crude oil and natural gas liquids produced by the Group including our share in equity affiliates (thousands of barrels)	683,822	1.0	677,023	(1.1)	684,522
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	20,391	2.3	19,934	10.5	18,038
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes)	64,196	0.7	63,773	1.8	62,667
Hydrocarbon proved reserves including our share in equity affiliates (millions of BOE)	17,401	0.6	17,296	0.2	17,269

(1) Adjusted for the impairment losses and dry hole write-offs (for details see page 22).

In 2013, net income attributable to OAO LUKOIL amounted to $7,832 million, a decrease of 28.8% from 2012. As a result of impairment test, the Group booked an impairment loss related to some upstream, downstream and power generating assets both in Russia and abroad in the total amount of $2.1 billion (net of tax and non-controlling interests). We also wrote off the cost of dry exploratory wells and related costs, in the total amount of $312 million. Thus, the total effect of non-recurring losses and write-offs on net income attributable to OAO LUKOIL in 2013 amounted to $2,449 million. Our adjusted EBITDA reached $19,255 million, which was 1.8% higher than in the prior year. The Company has broken the three-year trend of crude oil production decline and increased daily hydrocarbon production by 1.5%. Depreciation, depletion and amortization increased by 19.1%, which was a result of acquisition of subsidiaries and general increase in value of depreciable assets. Compared to 2012, our capital expenditures increased by 28.4%. At the same time, despite significant capital investments, such as the development of our key upstream projects and modernization of refineries, the Company gained free cash flow of $643 million.

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 39 countries on four continents.

LUKOIL is one of the world's largest energy companies in terms of hydrocarbon reserves that amounted to 17.4 billion BOE as of January 1, 2014 and comprised of 13.5 billion barrels of crude oil and 23.6 trillion cubic feet of gas.

Our operations are divided into four main business segments:

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

Each of our four main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the "Domestic crude oil and refined products prices" section on page 9, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of crude oil refining and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 21 "Segment information" to the consolidated financial statements.

Recent developments and outlook

The following has been achieved in 2013:

Exploration and production

- 9 new oil and gas fields were brought into production (2012 – 8 oil and gas fields).
- The trend of crude oil production decline was broken and daily liquids production volumes increased by 1.2% as a result of new acquisition, growth of drilling footage and reservoir stimulation.
- Our daily gas production increased by 2.8% compared to 2012.
- In Iraq, the Company approached the final stage of development of the West Qurnah-2 oilfield.

Refining

- In December, we increased the Group’s ownership stake in the joint venture operating the ISAB refining complex (“ISAB”) from 80% to 100%.
- The Company continued the construction of a vacuum gasoil refinery complex at the Volgograd refinery and a catalytic cracking unit at the Nizhny Novgorod refinery.

Marketing

- In July, in line with market diversification strategy, the Company commenced supplies of its light crude oil through the Eastern Siberia – Pacific Ocean pipeline. This allows us to preserve the premium quality of crude oil and thus increases the efficiency of export, compared to export to traditional Western markets.

Power generation

- In July-October, two combined cycle gas turbines with a combined capacity of 235 MW were put into operation in Astraknan, Russia.

Corporate center

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

These and other achievements in 2013 are described in detail further in this report.

Changes in the Group structure

In December 2013, after approval by European regulatory authorities, the Group acquired the remaining 20% interest in the joint venture which operates the ISAB for €426 million (approximately $583 million) after final adjustments, increasing its stake in the joint venture from 80% to 100%. This transaction was exercised in line with the initial agreement on the establishment of the joint venture signed in 2008. This agreement gave the second investor, ERG S.p.A., a step-by-step put option to sell its share in the joint venture to the Group. The Group obtained control over this joint venture in September 2012, when within this agreement, it acquired a 20% interest in the joint venture for €494 million (approximately $621 million) and increased its stake to 80%.

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

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

Resource base

The table below summarizes the net proved reserves of consolidated subsidiaries and our share in equity affiliates under SEC standards (until the economic limit of commercial production is reached) that have been derived or extracted from our reserve reports audited by Miller and Lents, Ltd., our independent reservoir engineers, as of January 1, 2014 and 2013.

		Changes in 2013			
(millions of BOE)	**January 1, 2014**	**Production[1]**	**Extensions, discoveries and changes in structure**	**Revision of previous estimates**	**January 1, 2013[2]**
Western Siberia	9,747	(441)	414	62	9,712
Timan-Pechora	2,320	(118)	78	(108)	2,468
Ural region	2,286	(116)	79	106	2,217
Volga region	1,238	(57)	223	9	1,063
Other in Russia	196	(14)	9	(15)	216
Outside Russia	1,614	(87)	19	62	1,620
Proved oil and gas reserves	**17,401**	**(833)**	**822**	**116**	**17,296**
Probable oil and gas reserves	**6,613**				**7,723**
Possible oil and gas reserves	**3,596**				**4,272**

[1] Gas production shown before own consumption.
[2] Excluding reserves related to the Imilorskoye, West Imilorskoye and Istochnoye fields.

The Company's proved reserves as of January 1, 2014 amount to 17,401 million BOE and comprise of 13,461 million barrels of crude oil and 23,642 billion cubic feet of gas. The incremental replacement of production by additional proved reserves in 2013 exceeded 100%.

The increase in proved reserves related to geological exploration, production drilling and acquisitions totaled 822 million BOE as a result of the exploration operations in the traditional regions of the Company's operations, accelerated commissioning of the fields discovered in 2013, and the acquisition of assets. According to initial estimations, proved reserves of acquired assets (ZAO Samara-Nafta and the Imilorsko-Istochniy license area) totaled 178 million BOE, unproved reserves and contingent resources amounted to 991 million BOE. Management expects a sizeable increase in the proved reserves related to these assets, as progress in the development of the respective oilfields is made.

Management expects the oil and gas volumes classified as contingent resources to be transferred to reserves as their commissioning date approaches, a program to enhance volumes of gas utilization is implemented and new advanced technologies are applied, which makes it possible to develop the hard-to-recover reserves in a cost-effective way.

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. Exploration and production outside of Russia is performed by our 100% subsidiary LUKOIL-Overseas Holding GmbH. This has stakes in PSA's and other projects in Kazakhstan, Azerbaijan, Uzbekistan, Iraq, Saudi Arabia, Egypt, Ghana, Cote d'Ivoire, Vietnam, Venezuela, Sierra Leone and Norway.

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

	2013	2012	2011
	(thousand BOE per day)		
Crude oil and natural gas liquids production[1]			
Consolidated subsidiaries			
Western Siberia	996	1,014	1,014
Timan-Pechora	302	309	348
Ural region	297	286	272
Volga region	120	77	69
Other in Russia	38	38	40
Total in Russia	1,753	1,724	1,743
Total outside Russia	65	69	71
Total consolidated subsidiaries	**1,818**	**1,793**	**1,814**
Our share in equity affiliates			
in Russia	8	8	7
outside Russia	47	49	54
Total share in equity affiliates	**55**	**57**	**61**
Total crude oil and natural gas liquids	**1,873**	**1,850**	**1,875**
Natural gas production available for sale[2]			
Consolidated subsidiaries			
Western Siberia	187	183	182
Timan-Pechora	14	12	9
Ural region	17	15	14
Volga region	6	7	7
Total in Russia	224	217	212
Total outside Russia	95	94	68
Total consolidated subsidiaries	**319**	**311**	**280**
Share in equity affiliates			
in Russia	1	1	1
outside Russia	9	8	10
Total share in production of equity affiliates	**10**	**9**	**11**
Total natural gas available for sale	**329**	**320**	**291**
Total daily hydrocarbon production	**2,202**	**2,170**	**2,166**
	(US dollar per BOE)		
Hydrocarbon extraction expenses	5.58	5.04	4.96
- in Russia	5.59	5.03	4.97
- outside Russia	5.43	5.07	4.85
	(millions of US dollars)		
Hydrocarbon extraction expenses	4,335	3,861	3,771
- in Russia	4,021	3,562	3,529
- outside Russia	314	299	242
Exploration expenses	602	364	532
- in Russia	218	205	93
- outside Russia	384	159	439
Mineral extraction tax	12,410	12,354	11,594
- in Russia	12,333	12,261	11,502
- outside Russia	77	93	92

(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 2013, our daily crude oil production increased by 1.3%, compared to 2012. We produced (including the Company's share in equity affiliates) 90.8 million tonnes, or 670.1 million barrels of crude oil. The main oil producing region for the Company is Western Siberia where we produced 54.6% of our crude oil in 2013 (56.4% in 2012).

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

		Change to 2012			
(thousands of tonnes)	**2013**	**Total, %**	**Change in structure**	**Organic change**	**2012**
Western Siberia	48,208	(2.0)	–	(1,006)	49,214
Timan-Pechora	15,232	(2.6)	–	(402)	15,634
Ural region	13,971	3.5	126	347	13,498
Volga region	5,801	61.0	1,820	378	3,603
Other in Russia	1,903	0.2	–	4	1,899
Crude oil produced in Russia	85,115	1.5	1,946	(679)	83,848
Crude oil produced internationally	3,143	(6.0)	(75)	(124)	3,342
Total crude oil produced by consolidated subsidiaries	**88,258**	**1.2**	**1,871**	**(803)**	**87,190**
Our share in crude oil produced by equity affiliates:					
in Russia	366	(5.2)	(63)	43	386
outside Russia	2,183	(4.3)	–	(97)	2,280
Total crude oil produced	**90,807**	**1.1**	**(1,808)**	**(857)**	**89,856**

The decrease in oil production in Western Siberia was due to natural depletion of reserves and an increase in water cut. The increasing water cut was also the reason for the decline of the production from the Yuzhnoye Khylchuyu oilfield in Timan-Pechora. Nevertheless, this was compensated for by the acquisitions of new upstream properties. The organic growth of our production in Russia was a result of the development the Yu. Korchagin greenfield in the Caspian Sea and greenfields in Timan-Pechora, successful employment of new technologies and an increase in drilling footage in traditional regions. As a result, our daily domestic crude oil and natural gas liquids production volumes increased by 1.7%, compared to 2012.

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

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 in international markets is normally used for trading activities, for supplying our international refineries or for processing at third party refineries.

	2013		**2012**		**2011**	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Purchases in Russia	5,447	743	1,994	272	4,010	547
Purchases for trading internationally	48,416	6,605	28,170	3,843	56,683	7,733
Purchases for refining internationally	75,607	10,315	91,713	12,512	95,070	12,970
Total crude oil purchased	**129,470**	**17,663**	**121,877**	**16,627**	**155,763**	**21,250**

A significant part of our crude oil purchases is for processing. Compared to 2012, our purchases for processing at international refineries decreased by 17.6%, largely, as a result of the increase in volumes of our own crude oil supplies and lower throughput at our refineries outside of Russia. At the same time, our purchases for trading increased by 71.9% to compensate for the decrease of crude oil export from Russia.

Production of gas and natural gas liquids. In 2013, we produced 20,391 million cubic meters (120 million BOE) of gas available for sale (including our share in equity affiliates), that is 2.3% more than in 2012.

Our major gas production field is the Nakhodkinskoe field, where we produced 8,272 million cubic meters of natural gas in 2013 (8,041 million cubic meters in 2012). Our international gas production increased by 1.4%, compared to 2012.

In 2013, the output of natural gas liquids at the Group gas processing plants in Western Siberia, Ural and Volgograd regions of Russia was 13.7 million BOE, compared to 13.6 million BOE in 2012.

Refining, marketing and trading

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

In December 2013, the Group obtained full control over ISAB after acquisition of the remaining 20% share. Initially, in December 2008, the Group acquired a 49% interest in ISAB, then increased its interest to 60% in April 2011 and to 80% in September 2012, when the control over the refinery was obtained and ISAB became our consolidated subsidiary, rather than equity affiliate.

Compared to 2012, the total volume of refined products produced by the Group (including our share in equity affiliates' production) increased by 0.7%. Production volumes at our Russian refineries increased by 2.3% against the background of low refining volumes at our refinery in Nizhny Novgorod in 2012 as a consequence of repair works. Production at our international refineries decreased by 2.5%. The increase of our share in the ISAB production was offset by the effect of decreased production at this refinery due to an overhaul carried out in 2013. Moreover, the volumes of production at our refinery in Romania decreased by 14.1%, compared to 2012, as a result of changes in market conditions and stoppage for maintenance.

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

Along with our own production of refined products we can refine crude oil at third party refineries depending on market conditions and other factors. In the periods considered, we processed our crude oil at third party refineries in Belarus (from January 2012 until August 2013, inclusive) and Kazakhstan.

The following table summarizes key figures for our refining activities.

	2013	**2012**	**2011**
		(millions of US dollars)	
Refining expenses at the Group refineries	2,170	1,669	1,418
- in Russia	1,156	1,141	1,112
- outside Russia	1,014	528	306
Refining expenses at affiliated refineries[(1)]	228	702	890
Refining expenses at third party refineries	58	96	7
Capital expenditures	2,184	1,406	783
- in Russia	1,393	988	586
- outside Russia	791	418	197
		(thousand barrels per day)	
Refinery throughput at the Group refineries	1,240	1,128	1,073
- in Russia	909	890	909
- outside Russia[(2)]	331	238	164
Refinery throughput at affiliated refineries[(1)(2)]	92	195	230
Refinery throughput at third party refineries	31	53	5
Total refinery throughput	**1,363**	**1,376**	**1,308**
		(thousands of tonnes)	
Refined products produced at the Group refineries	43,426	42,468	43,248
Production of the Group refineries outside Russia	16,170	11,541	7,807
Production of affiliated refineries outside of Russia[(1)]	4,600	9,764	11,612
Refined products produced by the Group including our share in equity affiliates	**64,196**	**63,773**	**62,667**
Refined products produced at third party refineries	1,439	2,472	256
Total refined products produced	**65,635**	**66,245**	**62,923**

(1) Including the amounts for Zeeland (45% share) and ISAB (49% share until April 2011, 60% share from April 2011 till September 2012).
(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 27 countries through nearly 5.6 thousand petrol stations (including franchisees). Most of the stations operate under the LUKOIL brand.

The table below summarizes figures for our trading activities.

	2013	2012	2011
	(thousands of tonnes)		
Retail sales	15,741	15,424	15,249
Wholesale sales	101,529	97,558	87,337
Total refined products sales	**117,270**	**112,982**	**102,586**
Refined products purchased in Russia	2,298	1,772	2,026
Refined products purchased internationally	58,172	52,761	45,655
Total refined products purchased	**60,470**	**54,533**	**47,681**

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

	2013		2012		2011	
	(thousands of barrels)	(thousands of tonnes)	(thousands of barrels)	(thousands of tonnes)	(thousands of barrels)	(thousands of tonnes)
Exports of crude oil using Transneft export routes	185,500	25,307	223,185	30,448	215,605	29,414
Exports of crude oil bypassing Transneft	47,770	6,517	31,418	4,286	38,739	5,285
Total crude oil exports	**233,270**	**31,824**	**254,603**	**34,734**	**254,344**	**34,699**
Exports of refined products		**23,419**		**22,537**		**24,029**

In 2013, the volume of our crude oil export from Russia decreased by 8.4%, compared to 2012, and we exported 37.4% of our total domestic crude oil production (41.4% – in 2012). The decrease of crude oil export was a result of higher sales in Russia and increased throughput at our domestic refineries.

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

In 2013, the volume of our export of refined products from Russia increased to 23.4 thousand tonnes, or by 3.9%, compared to 2012. Primarily, we export from Russia diesel fuel, fuel oil and gasoil. These products accounted for approximately 88.9% of our refined products export volumes.

In 2013, our revenue from export of crude oil and refined products from Russia both to Group companies and third parties amounted to $22,885 million and $17,309 million, respectively ($25,174 million for crude oil and $16,779 million for refined products in 2012).

Power generation

In 2013, we continued to develop the power generation sector of our business as part of our strategic development program. This new sector encompasses all aspects of the power generation business, from generation to transmission and sale of heat and electrical power. Our power generation business sector now includes OOO LUKOIL-Volgogradenergo, OOO LUKOIL-Kubanenergo, OOO LUKOIL-Astrakhanenergo, OOO LUKOIL-Rostovenergo, OOO LUKOIL-Stavropolenergo, OOO LUKOIL-TTK, OOO LUKOIL-Ecoenergo, our own power generating facilities at our oil and gas fields in Russia and power generators in Bulgaria and Romania. Our total output of electrical energy was 15.7 billion kW-h in 2013 (15.4 billion kW-h in 2012 and 13.1 billion kW-h in 2011). In 2013, our total output of heat energy was approximately 13.6 million Gcal (14.7 million Gcal in 2012 and 15.5 million Gcal in 2011).

In 2013, we put into operation two combined cycle gas turbine (CCGT) units in Astrakhan with a combined capacity of 235 MW.

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. In 2013, the Brent crude oil price fluctuated between $96 and $119 per barrel and reached its peak of $119.03 in February. During the fourth quarter of 2013, the average price of the Brent crude oil was 1.0% lower than in the third quarter of 2013.

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

	2013	Change to 2012, %	2012	Change to 2011, %	2011
	(in US dollars per barrel, except for figures in percent)				
Brent crude	108.66	(2.7)	111.67	0.4	111.26
Urals crude (CIF Mediterranean) [1]	108.03	(2.3)	110.55	1.3	109.10
Urals crude (CIF Rotterdam) [1]	107.38	(2.6)	110.19	1.0	109.08
	(in US dollars per metric tonne, except for figures in percent)				
Fuel oil 3.5% (FOB Rotterdam)	591.43	(6.3)	631.08	3.5	609.51
Diesel fuel 10 ppm (FOB Rotterdam)	938.66	(4.2)	980.00	2.2	958.73
High-octane gasoline (FOB Rotterdam)	986.86	(4.8)	1,036.14	5.3	984.12

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 2013, 2012 and 2011.

	2013	Change to 2012, %	2012	Change to 2011, %	2011
	(in US dollars per metric tonne, except for figures in percent)				
Fuel oil	341.32	6.6	320.29	0.4	318.99
Diesel fuel	850.78	2.2	832.71	9.5	760.53
High-octane gasoline (Regular)	829.69	1.9	813.94	(5.1)	857.70
High-octane gasoline (Premium)	897.10	3.2	869.33	(3.2)	897.81

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 devaluation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 4.2% in 2013, compared to 2012.

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

	2013	2012	2011
Ruble inflation (CPI), %	6.5	6.6	6.1
Average exchange rate for the period (ruble to US dollar)	31.85	31.09	29.39
Exchange rate at the end of the period (ruble to US dollar)	32.73	30.37	32.20

Tax burden

Given the relative size of our activities in Russia, our tax profile is largely determined by the taxes payable in Russia (based on records maintained under Russian legislation – not US GAAP). In 2013, 2012 and 2011, the tax charge on the operations in Russia was approximately 88% of our total tax charge.

Apart of income tax, fundamental taxes specific to the oil industry in Russia are mineral extraction tax, excise and export tariffs. In addition to above mentioned taxes, we are subject to a number of other taxes in Russia, including social taxes, property tax, VAT and other local and regional taxes.

The effective rates of total taxes and tariffs (total taxes, including income taxes, taxes other than on income and excise and export tariffs, divided by income before taxes and tariffs) for 2013, 2012 and 2011, respectively, were 84%, 78% and 80%. In 2013, tax expenses in Russia were about 52% of the domestic and export sales revenue of Russian companies of the Group.

The measures that we use for tax planning and management strategies have been based on our understanding of tax legislation existing at the time of implementation of these measures. We are subject to tax authority audits on an ongoing basis, as is normal in the Russian environment, and, at times, the authorities have attempted to impose significant additional taxes on us. We believe that we have adequately met and provided for tax liabilities based on our interpretation of existing tax legislation. However, the relevant authorities may have differing interpretations and the effects could be significant.

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

		2013(1)	**Change to 2012, %**	**2012**(1)	**Change to 2011, %**	**2011**(1)
Export tariffs on crude oil	$/tonne	392.14	(3.0)	404.15	(1.2)	409.19
Export tariffs on refined products						
Middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	258.78	(3.0)	266.70	(2.8)	274.27
Light distillates						
gasoline	$/tonne	352.91	(3.0)	363.72	6.4	341.94
straight-run gasoline	$/tonne	352.91	(3.0)	363.72	9.2	333.08
Liquid fuels (fuel oil)	$/tonne	258.78	(3.0)	266.70	27.9	208.46
Mineral extraction tax						
Crude oil	RUR/tonne	5,329.58	5.2	5,065.95	13.7	4,456.54
Natural gas	RUR/1,000 m^3	333.50	32.9	251.00	5.9	237.00

(1) Average values.

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

		2013(1)	**Change to 2012, %**	**2012**(1)	**Change to 2011, %**	**2011**(1)
Mineral extraction tax						
Crude oil	$/tonne	167.34	2.7	162.93	7.4	151.65
Natural gas	$/1,000 m^3	10.47	29.7	8.07	0.1	8.06

(1) Average values.

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

Crude oil extraction tax rate is determined by adjusting the base rate depending on the international market price of Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals blend international market price for a tax period is less than or equal to $15.00 per barrel. Each $1.00 per barrel increase in the international Urals blend price over the threshold ($15.00 per barrel) results in an increase of the tax rate by $1.80 per tonne extracted (or $0.25 per barrel extracted using a conversion factor of 7.33) above the base rate.

In 2013, the base rate was 470 rubles per metric tonne extracted (446 rubles in 2012). For 2014, the base rate is set at 493 rubles per metric tonne extracted.

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

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

Natural gas extraction tax rate. The mineral extraction tax on natural gas produced by independent producers in Russia is calculated using a flat rate. Since July 2013, the rate was set at 402 rubles per thousand cubic meters. In the first half of 2013, the rate was 265 rubles per thousand cubic meters, while in 2012 the rate amounted to 251 rubles. For 2014, the rate is set at 474 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. The list of the oilfields where the reduced rate applies includes our Yu. Korchagin and V. Filanovsky oilfields located in the Caspian Sea.

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

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

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

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

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

Excise rates on refined products in Russia are tied to the ecological class of fuel. Excise tax rates for 2013, 2012 and 2011 are listed below:

		2013	**Change to 2012, %**	**2012**	**Change to 2011, %**	**2011**
Gasoline						
Below Euro-3	RUR/tonne	10,100.00	26.6	7,976.37	33.1	5,995.00
Euro-3	RUR/tonne	9,750.00	27.7	7,633.37	34.6	5,672.00
Euro-4	RUR/tonne	8,761.64	28.4	6,822.00	32.6	5,143.00
Euro-5	RUR/tonne	5,448.99	(8.8)	5,977.91	16.2	5,143.00
Diesel fuel						
Below Euro-3	RUR/tonne	5,860.00	39.5	4,199.55	52.5	2,753.00
Euro-3	RUR/tonne	5,860.00	44.4	4,058.33	63.3	2,485.00
Euro-4	RUR/tonne	5,017.68	40.9	3,562.00	58.5	2,247.00
Euro-5	RUR/tonne	4,417.68	35.5	3,260.36	45.1	2,247.00
Motor oils	RUR/tonne	7,509.00	23.7	6,072.00	29.7	4,681.00
Straight-run gasoline	RUR/tonne	10,229.00	30.7	7,824.00	28.5	6,089.00

		2013	Change to 2012, %	2012	Change to 2011, %	2011
Gasoline						
Below Euro-3	$/tonne	317.13	23.6	256.53	25.8	204.00
Euro-3	$/tonne	306.14	24.7	245.50	27.2	193.01
Euro-4	$/tonne	275.11	25.4	219.41	25.4	175.01
Euro-5	$/tonne	171.09	(11.0)	192.26	9.9	175.01
Diesel fuel						
Below Euro-3	$/tonne	184.00	36.2	135.06	44.2	93.68
Euro-3	$/tonne	184.00	41.0	130.52	54.4	84.56
Euro-4	$/tonne	157.55	37.5	114.56	49.8	76.46
Euro-5	$/tonne	138.71	32.3	104.86	37.1	76.46
Motor oils	$/tonne	235.78	20.7	195.29	22.6	159.29
Straight-run gasoline	$/tonne	321.18	27.6	251.63	21.4	207.20

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

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

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

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

Transportation of crude oil and refined products in Russia

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

Transportation of crude oil produced in Russia to refineries and export destinations is performed primarily through the trunk oil pipeline system of the state-owned company, 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, 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.

Year ended December 31, 2013, compared to years ended December 31, 2012 and December 31, 2011

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

	2013	2012	2011
	(millions of US dollars)		
Revenues			
Sales (including excise and export tariffs)	141,452	139,171	133,650
Costs and other deductions			
Operating expenses	(10,086)	(9,359)	(9,055)
Cost of purchased crude oil, gas and products	(65,924)	(64,148)	(59,694)
Transportation expenses	(6,290)	(6,171)	(6,121)
Selling, general and administrative expenses	(3,849)	(3,755)	(3,822)
Depreciation, depletion and amortization	(5,756)	(4,832)	(4,473)
Taxes other than income taxes	(13,803)	(13,666)	(12,918)
Excise and export tariffs	(22,334)	(22,836)	(22,217)
Exploration expense	(602)	(364)	(532)
(Loss) gain on disposals and impairments of assets	(2,561)	30	(1,663)
Income from operating activities	**10,247**	**14,070**	**13,155**
Interest expense	(488)	(538)	(694)
Interest and dividend income	239	257	211
Equity share in income of affiliates	575	518	690
Currency translation loss	(443)	(512)	(301)
Other non-operating income (expense)	328	(72)	58
Income before income taxes	**10,458**	**13,723**	**13,119**
Current income taxes	(2,051)	(2,738)	(2,678)
Deferred income taxes	(780)	(60)	(615)
Total income tax expense	**(2,831)**	**(2,798)**	**(3,293)**
Net income	**7,627**	**10,925**	**9,826**
Net loss attributable to non-controlling interests	205	79	531
Net income attributable to OAO LUKOIL	**7,832**	**11,004**	**10,357**
Earning per share of common stock attributable to OAO LUKOIL (in US dollars):			
Basic	10.38	14.47	13.30
Diluted	10.18	14.17	13.04

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

Sales revenues

Sales breakdown	2013	2012	2011
	(millions of US dollars)		
Crude oil			
Export and sales on international markets other than CIS	22,350	24,414	30,132
Export and sales to CIS	1,920	1,622	2,390
Domestic sales	3,071	1,634	1,571
	27,341	**27,670**	**34,093**
Refined products			
Export and sales on international markets			
Wholesale	76,966	75,880	65,060
Retail	10,830	10,724	11,275
Domestic sales			
Wholesale	8,053	8,113	7,349
Retail	9,423	8,690	7,893
	105,272	**103,407**	**91,577**
Petrochemicals			
Export and sales on international markets	936	992	1,095
Domestic sales	886	418	914
	1,822	**1,410**	**2,009**
Gas and gas products			
Export and sales on international markets	2,295	2,385	1,878
Domestic sales	1,153	1,092	1,001
	3,448	**3,477**	**2,879**
Sales of energy and related services	**1,575**	**1,394**	**1,472**
Other			
Sales on international markets	1,178	962	880
Domestic sales	816	851	740
	1,994	**1,813**	**1,620**
Total sales	**141,452**	**139,171**	**133,650**

Sales volumes	2013	2012	2011
Crude oil	(thousands of barrels)		
Export and sales on international markets other than CIS	207,021	222,466	275,696
Export and sales to CIS	37,881	31,622	45,329
Domestic sales	62,224	33,264	32,699
	307,126	**287,352**	**353,724**
Crude oil	(thousands of tonnes)		
Export and sales on international markets other than CIS	28,243	30,350	37 612
Export and sales to CIS	5,168	4,314	6 184
Domestic sales	8,489	4,538	4 461
	41,900	**39,202**	**48 257**
Refined products	(thousands of tonnes)		
Export and sales on international markets			
Wholesale	90,097	85,917	76,313
Retail	6,580	6,568	6,945
Domestic sales			
Wholesale	11,432	11,641	11,024
Retail	9,161	8,856	8,304
	117,270	**112,982**	**102,586**
Total sales volume of crude oil and refined products	**159,170**	**152,184**	**150,843**

Realized average sales prices		2013	2012	2011
Average realized price international				
Oil (excluding CIS)	($/barrel)	107.96	109.74	109.30
Oil (CIS)	($/barrel)	50.70	51.31	52.71
Refined products				
Wholesale	($/tonne)	854.26	883.18	852.55
Retail	($/tonne)	1,645.94	1,632.81	1,623.53
Average realized price within Russia				
Oil	($/barrel)	49.35	49.12	48.06
Refined products				
Wholesale	($/tonne)	704.48	696.91	666.62
Retail	($/tonne)	1,028.58	981.21	950.51

In 2013, our revenues increased by $2,281 million, or by 1.6%, compared to 2012 (in 2012 our revenues increased by $5,521 million, or by 4.1%, compared to 2011). Our revenues from crude oil sales decreased by $329 million, or by 1.2% (in 2012, revenues from crude oil sales decreased by $6,423 million, or by 18.8%). Our revenues from sales of refined products increased by $1,865 million, or by 1.8% (in 2012, revenues from sales of refined products increased by $11,830 million, or by 12.9%).

Sales of crude oil

2013 vs. 2012

Compared to 2012, our international sales volumes decreased by 1,253 thousand tonnes, or by 3.6%, due to decreased export from Russia together with the increased supplies of own crude oil to our overseas refineries. Along with the decrease in crude oil prices, this led to the decrease in our international sales revenue by 6.8%, or by $1,766 million. At the same time, domestic sales volumes increased nearly two-fold, compared to 2012, due to significant increase of domestic demand and increase of crude oil production in Russia. As a result, in 2013, our domestic sales revenue increased by 87.9%, or by $1,437 million.

In 2013, our revenue from crude oil export from Russia both to the Group companies and third parties amounted to $22,885 million.

2012 vs. 2011

Compared to 2011, our total crude oil sales revenues decreased by $6,423 million, or by 18.8%, in 2012 as a result of the decrease in sales volumes by 18.8%, or by 9,055 thousand tonnes, due to lower scale of trading operations, increase in refinery throughput and decrease in production.

In 2012, our revenue from crude oil export from Russia both to the Group companies and third parties amounted to $25,174 million.

Sales of refined products

2013 vs. 2012

Compared to 2012, our revenue from the wholesale of refined products outside of Russia increased by $1,086 million, or by 1.4%. The main reason for this was the increase in sales volumes by 4.9%, as a result of higher volumes of refined products trading. At the same time, our realized wholesale prices decreased by 3.3%, compared to 2012.

Compared to 2012, neither our retail volumes nor retail prices outside of Russia changed significantly, therefore, our international retail sales revenue remained on the level of 2012.

In 2013, our revenue from the wholesale of refined products on the domestic market did not change significantly. Decrease in sales volumes by 209 thousand tonnes, or by 1.8%, was compensated by the increase in sales price by 1.1%.

Our revenue from retail sales in Russia increased by $733 million, or by 8.4%, in 2013. Retail sales volumes increased by 3.4%, as a result of the increase in domestic demand for motor fuels. Average retail prices in Russia increased by 4.8%, compared to 2012.

In 2013, our revenue from export of refined products from Russia both to Group companies and third parties amounted to $17,309 million.

2012 vs. 2011

Compared to 2011, our revenue from the wholesale of refined products outside of Russia increased by $10,820 million, or by 16.6%, as a result of an increase in sales volumes by 12.6% and prices by 3.6%.

In 2012, our revenue from international retail sales decreased by $551 million, or by 4.9%. Average prices increased by 0.6% while sales volumes decreased by 5.4%, or by 377 thousand tonnes, mainly as a result of restructuring of our retail network in the USA.

In 2012, our revenue from the wholesale of refined products on the domestic market increased by $764 million, or by 10.4%. Our average realized price increased by 4.5% and our sales volumes – by 5.6%.

Our revenue from retail sales in Russia increased by $797 million, or by 10.1%, in 2012. Domestic retail sales volumes increased by 6.6% resulting from the increase in domestic demand for motor fuels. Average retail prices in Russia increased by 3.2%, compared to 2011.

In 2012, our revenue from export of refined products from Russia both to Group companies and third parties amounted to $16,779 million.

Sales of petrochemical products

2013 vs. 2012

Our revenue from sales of petrochemical products increased by $412 million, or by 29.2%, in 2013. Domestic sales volumes increased by 413 thousand tonnes, or by 121.5%, after resuming of the production at our petrochemical plant in the Stavropol region of Russia at the end of the third quarter of 2012. At the same time, in 2013, our international sales volumes decreased by 18.1%, due to a temporary shutdown of our petrochemical plant Karpatnaftochim Ltd. in Ukraine, which resulted from unfavorable economic conditions.

2012 vs. 2011

In 2012, our revenue from sales of petrochemical products decreased by $599 million, or by 29.8%, mainly as a consequence of a fire at our petrochemical plant in the Stavropol region of Russia in December 2011. Domestic sales volumes dropped by 55.0% compared to 2011. International sales volumes also decreased by 8.2%.

Sales of gas and gas products

2013 vs. 2012

Sales of gas and gas refined products decreased by $29 million, or by 0.8%, in 2013, compared to 2012.

Gas products wholesales revenue decreased by $146 million, or by 11.0%, in 2013. Average realized wholesale prices decreased by 2.0% and gas products wholesale volumes decreased by 9.2% as a result of planned overhauls performed at our gas processing plants in the Ural region and Western Siberia in 2013.

In 2013, retail gas products revenue increased by $12 million, or by 2.0%, compared to 2012.

Natural gas sales revenue increased by $105 million, or by 6.8%, in 2013 as a result of the increase in natural gas sales price in Russia, compared to 2012.

2012 vs. 2011

Sales of gas and gas refined products increased by $598 million, or by 20.8%, in 2012.

Gas products wholesales revenue increased by $129 million, or by 10.8%, in 2012. Average realized wholesale prices for gas products decreased by 2.4%, while sales volumes increased by 13.6%.

Retail gas products revenue remained on the level of 2011.

Natural gas sales revenue increased by $422 million, or by 48.8%, in 2012. This revenue increased both domestically and internationally. In the domestic market, this was mainly a result of the increase in the selling price to Gazprom by 37.0%. The main reason for the rise of revenue outside of Russia was the increase of both sales volumes and prices in Uzbekistan.

Sales of energy and related services

2013 vs. 2012

Our revenue from sales of electricity, heat and related services increased by $181 million, or by 13.0%, in 2013, due to commissioning of a CCGT unit with a capacity of 410 MW in Krasnodar, Russia in late 2012 and another two CCGT units with a combined capacity of 235 MW in Astrakhan, Russia in mid-2013, and consequent increase in volumes of power and capacity generation in 2013.

2012 vs. 2011

In 2012, our revenue from sales of electricity, heat and related services decreased by $78 million, or by 5.3%. Compared to 2011, the revenue of our power generating subsidiaries increased, among other factors, as a result of commencement of sales of energy to third parties in Ukraine and Bulgaria. At the same time, the volume of resale operations decreased.

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.

2013 vs. 2012

In 2013, other sales increased by $181 million, or by 10.0%.

Since obtaining control over the ISAB in September 2012, other sales also include revenue from processing services, rendered by this refinery complex. In 2013, the amount of this revenue totaled $218 million.

2012 vs. 2011

In 2012, other sales increased by $193 million, or by 11.9%. This increase includes $85 million of revenue from processing operations at ISAB during September-December 2012.

Operating expenses

Operating expenses include the following:

	2013	2012	2011
	(millions of US dollars)		
Hydrocarbon extraction expenses	4,335	3,861	3,771
Own refining expenses	2,170	1,669	1,418
Refining expenses at third parties and affiliated refineries	286	798	897
Cost of processing operations at ISAB	185	64	–
Expenses for crude oil transportation to refineries	1,265	1,241	1,060
Power generation and distribution expenses	717	619	617
Petrochemical expenses	320	303	343
Other operating expenses	808	804	949
Total operating expenses	**10,086**	**9,359**	**9,055**

The method of allocation of operating expenses above differs from the approach used in preparing the data for Note 21 “Segment information” to our consolidated financial statements. Expenditures in the segment reporting are grouped depending on the segment to which a particular company belongs. Operating expenses for the purposes of this analysis are grouped based on the nature of the costs incurred.

Our operating expenses increased by $727 million, or by 7.8%, compared to 2012.

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.

2013 vs. 2012

In 2013, our extraction expenses increased by $474 million, or by 12.3%, as a result of the increase in energy costs triggered by the tariffs growth, repairs, artificial stimulation of reservoirs and maintenance costs. In 2013, $68 million of the extraction expenses growth refer to ZAO Samara-Nafta, acquired in April 2013. Our average hydrocarbon extraction cost increased from $5.04 per BOE to $5.58 per BOE, or by 10.7%, in 2013.

2012 vs. 2011

In 2012, our extraction expenses increased by $90 million, or by 2.4%. Increase in costs of artificial stimulation of reservoirs, power supply, repairs and maintenance and labor costs was largely compensated by devaluation of ruble against the US dollar. Our average hydrocarbon extraction cost increased from $4.96 per BOE in 2011 to $5.04 per BOE in 2012.

Own refining expense

2013 vs. 2012

Our own refining expenses increased by $501 million, or by 30.0%, compared to 2012.

In 2013, refining expenses at our domestic refineries increased by 1.3%, or by $15 million. The growth of expense related to higher volumes of production and increased energy costs was partially offset by decreased consumption and cost of additives.

Refining expenses at our international refineries increased by 92.0%, or by $486 million. The increase was mainly due to obtaining control over ISAB in September 2012 (see *Refining, marketing and trading* section for details).

2012 vs. 2011

Our own refining expenses increased by $251 million, or by 17.7%, in 2012.

Refining expenses at our domestic refineries increased by 2.6%, or by $29 million, compared to 2011. The increase of expenses due to higher consumption and cost of additives and overhauls was partially offset by the ruble devaluation.

Refining expenses at our international refineries increased by 72.5%, or by $222 million, compared to 2011. The increase was mainly due to obtaining control over ISAB in September 2012 (see *Refining, marketing and trading* section for details).

Refining expenses at third party and affiliated refineries

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

2013 vs. 2012

In 2013, refining expenses at third party and affiliated refineries decreased by 64.2%, or by $512 million, as a result of obtaining control over ISAB in September 2012 (see *Refining, marketing and trading* section for details) and ceasing of crude oil processing at third party refineries in Belarus since September 2013.

2012 vs. 2011

In 2012, refining expenses at third party and affiliated refineries decreased by 11.0%, or by $99 million. The decrease to 2011 was due to obtaining control over ISAB in September 2012 (see *Refining, marketing and trading* section for details). This was partially offset by commencement of crude oil processing at third party refineries in Belarus in the beginning 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.

2013 vs. 2012

In 2013, our expenses for crude oil transportation to refineries increased by $24 million, or by 1.9%. The increase in volume of supplies of crude oil produced by the Group in Russia to our refineries outside the Custom Union, compared to 2012, was partially offset by ceasing of crude oil processing at third party refineries in Belarus since September 2013.

2012 vs. 2011

In 2012, expenses for crude oil transportation to refineries increased by $181 million, or by 17.1%. The increase was largely due to supplies of our crude oil to the refineries in Belarus, where we commenced crude oil processing in the first quarter of 2012.

Petrochemical expenses

2013 vs. 2012

In 2013, operating expenses of our petrochemical plants increased by $17 million, or by 5.6%, compared to 2012. The increase of expenses in Russia related largely to resuming production at our petrochemical plant in the Stavropol region of Russia at the end of the third quarter of 2012 was partially compensated by the decrease of expenses at our petrochemical plant Karpatnaftochim Ltd. in Ukraine as a result of its temporary shutdown due to unfavorable economic conditions.

2012 vs. 2011

In 2012, operating expenses of our petrochemical plants decreased by $40 million, or by 11.7%, compared to 2011. Despite the sharp decrease in production as a result of the fire that destroyed the ethylene production unit at our plant in the Stavropol region of Russia, operating expenses of the plant didn't decrease significantly due to overhauls at other plant units. The effect of the decreased production at the Group's other petrochemical plants and the devaluation of local currencies against the US dollar also contributed to the decrease of expenses, but were partially offset by the effect of obtaining control over ISAB, which has some petrochemical production lines, in September 2012.

Power generation and distribution expenses

2013 vs. 2012

In 2013, power generation and distribution expenses increased by $98 million, or by 15.8%, due to commissioning of a CCGT unit with a capacity of 410 MW in Krasnodar, Russia in late 2012 and two CCGT units with a combined capacity of 235 MW in Astrakhan, Russia in mid-2013, and consequent increase in volumes of power generation in 2013.

2012 vs. 2011

In 2012, power generation and distribution expenses increased by $2 million, or by 0.3%

Other operating expenses

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

2013 vs. 2012

Other operating expenses increased by $4 million, or by 0.5%, in 2013.

2012 vs. 2011

In 2012, other operating expenses decreased by $145 million, or by 15.3%, driven largely by movements of the fair value of liabilities related to asset retirement obligations.

Cost of purchased crude oil, gas and products

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

2013 vs. 2012

Cost of purchased crude oil, gas and products increased by $1,776 million, or by 2.8%, in 2013. The increase in the refined products trading volumes was partially offset by the decrease in international crude oil prices.

In 2013, we recognized a $200 million net loss from hedging, compared to a $321 million net loss in 2012.

2012 vs. 2011

Cost of purchased crude oil, gas and products increased by $4,454 million in 2012, or by 7.5%, compared to 2011, mainly driven by the movements in refined products trading volumes.

In 2012, we recognized a $321 million net loss from hedging, compared to a $657 million net loss in 2011.

Transportation expenses

2013 vs. 2012

Our transportation expenses increased by $119 million, or by 1.9%, compared to 2012. The increase in transportation expenses was due to a change in sales structure. In 2013, we increased export of refined products from Russia and decreased export of crude oil together with an increase in domestic sales. The higher level of transportation tariffs for refined products, compared to those for crude oil, resulted in the increase of transportation expenses.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed to 2012 as follows: crude oil pipeline tariffs decreased by 2.3%, railway tariffs for refined products transportation increased by 4.8%, crude oil freight rates decreased by 5.4%, and refined products freight rates decreased by 13.1%.

2012 vs. 2011

Our transportation expenses did not change significantly compared to 2011.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed to 2011 as follows: crude oil pipeline tariffs increased by 2.8%, railway tariffs for refined products transportation decreased by 3.6%, crude oil freight rates increased by 10.6%, and refined products freight rates increased by 6.2%.

Depreciation, depletion and amortization

2013 vs. 2012

Our depreciation, depletion and amortization expenses increased by $924 million, or by 19.1%, compared to 2012. This was a result of the Company's capital expenditures and the corresponding increase in value of depreciable assets. Moreover, the acquisition of ZAO Samara-Nafta, the increase of production from the Yu. Korchagin field in the Caspian Sea and the effect of obtaining control over ISAB in September 2012 contributed to this increase.

2012 vs. 2011

Our depreciation, depletion and amortization expenses increased by $359 million, or by 8.0%, compared to 2011.

Equity share in income of affiliates

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

2013 vs. 2012

Our share in income of affiliates increased by $57 million, or by 11.0%, compared to 2012. The main reason for this was a sharp increase in income of Turgai Petroleum against the background of low net income due to the additional excess profit tax for prior periods accrued by Turgai Petroleum in 2012.

2012 vs. 2011

Compared to 2011, our share in income of affiliates decreased by $172 million, or by 24.9%. The main reasons for this were a decrease of crude oil production by our Kazakhstani affiliates as well as the provision for additional excess profit tax for prior periods accrued by Turgai Petroleum.

Taxes other than income taxes

	2013	2012	2011
		(millions of US dollars)	
In Russia			
Mineral extraction taxes	12,333	12,261	11,502
Social security taxes and contributions	517	493	480
Property tax	539	511	538
Other taxes	107	82	77
Total in Russia	**13,496**	**13,347**	**12,597**
International			
Mineral extraction taxes	77	93	92
Social security taxes and contributions	123	111	107
Property tax	32	24	35
Other taxes	75	91	87
Total internationally	**307**	**319**	**321**
Total	**13,803**	**13,666**	**12,918**

2013 vs. 2012

In 2013, taxes other than income taxes increased by 1.0%, or by $137 million, compared to 2012. Our mineral extraction tax expenses did not change significantly compared to 2012. The effects of growth of mineral extraction tax rate and the increase in domestic crude oil production were offset by the increase in the amount of mineral extraction tax incentive.

In 2013, application of the reduced rate for crude oil produced from depleted oilfields and the zero rate for crude oil produced from oilfields with extra heavy crude oil and from greenfields led to $1,921 million mineral extraction tax reduction ($1,490 million in 2012). Of this amount, $229 million in 2013 refer to the production from the Yu. Korchagin field in the Caspian Sea ($129 million in 2012).

2012 vs. 2011

Taxes other than income taxes increased by 5.8%, or by $748 million, compared to 2011. This was mainly due to the growth of mineral extraction tax expenses in Russia driven by the increase in tax rate.

In 2012, application of decreased rate for crude oil produced from depleted oilfields and the zero rate for crude oil produced from oilfields with extra heavy crude oil and from greenfields led to $1,490 million tax reduction ($1,161 million in 2011). Of this amount, $129 million refer to production from the Yu. Korchagin field on the Caspian seashore.

Excise and export tariffs

	2013	2012	2011
		(millions of US dollars)	
In Russia			
Excise tax on refined products	1,950	1,922	1,710
Crude oil export tariffs	10,030	11,315	11,714
Refined products export tariffs	6,263	5,561	5,028
Total in Russia	**18,243**	**18,798**	**18,452**
International			
Excise tax on refined products	3,598	3,355	3,445
Crude oil export tariffs	251	274	319
Refined products export tariffs	242	409	1
Total internationally	**4,091**	**4,038**	**3,765**
Total	**22,334**	**22,836**	**22,217**

2013 vs. 2012

Following the decrease of export duty rate and export volumes in 2013, our crude oil export tariffs decreased by $773 million, or by 4.4%. Export tariff savings on crude oil produced from the Yu. Korchagin field in the Caspian Sea amounted to $275 million in 2013. At the same time, compared to 2012, our refined products export tariffs increased as a result of the increase of volumes of refined products exported outside of the Customs Union.

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

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

2012 vs. 2011

Export tariffs increased by $497 million, or by 2.9%, compared to 2011. In Russia, export tariffs for refined products increased by 10.6% despite the decrease of refined products export volumes by 6.2% as a result of a sharp increase in the export duty rate for fuel oil (by 27.9%). The share of fuel oil in the Group export structure in 2012 was approximately 40%. This increase was partially offset by the decrease of crude oil export tariffs, largely, due to a higher share of crude oil export to Belarus. Moreover, export tariff savings on crude oil produced from the Yu. Korchagin field in the Caspian Sea amounted to $150 million in 2012. Expenses for refined products export tariffs outside of Russia refer to export from Belarus, where we commenced crude oil processing in the beginning of 2012.

In Russia, the increase of excise expense to 2011 was driven mainly by the growth of excise rates. Although the excise rates for motor fuels increased significantly compared to 2011, the increase of share of Euro-5 motor fuels in our production let us avoid sharp increase of excise expenses in Russia. In the second half of 2012, all the gasoline produced by the Group in Russia was compliant with Euro-5 ecological class, while in 2011 the share of Euro-5 gasoline was relatively insignificant.

The decrease in excise tax expense outside of Russia to 2011 was a result of lower volume of sales subject to excises as well as of the devaluation of euro and local currencies against the US dollar.

Exploration expenses

2013 vs. 2012

Our exploration expenses increased up to $238 million, or by 65.4%. Dry hole costs amounted to $314 million in 2013 and $127 million in 2012.

In 2013, we charged to expense the costs of exploratory wells in Ghana in the amount of $92 million, in Cote d'Ivoire in the amount of $89 million, in Sierra Leone in the amount of $81 million and in Vietnam in the amount of $15 million. The costs of signing bonuses, in the total amount of $35 million, which was also written off in 2013, relate to the projects in Sierra Leone and Vietnam. This was included in Other non-operating income (expense). In Russia, dry hole cost amounted to $36 million and related mostly to the results of exploratory drilling in the Volga region.

2012 vs. 2011

Our exploration expenses decreased by $168 million, or by 31.6%, during 2012. Dry hole costs amounted to $127 million in 2012 and $417 million in 2011. At the same time, we significantly increased the amount of seismic work in Russia.

In the fourth quarter of 2012, we charged to expense the cost of an exploratory well in Sierra Leone in the amount of $26 million. In the second quarter, we charged to expense the cost of an exploratory well in Volga region of Russia in the amount of $50 million.

(Loss) gain on disposals and impairments of assets

2013 vs. 2012

In 2013, the Company recognized an impairment loss in the total amount of $2,466 million.

The Company recognized an impairment loss for its exploration and production assets in the amount of $941 million, including $510 million related to the Yuzhnoye Khylchuyu oil field in the Timan-Pechora region of the Russian Federation, due to a revision of geological models.

Also, the Company recognized an impairment loss for the assets of Karpatnaftochim Ltd., a petrochemical plant in Ukraine, in the amount of $411 million due to economic instability and unfavorable economic conditions.

The Company recognized an impairment loss of assets of OOO LUKOIL-Ecoenergo, a power generating company in European Russia, in the amount of $270 million due to unfavorable market conditions in the energy sector in Southern Russia.

An impairment loss in the amount of $198 million was recognized in the refining, marketing and distribution segment due to unfavorable market conditions.

The Group recognized an impairment loss in the amount of $646 million related to goodwill on the acquisition of ISAB due to changes in the economic environment.

In 2013, the cumulative impact of the above mentioned impairment losses on net income attributable to OAO LUKOIL totaled $2.1 billion and impact on our EBITDA totaled $2.3 billion.

2012 vs. 2011

In the second quarter of 2012, the Group recognized a gain of $178 million from sale of 1.5% (10% of our share) in KPO to a state-owned KazMunayGaz. The tax effect of the deal amounted to $148 million of the income tax expense.

In 2011, as a result of respective analysis the Company recognized an impairment loss for exploration and production assets related to the Yuzhnoye Khylchuyu oilfield in the amount of $1,261 million. An impact on net income attributable to OAO LUKOIL amounted to $955 million and an impact on our EBITDA amounted to $883 million.

Other non-operating income (expense)

2013 vs. 2012

In 2013, we recognized income of $199 million related to the revaluation to fair value of the Group's 50% interest in ZAO Kama-oil as at the date of acquisition of the remaining 50% interest.

2012 vs. 2011

Other non-operating expense of 2012 represented amounts of individually insignificant gains and losses. In 2011, other non-operating income included the effect of the recalculation of the extraction tax incentive by certain Group companies for prior periods in the total amount of $433 million.

Income taxes

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

2013 vs. 2012

Our total income tax expense increased by $33 million, or by 1.2%, compared to 2012. At the same time, our income before income tax decreased by $3,265 million, or by 23.8%.

In 2013, our effective income tax rate was 27.1%, compared to 20.4% in 2012. The high level of the effective income tax rate in 2013 was mostly due to non-deductible impairment losses (for details see page 22). Moreover, in 2012, our effective income tax rate was supported by tax deductible currency translation losses reported by Russian subsidiaries, whereas in 2013 currency translation gain had the opposite impact and increased our income tax expense.

2012 vs. 2011

Our total income tax expense decreased by $495 million, or by 15.0%, compared to 2011. At the same time, our income before income tax increased by $604 million, or by 4.6%.

In 2012, our effective income tax rate was 20.4%, compared to 25.1% in 2011. The high level of the effective income tax rate in 2011 was mostly due to the impairment loss related to the Yuzhnoye Khylchuyu oilfield.

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

	2013	2012	2011
		(millions of US dollars)	
Net income	**7,832**	**11,004**	**10,357**
Add back:			
Income tax expense	2,831	2,798	3,293
Depreciation and amortization	5,756	4,832	4,473
Interest expense	488	538	694
Interest and dividend income	(239)	(257)	(211)
EBITDA	**16,668**	**18,915**	**18,606**
Adjustment for impairment loss and dry-hole write offs[1]	2,587	–	883
Adjusted EBITDA	**19,255**	**18,915**	**19,489**

[1] For details see page 22.

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

	2013	2012	2011
	(millions of US dollars)		
Net cash provided by operating activities	16,449	18,997	15,514
Net cash used in investing activities	(18,639)	(13,216)	(9,013)
Net cash provided by (used in) financing activities	1,029	(5,680)	(6,023)

Operating activities

Our primary source of cash flow is funds generated from our operations. In 2013, cash generated from operations decreased by 13.4%, compared to the prior year, and amounted to $16,449 million. During 2013, the adverse impact of the increase of working capital on our cash flow from operating activity totaled $1,063 million. At the same time, during 2012, our cash flow from operating activity was supported by a decrease of working capital by $2,293 million.

Investing activities

The increase in cash used in investing activities by 41.0%, compared to 2012, mainly resulted from increases in capital expenditures and the acquisition of licenses, as well as acquisitions of subsidiaries.

Our capital expenditures, including non-cash transactions, amounted to $15,434 million, which was 30.2% higher than in 2012.

	2013	2012	2011
	(millions of US dollars)		
Capital expenditures[1]			
Exploration and production			
Russia	8,325	7,085	5,132
International	3,483	1,888	1,545
Total exploration and production	11,808	8,973	6,677
Refining, marketing and distribution			
Russia	1,736	1,439	982
International	979	568	324
Total refining, marketing and distribution	2,715	2,007	1,306
Chemicals			
Russia	105	62	55
International	8	28	34
Total chemicals	113	90	89
Power generation and distribution	285	503	196
Other	513	277	224
Total capital expenditures	**15,434**	**11,850**	**8,492**

[1] Including non-cash transactions and prepayments.

Capital expenditures in exploration and production segment increased by $2,835 million, or by 31.6%, compared to 2012. In Russia, the increase was mostly due to higher volumes and the cost of production drilling in the Ural region, the Komi Republic and Western Siberia. Internationally, the increase was largely related to investments in our West Qurnah-2 project in Iraq.

The increase in our refining, marketing and distribution capital expenditures in Russia refers to construction of a vacuum gasoil refinery complex at our refinery in Volgograd and construction of a catalytic cracking unit at the Nizhny Novgorod refinery. Outside of Russia, the increase in our refining, marketing and distribution capital expenditures was mainly due to continued construction of a heavy residue processing complex at the Bulgarian refinery.

Other capital expenditures refer to investments of OAO Arkhangelskgeoldobycha, a Group company, involved in diamond deposits development in the Arkhangelsk region of Russia.

The high level of capital expenditures in power generation sector in 2012 was a result of fulfillment of our investment program, namely construction of 235 MW combined cycle gas turbine in Astrakhan.

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

	2013	2012	2011
	(millions of US dollars)		
Yamal	338	476	372
Caspian region[1]	1,635	1,425	555
Ghana	20	13	216
Cote d'Ivoire	180	44	227
Iraq	2,040	924	203
Uzbekistan	657	477	480
Total	**4,870**	**3,359**	**2,053**

[1] Russian and international projects.

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

	2013	2012	2011
	(millions of US dollars)		
Acquisitions of subsidiaries and associates[1]			
Exploration and production			
Russia	2,397	200	252
International	–	22	500
Total exploration and production	2,397	222	752
Refining, marketing and distribution			
Russia	333	25	10
International	46	658	342
Total refining, marketing and distribution	379	683	352
Power generation and distribution	30	–	–
Less cash acquired	(21)	(19)	(4)
Total acquisitions	**2,785**	**886**	**1,100**

[1] Including prepayments related to acquisitions and non-cash transactions.

In 2013, the Company spent $2.1 billion for the acquisition of 100% of the shares of ZAO Samara-Nafta and $266 million for the acquisition of the remaining 50% of the shares of ZAO Kama-oil.

In 2012, the Group acquired an additional 20% share in ISAB for $609 million.

Financing activities

In 2013, net movements of short-term and long-term debt generated an inflow of $4,125 million, compared to an outflow of $1,266 million in 2012.

In the fourth quarter of 2013, the Company received a loan from OAO Sberbank in the amount of $1.5 billion, maturing up to 2018. Borrowings under this agreement bear interest at twelve month LIBOR plus 2.50% per annum.

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

In December 2013, the Company paid $583 million for the remaining 20% interest in ISAB.

In 2012, we purchased Company's stock worth $128 million and spent $740 million for purchase of equity-linked notes.

Credit rating

Standard & Poor's Ratings Services increased its long-term corporate credit rating and all debt ratings on the Company to BBB with stable outlook.

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

Fitch Ratings increased the Company's long-term issuer default rating to BBB with stable outlook.

Contractual obligations, other contingencies and off balance sheet arrangements

Capital commitments and contractual obligations

Under the terms of existing exploration and production license agreements in Russia the Group has to fulfill certain obligations: oil and gas exploration, wells drilling, fields development, etc., and the Group also has commitments to reach a defined level of extraction on the fields. Management believes that the Group’s approved annual capital expenditure budgets fully cover all the requirements of the described license obligations.

In February 2013, the Group started to construct a vacuum gasoil refinery complex at OOO LUKOIL-Volgogradneftepererabotka. Completion is expected at the end of 2015. As of December 31, 2013, the amount of capital commitment related to this construction is evaluated as $1,328 million.

In 2012, a construction agreement for a heavy-residue hydrocracking complex at LUKOIL Neftochim Bourgas AD in Bulgaria was signed. Commissioning of the complex is expected in 2015. As of December 31, 2013, the amount of capital commitment related to this construction is evaluated as $518 million.

Group companies have commitments for capital expenditure contributions in the amount of $318 million related to various production sharing agreements over the next 24 years.

The Company has signed a three-year agreement for the years 2013-2015 for drilling services with EDC Group Advisory Company Limited. The volume of these services is based on the Group’s capital construction program, which is re-evaluated on an annual basis. As of December 31, 2013, the amount of capital commitment under this agreement for 2014 is evaluated as $1,482 million.

The Company has signed a strategic agreement for the ongoing provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group’s capital construction program, which is re-evaluated on an annual basis. As of December 31, 2013, the the amount of capital commitment under this agreement for 2014 is evaluated as $215 million.

The Group has signed a number of agreements for the years 2013-2015 for construction of offshore platforms in the Caspian region. As of December 31, 2013, the amount of this capital commitment is evaluated as $1,371 million.

The Group has a commitment to execute the capital construction program of its power generation segment and under the terms of this program power plants with a total capacity of 890 MW should be constructed. As of December 31, 2013, the amount of this commitment is evaluated as $87 million.

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

(millions of US dollars)	Total	2014	2015	2016	2017	2018	After
On balance sheet							
Short term debt	156	156	–	–	–	–	–
Long-term bank loans and borrowings	2,660	249	234	217	138	1,590	232
Long-term non-bank loans and borrowings	2	–	–	–	–	–	2
6.375% Non-convertible US dollar bonds, maturing 2014	899	899	–	–	–	–	–
2.625% Convertible US dollar bonds, maturing 2015	1,462	–	–	–	–	–	–
6.356% Non-convertible US dollar bonds, maturing 2017	500	–	–	–	500	–	–
3.416% Non-convertible US dollar bonds, maturing 2018	1,500	–	–	–	–	1,500	–
7.250% Non-convertible US dollar bonds, maturing 2019	597	–	–	–	–	–	597
6.125% Non-convertible US dollar bonds, maturing 2020	998	–	–	–	–	–	998
6.656% Non-convertible US dollar bonds, maturing 2022	500	–	–	–	–	–	500
4.563% Non-convertible US dollar bonds, maturing 2023	1,500	–	–	–	–	–	1,500
Capital lease obligation	47	34	12	1	–	–	–
TOTAL	**10,821**	**1,338**	**1,708**	**218**	**638**	**3,090**	**3,829**
Off balance sheet							
Operating lease obligations	**453**	154	82	57	43	37	80
Capital commitments in PSAs	**318**	151	18	18	18	6	107
Capital commitments of power generating segment	**87**	85	2	–	–	–	–
Capital commitments under contract with EDC Group Advisory Company Limited	**1,482**	1,482	–	–	–	–	–
Capital commitments of LUKOIL Neftochim Bourgas AD	**518**	505	13	–	–	–	–
Capital commitments of Volgograd Refinery	**1,328**	560	750	18	–	–	–
Obligation under contract with ZAO Globalstroy-Engineering	**223**	215	8	–	–	–	–
Obligation under contracts for the development of the V. Filanovsky oilfield	**1,371**	595	776(1)	–	–	–	–

(1) Amount for 2015 and 2016.

Litigation and claims

On November 27, 2001, Archangel Diamond Corporation ("ADC"), a Canadian diamond development company, filed a lawsuit in the Denver District Court, Colorado against OAO Arkhangelskgeoldobycha ("AGD"), a Group company, and the Company (together the "Defendants"). ADC alleged that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. ADC claimed compensatory damages of $1.2 billion and punitive damages of $3.6 billion. On October 15, 2002, the District Court dismissed the lawsuit for lack of personal jurisdiction. This ruling was upheld by the Colorado Court of Appeals on March 25, 2004. However, on November 21, 2005, due to a procedural error, the Colorado Supreme Court remanded the case to the Colorado Court of Appeals and the Colorado Court of Appeals remanded the case to the District Court. On October 20, 2011, the Denver District Court dismissed all claims against the Company for lack of jurisdiction. On August 23, 2012, the Colorado Court of Appeals affirmed this decision. On July 1, 2013, the Colorado Supreme Court denied ADC's Petition for Writ of Certiorari. The case in the state court is therefore over.

On January 6, 2012, ADC filed a lawsuit in the US District Court for the District of Colorado (federal court) reasserting almost identical claims asserted in the aforementioned lawsuit and dismissed by the Denver District Court (state court) notwithstanding ADC's appeal of the state court's decision. In a Federal Court case, the Company has filed a Motion to Dismiss and discovery has been stayed pending further action. ADC has appealed the decision to stay discovery to the US District Court. The court hearing took place on November 19, 2013. The ruling of the judge is expected to be issued soon. The Company plans to seek dismissal of the case and vigorously defend the matter. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

The Group is involved in various other claims and legal proceedings arising in the normal course of business. While these claims may seek substantial damages against the Group and are subject to uncertainty inherent in any litigation, management does not believe that the ultimate resolution of such matters will have a material adverse impact on the Group's operating results or financial condition.

Critical accounting policies

The preparation of financial statements in conformity with US GAAP requires management to select appropriate accounting policies and to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. See Note 2 "Summary of significant accounting policies" to our consolidated financial statements for descriptions of the Company's major accounting policies. Certain of these accounting policies involve judgments and uncertainties to such an extent that there is a reasonable likelihood that materially different amounts would have been reported under different conditions, or if different assumptions had been used.

Forward-looking statements

Certain statements in this document are not historical facts and are "forward-looking." We may from time to time make written or oral forward-looking statements in reports to shareholders and in other communications. Examples of such forward-looking statements include, but are not limited to:

- statements of our plans, objectives or goals, including those related to products or services
- statements of future economic performance
- statements of assumptions underlying such statements.

Forward looking statements that may be made by us from time to time (but that are not included in this document) may also include projections or expectations of revenues, income (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios. Words such as "believes," "anticipates," "expects," "estimates," "intends" and "plans" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. You should be aware that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements.

These factors include:

- inflation, interest rate and exchange rate fluctuations
- the price of oil
- the effects of, and changes in, Russian government policy
- the effects of competition in the geographic and business areas in which we conduct operations
- the effects of changes in laws, regulations, taxation or accounting standards or practices
- our ability to increase market share for our products and control expenses
- acquisitions or divestitures
- technological changes
- our success at managing the risks of the aforementioned factors.

This list of important factors is not exhaustive. When relying on forward-looking statements, you should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as of the date on which they are made, and, subject to any continuing obligations under the Listing Rules of the U.K. Listing Authority, we do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.