

ALWAYS MOVING FORWARD



# ANNUAL REPORT

# 2012

**FOCUS:**

UZBEK PROJECTS  
AS BUSINESS  
DRIVERS

**TRENDS:**

TECHNOLOGY AND INNOVATION  
GREEN ENERGY

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# Letter to Shareholders

## DEAR SHAREHOLDERS!

LUKOIL achieved record financial results by a number of indicators in 2012, confirming its business efficiency and strong financial position. Net income of LUKOIL Group was in excess of \$11 billion and net income per share rose by 8.8% to \$14.47. Net income per barrel of production reached \$13.9, which is the best figure in the Russian oil & gas industry. The Company's net debt declined by 41.5% in 2012. Record financial results and success in implementation of the Company's strategy were reflected in growth of the price for Company shares by 17.5% in the course of the year.

**90** rubles per share  
recommended  
dividends

## Lukoil paid first-ever interim dividends of 40 rubles per share

We are building a Company that offers long-term shareholder value by investing in the main business and by ensuring that remaining capital is returned to shareholders. Our focus on returns to shareholders was demonstrated in the reporting year by 20.0% increase of dividends per share and payment of the first interim dividends in Company history for the respective reporting period of 2012 at a level of 40 rubles per share. The Board of Directors recommended payment of 50 rubles per share as dividends for 2012. So the total dividend amount for the 2012 financial year may be 90 rubles per share and dividend yield – 4.9%.

**0.5** %  
growth of hydrocarbon  
production

There were special reasons to be satisfied with developments in the **Exploration & Production business segment** during 2012:

## For the first time in many years the Company obtained access to mineral areas with federal status in Western Siberia

including the Imilorskoye+Zapadno-Imilorskoye and Istochnoye fields with recoverable C1+C2 oil reserves of 193.7 million tonnes (1.4 billion barrels) under Russian classification.

As increasing amounts of hard-to-recover reserves are brought into production the Company is concentrating on maximizing the value of projects and the efficiency of capital expenditures to ensure sustainable growth of production. Successful use of new technologies and increase of drilling in traditional production regions enabled us to achieve an increase of hydrocarbon output by 0.5% and stabilization of oil output in the reporting year.

The largest increase in hydrocarbon output in the coming decade is expected from promising Company projects in Iraq, Central Asia, the Caspian and Yamal-Nenets Autonomous District. We have already begun production drilling and construction of an oil preparation unit at the enormous West Qurna-2 filed in Iraq.

Investments during 2012 in high-tech field development techniques, drilling of horizontal wells and hydrofracturing enabled the Company to bring more reserves into production in the Northern Caspian and the Komi Republic. Reserve replacement exceeded 100% in the reporting year. Increase of proved reserves thanks to geological exploration work, production drilling and acquisitions amounted to 703 million boe.

We kept up rapid development of our **Refining & Marketing** business segment in 2012, focusing efforts on growth of operating efficiency and refining depth. Our efforts were supported by improvements to Russian legislation, which favor the production of value-added and environmentally friendly fuel types. Ongoing modernization of the Perm and Ukhta refineries and installation of catalytic cracking at the Nizhny Novgorod Refinery will substantially increase the Group's financial results in the segment. All of the Group's Russian refineries switched to production of automotive gasolines meeting Euro-5 requirements in 2012. LUKOIL plans to decrease output of dark products at its Russian refineries in the coming decade. Total crude oil throughput at Group refineries in 2012 grew by 5.1% to 1,128 thousand barrels per day.

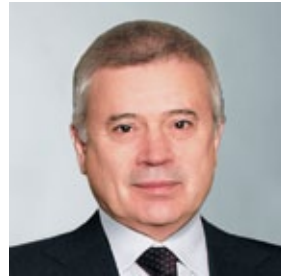
The Group has started work on alternative energy projects: in 2012 we purchased a wind power station in Bulgaria with capacity of 40 megawatts, representing 10% of the total wind energy market in Bulgaria.

We are conscious of our responsibility for securing sustainable development in our operating regions, and we therefore pay much attention to issues concerning the environment, our personnel, customers and investors, as well as cooperation with government. As a Company with presence on global markets we are constantly improving our business to ensure that it matches international standards. In 2012 LUKOIL carried out an optimization of its



**Valery Grayfer**

Chairman of the LUKOIL Board of Directors



**Vagit Alekperov**

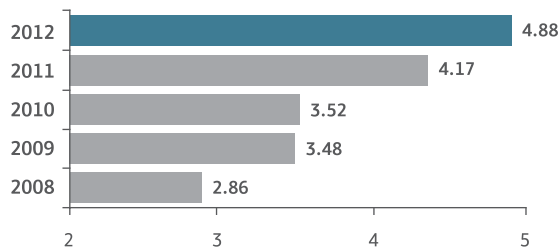
President of LUKOIL



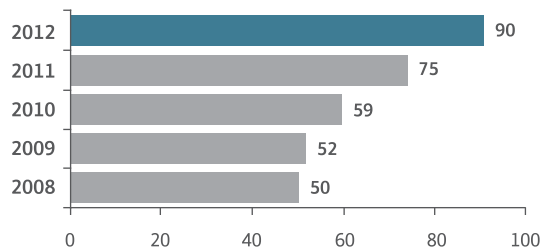
organizational structure, eliminating inefficient links and doubling of management functions. The Company has made further gains in labor productivity: net income per employee rose by 14.1% in the reporting year to a level of \$98 thousand.

LUKOIL showed its ability to rise to challenges once again in 2012. We have built a solid foundation for carrying out strategic plans that will generate more value for all of our Company's shareholders.

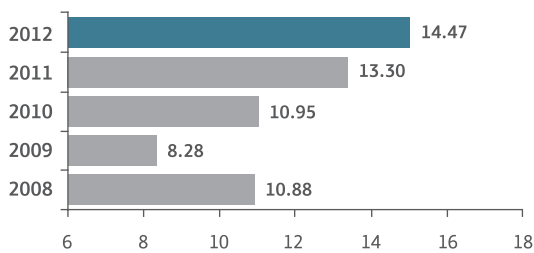
Dividend yield, %



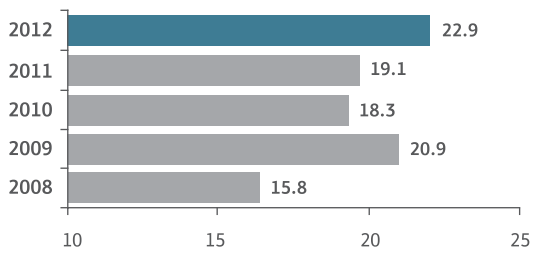
Dividend per share, rubles



Basic earnings per share, \$



Payout ratio, %



# LUKOIL in the World

<< Letter to Shareholders // LUKOIL in the World >>

LUKOIL is one of the biggest international vertically-integrated oil & gas companies



Geological Exploration  
Preparation for Production



Oil & Gas Production



Oil & Petroleum Product  
Transshipment



Oil Refining & Gas Processing



Petrochemicals



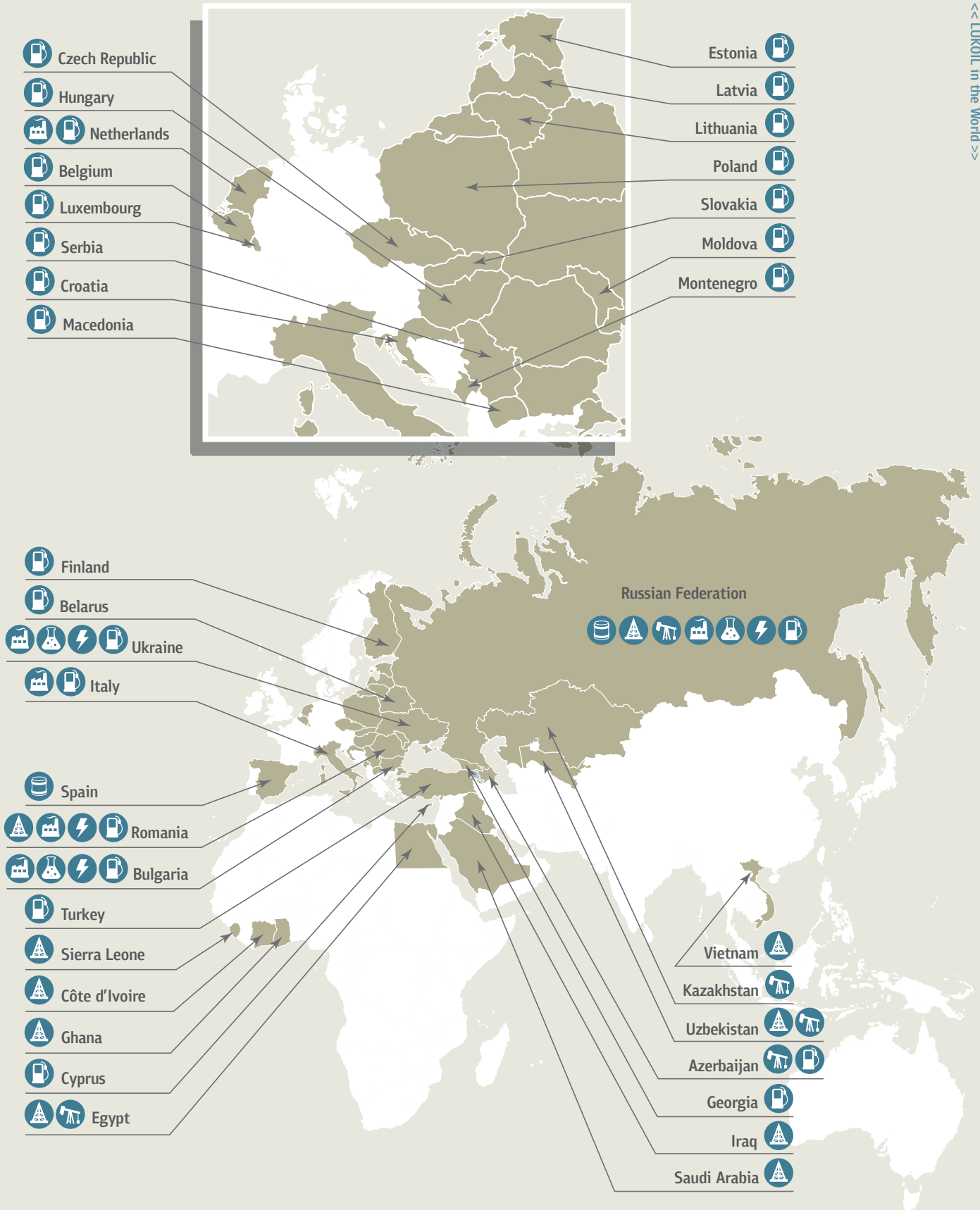
Power Generation



Sales & Marketing



Venezuela



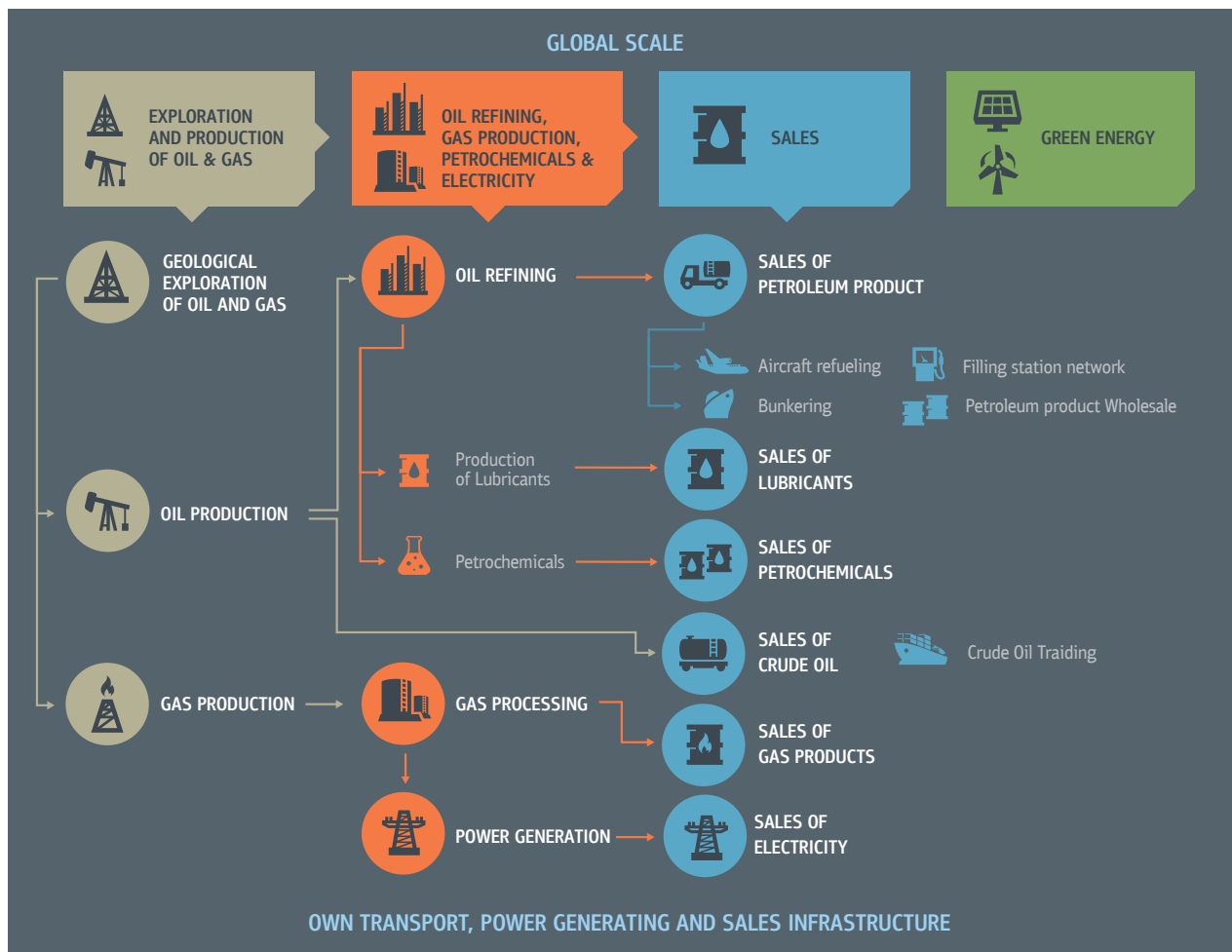
## Business Model

We control the entire production chain from extraction of hydrocarbons to the sale of fuels and other products to end-users. This means that we can efficiently manage all stages of our business.

Production assets of the Group in Russia and abroad consist of 490 audited fields, 8 refineries, 2 mini-refineries and 1 refining complex (total refining in 2012 was 66.06 million tonnes),

4 gas-processing plants (gas processing in 2012 was 3.3 billion cubic meters), 3 petrochemical plants (output in 2012 was 0.9 million tonnes), 8 electricity generating enterprises (production of electricity in 2012 was 15.4 billion kWh), 4 transshipment terminals (exports of crude oil via the terminals totaled 4.2 million tonnes in 2012) and about 5.9 thousand filling stations.

### Vertical integration assists the growth of Company efficiency and lowers risks for end-users



## Main Operating and Financial Indicators

Main financial and market indicators	2012	2011	Change, %
Sales, \$ million	139,171	133,650	4.1
EBITDA, \$ million	18,915	18,606	1.7
Net income, \$ million	11,004	10,357	6.2
Basic EPS, \$	14.47	13.30	8.8
ROACE, %	14.4	14.0	2.9
Capital expenditures, \$ million	11,850	8,492	39.5
Investments (acquisition of subsidiaries), <sup>1</sup> \$ million	1,521	1,134	34.1
Share price (MICEX, end of year), rubles	2,000.2	1,701.0	17.6
Dividend per share, rubles	90	75	20.0
<b>Main operating indicators</b>			
3P oil reserves, million barrels	22,994	23,602	-2.6
3P gas reserves, billion cubic feet	37,777	36,125	4.6
3P hydrocarbon reserves, million boe	29,291	29,623	-1.1
Crude oil and liquids production, million barrels	677	684	-1.0
Production of marketable gas, million cubic meters	19,934	18,038	10.5
Production of marketable hydrocarbons, <sup>2</sup> million boe	794.3	790.7	0.5
Throughputs at own refineries and at ISAB and Zeeland, million tonnes	66.1	64.9	1.8
Gas processing, million cubic meters	3,348	3,199	4.7
Production of petrochemicals, thousand tonnes	894	1,465	-39.0
Crude oil exports, million tonnes	34.7	34.7	0.1
Petroleum product exports, million tonnes	22.5	24.0	-6.2
Crude oil sales, million tonnes	39.20	48.26	-18.8
Wholesale sales of petroleum products, million tonnes	97.56	87.34	11.7
Retail sales of petroleum and gas products, million tonnes	15.94	15.76	1.1
Number of filling stations (owned, leased and franchises)	5,928	5,994	-1.1
Average number of employees, thousand	112.0	120.3	-6.9

<sup>1</sup> Including prepayments due to acquisition of subsidiaries.

<sup>2</sup> Including liquid hydrocarbons produced at the Group's gas-processing plants.



## Events in 2012

<< Main Operating and Financial Indicators // Events in 2012 >>

2 100

1,950

1,800

1,650

1,500

### First quarter

#### JANUARY

##### Start of work on a tar hydrocracking facility at the Burgas Refinery (Bulgaria)

The facility is the main element of a complex for refining of heavy residues, which will enable the Refinery to increase production of Euro-5 diesel fuel by 1.2 million tonnes and to cease production of high-sulphur fuel oil. The tar hydrocracker will have 2.5 million tonnes annual capacity and is scheduled for launch in January 2015.

#### FEBRUARY

##### Increase of green energy capacities

The company LUKERG Renew acquired an interest in a wind-powered electricity generating station in Bulgaria with capacity of 40 megawatts, representing 10% of total electricity produced by wind power in Bulgaria.

##### LUKOIL implements the first project under the Kyoto protocol

OA0 "RITEK" has sold 365 thousand tonnes of carbon units in the European emissions market pursuant to the Kyoto Protocol<sup>1</sup>.

The Company managed to reduce emission volumes through three associated gas utilization projects at Sredne-Khulymskoye, Vostochno-Perevalnoye and Serginskoye oil fields in Tyumen region.

LUKOIL intends to invest the receipts from carbon unit trades in new emission abatement and associated gas utilization projects.

#### MARCH

##### Signing of field construction contracts for West Qurna-2 in Iraq

Construction of 5 well-cluster pads with 67 production wells and of 5 oil collection lines will be carried out over a period of 29 months by Samsung Engineering (South Korea). A gas turbine power station will be built by ENKA Insaat (Turkey) in a period of 27 months. Expansion of reservoir capacity at the crude oil export port of Tuba will be carried out by Entrepose Projets/Rosco (France and Jordan) in a period of 22 months.

### Second quarter

#### APRIL

##### Construction of underwater pipelines in the Caspian Sea

It is planned to lay two pipelines on the seabed by 2015: an oil pipeline with diameter of 559 mm, extending for 114 km from the coast, and a gas pipeline with 711 mm diameter, extending for 114 km.

##### Start of development work at the West Qurna-2 field

LUKOIL began drilling and work on construction of the main surface facility, an oil preparation unit. The production drilling project envisages the construction of 23 slanted wells, work on which will be carried out simultaneously from five well cluster pads using the latest diesel-generating plants with lift capacity of 450 tonnes.

##### Opening of a terminal in Barcelona

The new terminal will enable LUKOIL to carry out re-export and distribution of diesel and jet fuel and biofuel in Spain. A new reservoir facility transforms the terminal into a major Mediterranean hub for transshipment of oil products with total capacity of 1 million cubic meters. The terminal is connected to the pipeline system of Hydrocarbonates Logistics Company, and has 8 racks for unloading of oil products road tankers with daily capacity for 400 road tankers.

#### JUNE

##### LUKOIL and ENEL agreed to cooperate

The companies will consider joint projects for exploration & production of natural gas in Russia and abroad, particularly at offshore fields in the Caspian Sea and North Africa. Prospects will also be considered for sale of liquefied gas and pipeline gas on the European and Russian markets.

##### The Annual General Meeting of Shareholders of LUKOIL

Shareholders approved the Company's Annual Report for 2011, financial statements and the payment of 75 rubles per ordinary share as dividends for 2011 (27.1% more than 59 rubles per share paid for 2010).

<sup>1</sup> 1 carbon unit equals 1 ton of greenhouse gas emissions abatement in CO<sub>2</sub>-equivalent.

January

February

March

April

May

June

## Third quarter

### JULY

#### LUKOIL wins bid for the supply of lubricants

From June of 2012 to June of 2013, LUKOIL will supply Magnitigirsk iron and steel works with 1,2 thousand tonnes of hydraulic oils for industrial and transportation hydraulic systems, as well as industrial hydraulic oils, turbine oils for steam and gas turbines, industrial recirculating oils for rolling mills and also with oils for heavy duty industrial power gears.

The award of the tender means that LUKOIL will successfully implement the import replacement program, enabling the domestic business consumer to use domestic products compliant with the foreign analogues.

### AUGUST

#### Start of production of new-generation engine lubricants

LUKOIL started production of a new range of engine lubricants, LUKOIL GENESIS, at the Ploesti Refinery (Romania). These lubricants fully comply with environmental requirements for lubricants to be used in Euro-5 and -6 engines and offer economies of about 1 liter of fuel per tank, compared with lubricants of the previous generation.

LUKOIL GENESIS lubricants are already being sold in EU countries. In Russia they will be used for first-fill of foreign cars manufactured in the country.

### SEPTEMBER

#### First Engine oil filling for cars manufactured an Kaliningrad (GM, GM Dat and Opel)

LLK-International (a wholly-owned LUKOIL subsidiary) signed an agreement with the Kaliningrad manufacturer Avtotor on the first filling of the engines of GM, GM Dat and Opel cars with its GENESIS FE 5W-30 oil.

#### First production at the Junin-6 block in Venezuela

Geological reserves at Junin-6 are about 53 billion barrels of oil. Output during the early-oil stage will reach 50 thousand barrels per day and peak output will be up to 450 thousand barrels per day. Duration of the contract is 25 years, renewable for a further 15 years.

## Fourth quarter

### OCTOBER

#### LUKOIL completes construction of Kharyaga – Yuzhnoye Khyrchuyu oil pipeline

The total length of the pipe is 158 km, and its annual capacity is 4 million tonnes. Launch of the pipeline will shorten the payback period for the Varandey terminal by substantially increasing capacity use at Varandey.

### NOVEMBER

#### LUKOIL joins Sierra Leone offshore project in the Gulf of Guinea

LUKOIL acquired 25% of the project for geological exploration, development and production in the territorial waters of the Republic of Sierra Leone in the Gulf of Guinea from the Canadian company Talisman Energy. Project participants are: Talisman Energy – 30% (operator), Petronas – 25%, Prontinal Ltd – 20%. Geological exploration work has identified several potentially productive sites at the block.

#### All diesel fuel production at the Volgograd Refinery meets Euro-5

Full compliance with Euro-5 standards for diesel fuel was made possible by commissioning of a new diesel hydrotreatment unit with annual capacity of 3 million tonnes. In addition to production of diesel fuel, the unit can also carry out hydrotreatment of up to 200 thousand tonnes of coker naphtha per year, boosting output of high-octane gasoline.

### DECEMBER

#### LUKOIL wins an auction for rights to mineral use in Western Siberia, including the Imilorskoye+Zapadno-Imilorskoye and Istochnoye fields

Geological and recoverable oil reserves in categories C1+C2 at the area were 855.5 and 193.7 million tonnes, respectively, as of January 1, 2012. The company offered a single payment for mineral use of \$1.67 billion, or \$1.2 per barrel of explored and evaluated reserves. Two oil fields have been discovered at the area: Imilorskoye+Zapadno-Imilorskoye and Istochnoye.

#### An Extraordinary General Meeting of Shareholders of the Company approves payment of an interim dividend

Shareholders decided to pay an interim dividend of 40 rubles per ordinary share.

+17.5%

July

August

September

October

November

December

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OIL PRODUCTION

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GAS FIELD  
DEVELOPMENT AND  
GAS PRODUCTION

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# EXPLORATION AND PRODUCTION OF OIL & GAS





## Strategy for 2012–2021 targets:

- At least 3.5% average annual growth of hydrocarbon output
- Stabilization of crude oil production in Western Siberia
- Increase of the crude oil recovery factor in Russia
- More than 80% of all investments to be spent on exploration & production
- Substantial increase in the share of international projects in total production
- Substantial increase in the share of gas in total hydrocarbon production

### Exploration & Production business segment indicators

Indicator, \$ million	2012	2011	Change, %
Revenue	47,089	44,858	5.0
EBITDA	13,858	12,126	14.3
Net income	8,326	6,665	24.9
Capital expenditures	8,902	6,629	34.3

Exploration & Production business segment is the main creator of Company value, generating more than

**75** %  
of net income



We are focused on ways of strengthening our resource base and using it in the most efficient way possible. This is what makes LUKOIL the highest achiever among Russia's vertically integrated oil companies (VICs) in terms of net income per barrel of produced hydrocarbons.

The most important event in the exploration & production segment during 2012 was stabilization of oil production levels in Western Siberia. In recent years we have invested heavily in the region in order to increase exploration and production drilling, and our success in halting output declines is the fruit of these efforts.

Investment in high-tech field development methods, such as horizontal drilling and hydraulic fracturing, has enabled the Company to bring additional reserves into development in the Northern Caspian and the Komi Republic.

Another significant achievement for LUKOIL in the reporting year was gaining access to resources with federal status in Western Siberia (the Imilorskoye+Zapadno-Imilorskoye and Istochnoye fields).

The most important development in the Company's foreign projects during 2012 was at the West Qurna-2 field in Iraq, where we started production drilling and construction of oil preparation facilities.

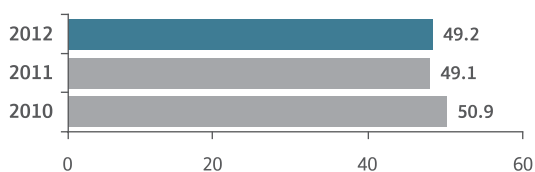
#### PRICE

Oil prices were highly volatile in 2012 due to political instability in the Middle East (Syria, Iran), debt problems in the US and the eurozone, increase of oil production in the US, Canada and Iraq, and the depletion of hydrocarbon fields in the North Sea.

The average price of Brent crude oil rose by 0.4% in 2012 compared with 2011 to \$111.7 per barrel and the average price of Urals oil rose by 1.3% to \$110.5 per barrel.

The gas market saw major fluctuations at the start of 2012 due to weather events in Europe. However, average full-year prices for gas on various trading floors in Europe showed a significant increase of 19-25% and the increase in the US was 15%.

Crude oil production in Western Siberia in 2012, million tonnes



**TAX ENVIRONMENT AND IMPROVEMENTS TO TAX LEGISLATION**

The scale of our activities in Russia means that our tax profile is largely determined by taxes payable in Russia. The main Russian duties and taxes, for which the Company is liable, are as follows: mineral extraction tax (MET), which accounted for 90.4% of total tax dues other than income tax in 2012; and excise and export duties, which are linked to international crude oil prices and change in accordance with crude price fluctuations.

Main tax and duty payments by the Company in 2012 except for income tax grew by \$1,379 million (+4.1%). The increase was mainly caused by growth of MET expenses, due to raising of the tax rate.


The MET rate for oil in 2012 increased by 7.4% in US dollar terms. Through the application of benefits we have been able to reduce MET tax costs by \$1,490 million, of which 8.7% related to the benefits of oil production at the Yu. Korchagin field in the Caspian Sea. The benefits include:

- reduced rate of MET at highly depleted fields;
- zero rate for new deposits;
- zero rate for high-viscosity oil.

Payment of crude oil export duty by the Company decreased by \$444 million in 2012 due to lowering of average export duty rates on crude oil by 1.2% and the application of the following benefits:

- reduction of export duties for new fields;
- a lower rate of export duty on high-viscosity oil (the '10-10-10' system). Reduced rate of export duty for a period of 10 years applicable to oil with high-viscosity of at least 10 thousand cps in reservoir conditions (10% of the standard duty).
- preferential export duties on crude oil (about 50% of the standard duty) for the Caspian Sea, Nenets Autonomous District, the Yamal-Nenets Autonomous District, Eastern Siberia, and shelf fields. Savings on exports of oil from the Yu. Korchagin field in 2012 amounted to \$150 million.

In projects regulated by PSAs, taxes continue to be paid in accordance with the terms of these agreements.

 [Fact Book, p. 110](#)  
[Analyst Databook, p. 69](#)

Revenue structure of a Russian oil exporter, \$/barrel



## Licensing

**LUKOIL became the first privately owned Company in Russia to obtain access to mineral areas with federal status, as defined by the Russian Law on Minerals.**

**426** licenses  
on the Group  
balance sheet

**11** licenses  
obtained  
in 2012

The Group continued its work in 2012 to obtain new licenses for mineral use and to optimize the license portfolio in order to raise the quality of the Company's reserve base.

The main event of the year in the licensing sphere was victory in an auction for usage rights at a mineral area with federal status in Western Siberia, including the Imilorskoye+Zapadno-Imilorskoye and Istochnoye fields. A license for mineral use will be issued for a period of 20 years. Under the terms of the auction, 30% of the oil, which is produced, will be processed at the Perm Refinery.

 Chapter 'Prospective Regions', p. 20

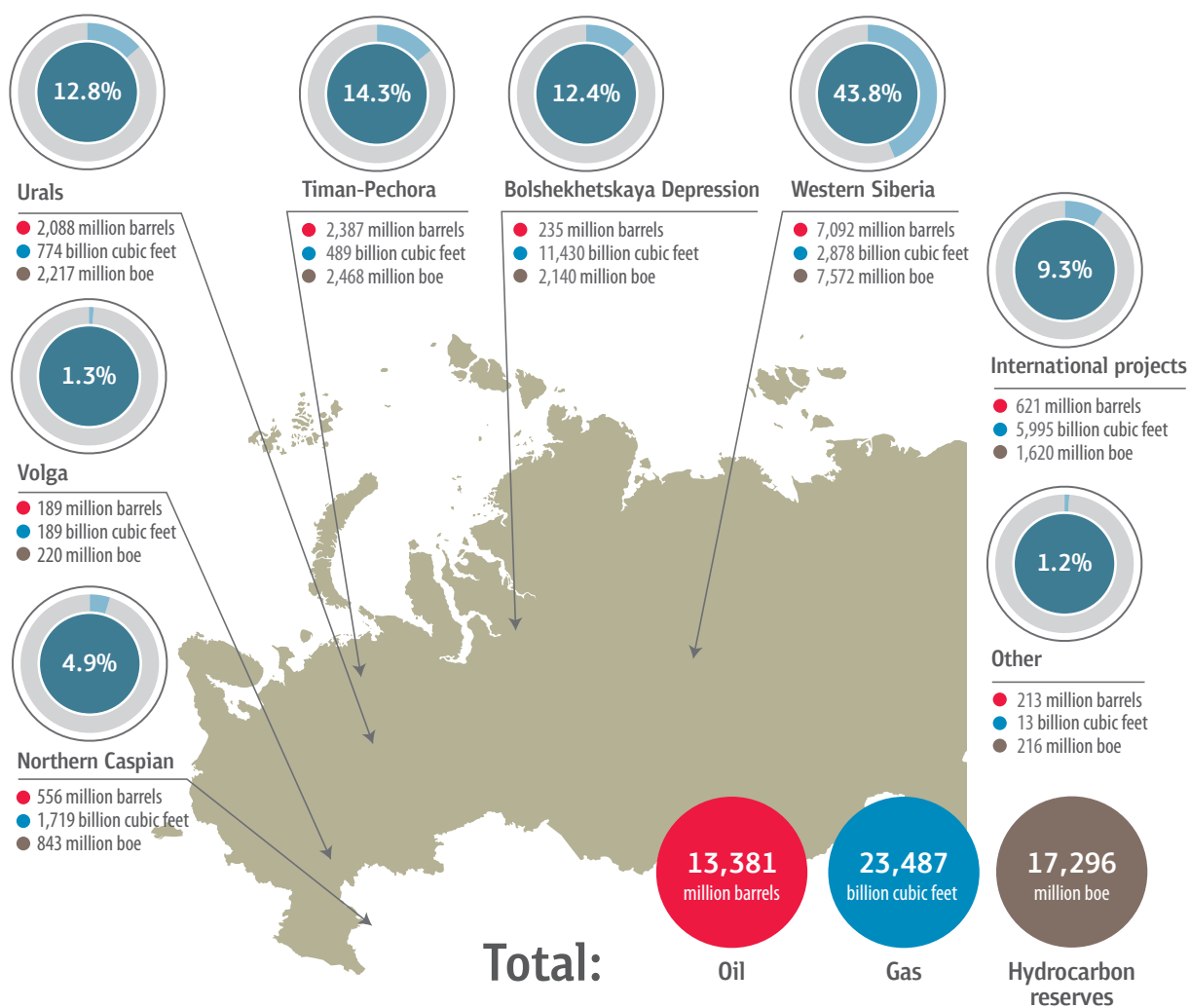
LUKOIL Group companies had 426 licenses on their balance sheets as of January 1, 2013, of which 338 were for exploration & production of hydrocarbons, 22 were for geological study, including prospecting and evaluation of mineral fields, and 66 were for geological study, exploration & production of raw hydrocarbons.

The Company obtained 11 new licenses for use of mineral resources in 2012, of which 5 as a result of auctions and competitions, 3 for geological study in response to an application by the mineral resources user, and 3 as a result of acquisition of an interest in another company.



# Crude Oil and Gas Reserves

## Proved oil & gas reserves of LUKOIL Group by regions in 2012



### Oil & gas reserves of LUKOIL Group

January 1, 2013	Oil	Gas	Oil + gas <sup>1</sup>
	million barrels	billion cubic feet	million boe
<b>Proved reserves</b>	<b>13,381</b>	<b>23,487</b>	<b>17,296</b>
of which:			
In development	8,537	8,727	9,992
Not in development	4,844	14,760	7,304
<b>Probable reserves</b>	<b>5,933</b>	<b>10,738</b>	<b>7,723</b>
<b>Possible reserves</b>	<b>3,680</b>	<b>3,552</b>	<b>4,272</b>

<sup>1</sup> Conversion ratio from cubic feet to barrels: 1 barrel = 6,000 cubic feet.



## LUKOIL's large resource potential provides a guarantee of strong development in the future

**29.3** billion boe  
**3P hydrocarbon reserves**

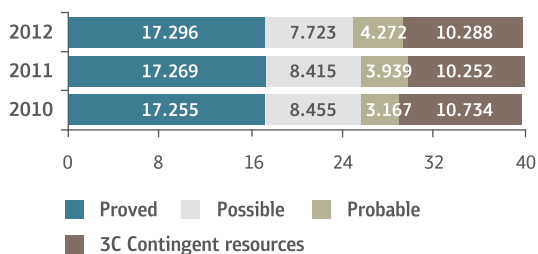
**10.3** billion boe  
**3C contingent resources**

We are working as hard as we can to realize our immense resource potential, converting it into proved reserves for future development. Replacement of production by proved reserves exceeded 100% in 2012. This achievement was due to:

- geological exploration, production drilling and acquisitions, which together gave an increase of proved reserves by 703 million boe (most of the growth was from additional exploration of fields in the Northern Caspian and Komi Republic);
- revision of previous estimates, which gave an increase of reserves by 142 million boe thanks to improvements in the technology used for development of existing fields, progress towards commissioning of several new deposits, and increase of gas utilization.

Organic reserve growth compensated 82% of hydrocarbon production in 2012. Most of the organic growth of proved reserves was obtained in Russia (613 million boe or 92% of the total).

### 3P hydrocarbon reserves and 3C contingent resources, billion boe



We carry out intensive geological exploration work, using the latest technology, and we are also implementing a program to increase rates of gas utilization in order to speed up the transfer of contingent resources to reserves as the time approaches for them to be brought into production.

Western Siberia, Timan-Pechora and the Urals account for most of the Group's reserves. The main part of proved gas reserves are in Bolshekhetskaya Depression (Western Siberia), Uzbekistan and the Caspian region. Some 58% of the Company's total proved reserves (64% of oil reserves and 37% of gas reserves) are in development. This reserve structure reflects high potential for increase of production by the Company in the medium term, particularly of gas production.

Most of LUKOIL's proved reserves are conventional. Only about 4.4% of proved reserves (3.8% of 3P reserves) consist of high-viscosity oil and 5.3% of proved reserves (7.0% of 3P) are at offshore fields. This structure means that the Company can control development costs efficiently and commission new fields more quickly.

[Fact Book, p. 19](#)  
[Analyst Databook, p. 7](#)

**LUKOIL is among Russian and international leaders by volumes of proved hydrocarbon reserves. The Group's ratio of proved hydrocarbon reserves to production is more than 21 years (20 years for oil and 28 years for gas).**

# Geological Exploration

## Geological Exploration Regions of LUKOIL Group



## We carry out exploration work in

# 11 countries around the world

LUKOIL is investing in prospective regions both in Russia and abroad, preparing the raw material base for production and ensuring that levels of production increase rapidly. The Company uses modern technology in its exploration work, which ensures growing efficiency of exploration. The success rate in prospecting and exploration drilling by the Group is about 70%.

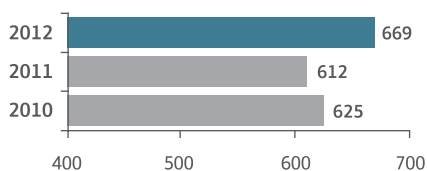
The Company substantially increased volumes of 3D seismic work (by 51.3% to 6,523 km<sup>2</sup>) in 2012 compared with 2011, in order to identify and detail structures, and to prepare for drilling of prospecting and exploration wells at promising sites. The volume of 2D seismic was 3,248 km.

Vertical seismic profiling, which details the geological structure around a well that has been drilled, was carried out at 15 wells in 2012. Exploration drilling increased by 26.5% to 201 thousand meters in 2012 and a total of 52 exploration wells were completed, of which 36 were productive.

Five new fields were discovered, of which two oil fields in Perm Region (Provorovskoye and Sukhareva), one oil field in Tatarstan (Zapadno-Bimskoye), one oil field in Volgograd Region (Dobroye) and one gas condensate field in Uzbekistan (Shurdarye). A total of 17 hydrocarbon accumulations were discovered at already known fields.

## Growth of proved reserves in 2012 as a result of geological exploration, production drilling and acquisitions totaled 703 million boe.

Increase/Discovery of new hydrocarbon reserves, million boe



Most of the increase was from further exploration of fields in the Northern Caspian and Komi Republic. Organic reserve growth compensated 82% of hydrocarbon production. Most of the organic growth of proved reserves was in Russia (613 million boe or 92% of the total).

## LARGEST PROSPECTING PROJECTS IN 2012

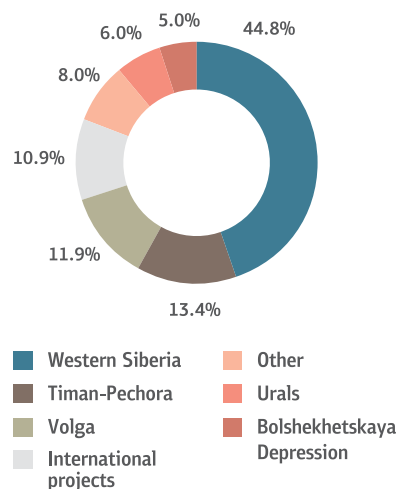
### Prospecting and exploration work in the Caspian Sea

The Northern Caspian will be a key region for growth of oil and gas production by the Company in the medium term, and LUKOIL is therefore devoting particular attention to the development of resource potential in the region. Increase of the Company's proved reserves to international standards in the region during 2012, thanks to additional exploration, was 109 million barrels (+14.9% to 2011).

Three wells were completed in the Caspian Sea and all of them were productive, so the success rate in exploration drilling was 100%.

A first prospecting well was drilled at the Zapadno-Sarmatskaya structure and confirmed gas presence in Tironian sediments, which have already been found to be productive at the Yu. Kuvykina (Sarmatskoye) field. Drilling work began on Zapadno-Sarmatskaya well № 2. A total 89 km<sup>2</sup> of 3D seismic surveying was carried out at the Sarmatskaya area, and 500 km of 2D survey work was completed at the Severny area for detailing of the Yuzhnaya and Yuzhno-Shirotnaya structures and to search for a zone of possible development of non-anticlinal features to the south of the Yu. Korchagin and V. Filanovsky fields.

Exploration drilling by regions (2012)



**Prospecting work in the Denisovskaya Depression (Komi Republic)**

A total 23.4 thousand meters of prospecting and exploration drilling was carried out in the Komi Republic and five wells were completed, of which four were productive (80% drilling success rate). Exploration wells № 2 and 4 at the Vostochno-Lambeishorskoye field were completed and transferred to the field operator. They are now operating with daily flow rates of about 600 cubic meters.


**Prospecting drilling in the Baltic Sea**

LUKOIL carried out exploration work both onshore in Kaliningrad Region and on the Baltic Sea shelf during 2012. Total drilling was 6 thousand meters and 100 km of 2D seismic work was carried out at the Yuzhny license area. Drilling of prospecting well № 1 in the Baltic Sea was completed (the distance drilled in 2012 was 4 thousand meters). The well is now being tested. A first prospecting well was also drilled at the Yuzhno-Volodarovskaya structure (1,930 meters drilled).

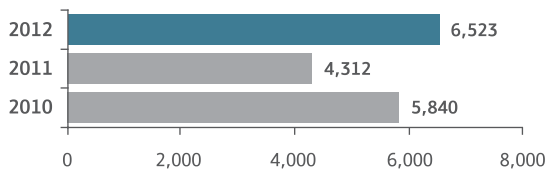
**Prospecting work in Uzbekistan**

At the Kandym block wells Parsankul-9 and Parsankul-10 were completed and testing gave daily gas inflows of 90 thousand cubic meters and 196 thousand cubic meters, respectively. Preparations were made for 3D seismic data acquisition and 450 km<sup>2</sup> of 3D work was carried out. The geological model of the Parsankul field was updated in 2012 and rapid assessment of C1 hydrocarbon reserve increment from the new wells was made.

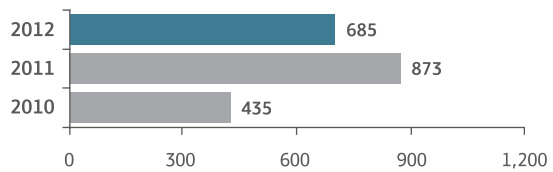
Drilling work was completed in the South-West Gissar project and well Shurdarye-2 was tested. Testing of Upper Carbonaceous sediments gave daily commercial inflow of gas and condensate at rates of 647 thousand cubic meters and 95 tonnes, respectively, marking discovery of the Shurdarye field.

 [Fact Book, p. 24](#)  
[Analyst Databook, p. 5](#)

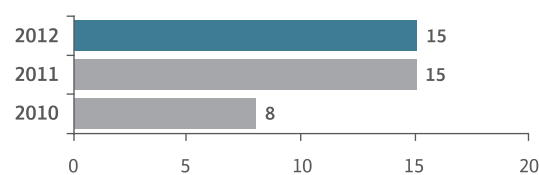
3D Seismic exploration, km<sup>2</sup>



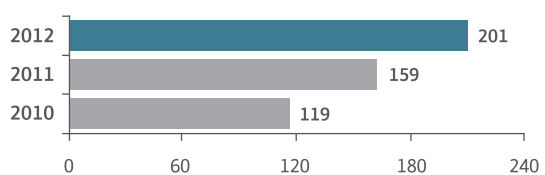
Spending on geological exploration, \$ million



Vertical seismic profiling, wells



Exploration drilling, th. meters



## Prospective Regions

### Prospective regions and fields in the exploration & production segment:

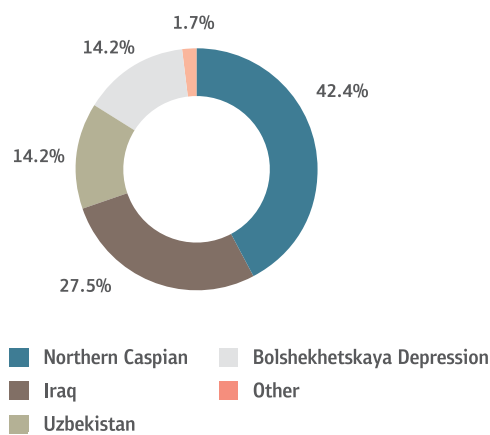


**LUKOIL continued to invest in prospective production regions during 2012, laying a solid foundation for the growth of hydrocarbon production in the future. The Company is committed to making the best use of its huge resource potential via two approaches:**

- establishment of operations in new regions, acquisition of licenses in Russia and abroad;
- use of new technologies at relatively depleted areas and in regions with reserves that are hard to recover.

Spending on prospective projects during 2012 amounted to \$3.4 billion, which is more than 28% of total capital spending in 2012. In Russia the Company invested more than \$1.4 billion for development of the Caspian region, and about \$0.5 billion on fields in the Bolshekhetskaya Depression. The greater part of foreign capex in the exploration & production segment in 2012 was at the West Qurna-2 field in Iraq.

Capital expenditures in prospective regions in 2012



PROSPECTIVE REGIONS IN RUSSIA

WESTERN SIBERIA

Western Siberia is an established region of hydrocarbon production for LUKOIL, and most of its oil fields are highly depleted. Prospects for increase of production of hydrocarbons in the region depend on the acquisition of new licenses, intensification of drilling work and use of secondary and tertiary recovery techniques (hydraulic fracturing, sidetracking, horizontal wells, etc.). Increase of hydrocarbon production will also be achieved through the development of gas fields in the region.

*Imilorskoye + Zapadno-Imilorskoye and Istochnoye fields*

LUKOIL strengthened its base in Western Siberia during 2012 through the acquisition of a license, which gives rights at the Imilorskoye + Zapadno-Imilorskoye and Istochnoye fields.

Geological and recoverable oil reserves (C1+C2) at the area as of January 1, 2012 were, respectively, 855.5 and 193.7 million tonnes. The license will enable the Company to greatly increase its reserves and raise future production levels in the strategic region of Western Siberia.

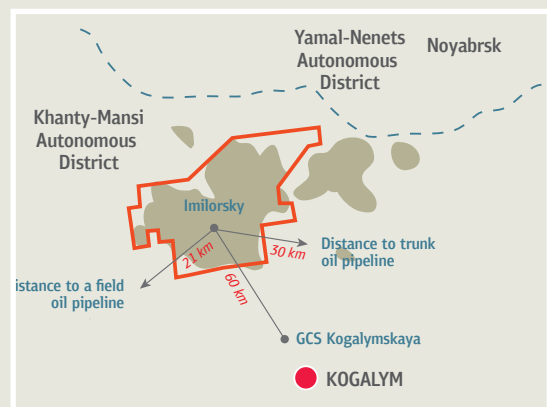
The Imilorskoye field has enormous resource potential, and ownership by the Company of developed infrastructure close by will reduce development costs. Efficient development of the field will create new jobs and increase tax revenues to the state budget. First production from Imilorskoye is expected in 2015.

DESCRIPTION

Two oil fields have been discovered at the territory: Imilorskoye + Zapadno-Imilorskoye (1987) and Istochnoye (1988). The company offered a single payment of 50.8 billion rubles for mineral usage rights, representing \$1.2 per barrel of proved and appraised reserves. Geological and recoverable oil reserves (C1+C2) at the area as of January 1, 2012 were 855.5 and 193.7 million tonnes, respectively.

The area is located in Surgut administrative sub-division of Khanty-Mansiysk Autonomous District, 65 km south-west of the city of Noyabrsk, which is in Yamal-NeNETS Autonomous District. A communication corridor passes at a distance of 29 km from the center of the area, and consists of a road with hard surface connecting Surgut with Noyabrsk, a trunk oil pipeline connecting the Kholmogory and West Surgut pumping stations, power transmission lines (500, 220 and 110 kilovolt) and a gas pipeline connecting Kholmogorskaya compression station to the Surgut gas-processing plant. A pipeline carrying marketable crude oil passes 15 km to the east of the area boundary, and trunk oil and gas pipeline routes pass 55 km to the east of the boundary.

The Imilorskoye field is directly adjacent to the largest LUKOIL field currently in development – the Tevlinsko-Russkinskoye field – and shares many of its geological features. The region around Imilorskoye is well equipped with facilities, having all of the necessary production and transportation infrastructure for field development, so Imilorskoye can be made ready and brought into production relatively quickly and with best-possible economic and synergy effects.



## TIMAN-PECHORA

The Timan-Pechora oil & gas province has substantial potential for production growth. LUKOIL plans to bring the heavy oil reserves of Timan-Pechora (about 4.4% of the Company's total proved reserves) into production more quickly by applying new technologies. Most of the Company's heavy oil reserves are located at the Yaregskoye and Usinsk fields, and development of the Trebs and Titov fields via a joint venture also offers potential for increase of hydrocarbon production in the region.

### *Trebs and Titov fields*

In 2011 LUKOIL together with OJSC Bashneft set up a joint venture to develop the Trebs and Titov oil fields, with LUKOIL taking a 25.1% stake in the development project. Production is expected to begin in 2013 and peak production will be 4.8 million tonnes per year. LUKOIL will obtain major synergies from the use of its own oil transport infrastructure (the Yuzhnoye Khylichuyu-Varandey pipeline and the Varandey terminal) to export oil from the fields.

 [Fact Book, p. 32](#)

### *Vostochno-Lambeishorskoye field*

The Vostochno-Lambeishorskoye field was discovered in the Denisovskaya Depression, in 2012 and first production was obtained in 2012, when three exploration wells were put into trial operation and gave flows of 1.4 thousand tonnes per day. Oil production in 2012 was 0.4 million tonnes and is expected to rise to 0.8–1.2 million tonnes per annum in 2013–2015 (a plateau level is expected 1.3 million tonnes). Proved oil reserves at the end of 2012 were 81 million barrels.

### *Yaregskoye field*

Yaregskoye is the Company's largest field with high-viscosity oil deposits and has proved reserves of 314 million barrels (equivalent to 47 million tonnes taking account of the high density of the oil). Output from the field has benefited from a preferential export duty rate, equal to 10% of the standard rate, since mid-2012. The peak production level should be 3.1 million tonnes.


 [Fact Book, p. 33](#)

### *Usinskoye field (permian-carbonaceous)*

The permian-carbonaceous deposit at the Usinskoye field is the Company's second largest source of high-viscosity oil.

Such oil qualifies for preferential taxation under the '10-10-10' system. The target production level at the field is 2.5 million tonnes per year.

Proved hydrocarbon reserves at the end of 2012 were 444 million boe.

 [Fact Book, p. 33](#)  
[Analyst Databook, p. 30](#)

## NORTHERN CASPIAN

The Northern Caspian will be a key region for growth of oil & gas output by LUKOIL in the medium term thanks to the development of large fields, which were discovered in the 2000s. The Company is giving special attention to the development of resource potential in the region. Additional exploration of fields there led to increase of the Company's proved reserves to international standards by 109 million barrels in 2012 (+14.9% to 2011).

### *Yu. Korchagin field*

LUKOIL began its production operations in the Russian sector of the Caspian Sea at the Yu. Korchagin field in 2010 and output from the field rose by 135% in 2012. The target is to produce 2.4 million tonnes per year at the field using long, highly complex horizontal wells. Proved hydrocarbon reserves at the end of 2012 were 86.5 million boe.

### *V. Filanovsky field*

The V. Filanovsky field will be the second production asset launched by LUKOIL in the offshore Caspian. Production is scheduled to begin in 2015 and should reach the target level of 6.1 million tonnes in 2016. Intensive work is currently underway on construction of infrastructure facilities (offshore platforms, pipelines, and equipment). The V. Filanovsky field is the biggest in the region and, unlike earlier discoveries, its reserves consist mainly of oil. Proved hydrocarbon reserves here at the end of 2012 were 487 million boe.


 [Fact Book, p. 37](#)

### *Gas fields in the Bolshekhetskaya depression*

Fields in the Bolshekhetskaya depression represent the Company's core production base for natural gas in Russia. LUKOIL's biggest operating gas field is Nakhodkinskoye, which accounted for about 95% of the Company's natural gas production in Russia in 2012. Other, equally large fields are scheduled for launch in the future.

These are Pyakyakhinskoye (scheduled launch in 2016), Yuzhno-Messoyakhskoye (2018) and Khalmerpayutinskoye (2019). Natural gas production by the Company in Russia should more than double over the next 10 years thanks to commissioning of these fields. Total production of natural gas by the Company in the Bolshekhetskaya depression, when all of the fields there are operational, should be in the order of 20 billion cubic meters.

Proved hydrocarbon reserves at fields in the Bolshekhetskaya depression at the end of 2012 were 2,140 million boe.

 [Fact Book, p. 31](#)  
[Analyst Databook, p. 33](#)

### PROSPECTIVE REGIONS ABROAD


Prospects for increasing hydrocarbon production in international projects relate mainly to the development of existing assets in Uzbekistan and Iraq.

#### UZBEKISTAN

LUKOIL's main gas projects outside Russia are concentrated in Uzbekistan. The Khauzak-Shady and South-West Gissar projects are in production and the Kandym project is scheduled for production launch in 2014. These projects are being implemented with support from the Government of Uzbekistan on financial terms, which are attractive to the Company. Production at the Gissar block reached the plateau target level in 2012 (1.1 billion cubic meters of natural gas per year). The target for annual production at the Kandym group of fields is 8.1 billion cubic meters of gas.

Total marketable hydrocarbon production from the Company's projects in Uzbekistan was 26 million boe in 2012, which is 53.3% more than in 2011.

Proved hydrocarbon reserves at fields in Uzbekistan were 793 million boe at the end of 2012.


 [Chapter: Uzbek Projects as Business Drivers, p. 30](#)  
[Fact Book, p. 51](#)  
[Analyst Databook, p. 37](#)

#### IRAQ

The West Qurna-2 field in Iraq will make the biggest single contribution to future growth in Company output of crude oil. Production drilling at the field began in 2012, and first outputs are expected in 2014. LUKOIL's contract at the field is for 25 years. The production target is 1.2 million barrels per day and should be maintained for 19.5 years.

LUKOIL's share of proved reserves at West Qurna-2 amounted to 165 million boe the end of 2012.

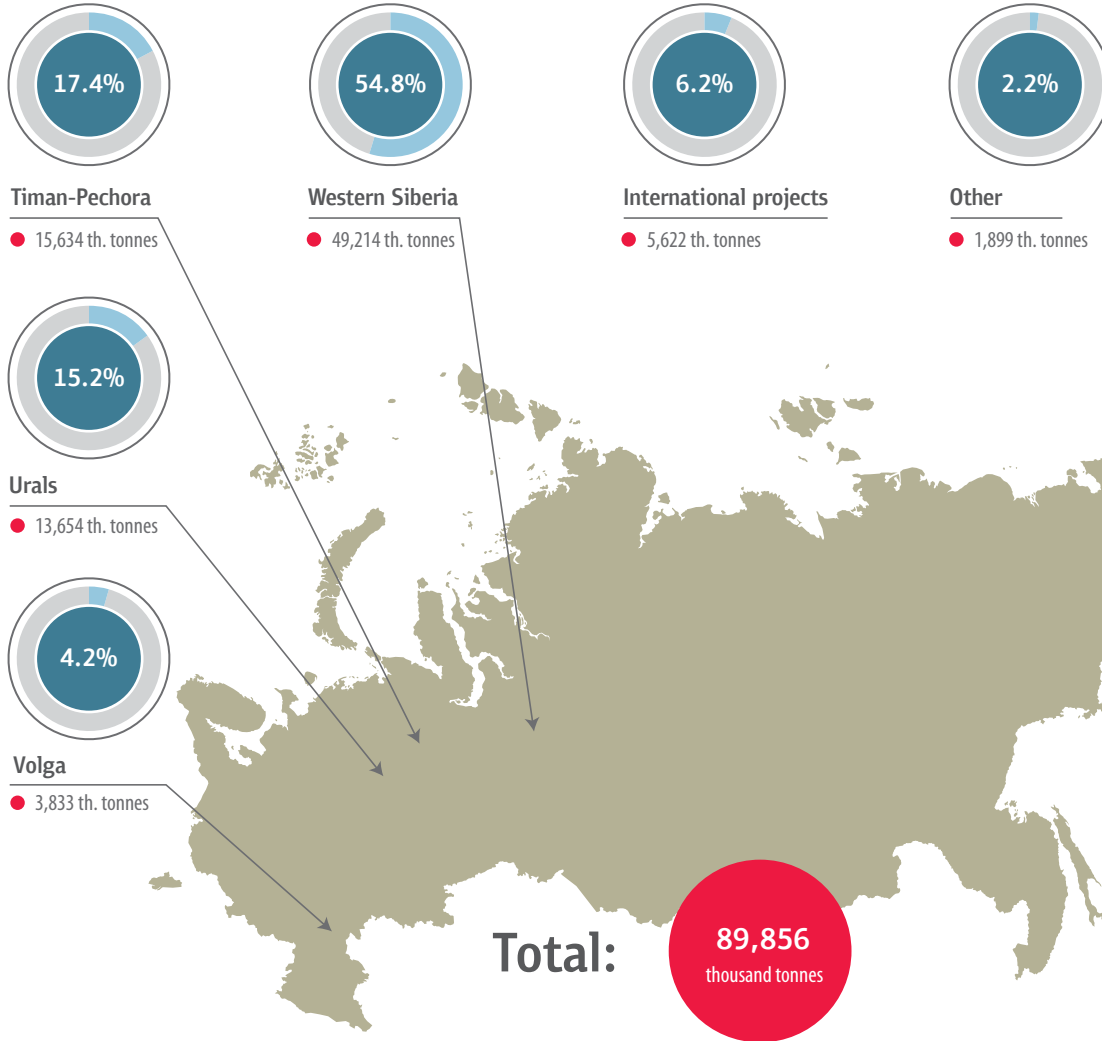
Agreement in principle was reached with authorized representatives of Iraqi state companies in late 2012 for reduction of the target levels of oil production at West Qurna-2 from 1.8 million to 1.2 million barrels per day and on extension of the production plateau from 13 to 19.5 years, together with extension of the total contract period from 20 to 25 years. These new base parameters will be reflected in the final development plan. The changes significantly lower levels of risk in implementation of the West Qurna-2 project.

 [Fact Book, p. 54](#)  
[Analyst Databook, p. 36](#)



# Oil Field Development and Oil Production

## LUKOIL oil production by regions



**In 2012, we succeeded in stabilizing output of crude oil at fields in Western Siberia, which provide 55% of total production by the Group.**

**89,856** th. tonnes of oil  
**The Group produced in 2012**  
 (1,813 thousand barrels per day)<sup>1</sup>

Improvement of systems for maintenance of formation pressure, efficient use of the latest enhanced oil recovery (EOR) technologies and of horizontal drilling led to increase of oil production in Western Siberia by 0.2%.

The main negative impact on production levels in 2012 was from decline in oil production at the Yuzhnoye Khylichuyu field in Timan-Pechora due to increased water content and shrinkage of recoverable reserves. Additional measures for stabilizing oil production at Yuzhnoye Khylichuyu have been developed and approved, including drilling of sidetracks and the use of dual injection systems.

In 2012 subsidiaries and affiliates of LUKOIL carried out hydrocarbon production at 402 fields in Russia and abroad.

**1,850** th. barrels per day  
**Oil and liquids production<sup>2</sup>**

The Company had 31.6 thousand production wells at the end of 2012, of which 27.7 thousand were actually producing, and the number of injection wells was 11.5 thousand (of which 9.1 thousand were under pressure). Production well numbers increased by 2.5% in comparison with 2011, while the number of injection wells grew by 5.1%, resulting in an overall increase

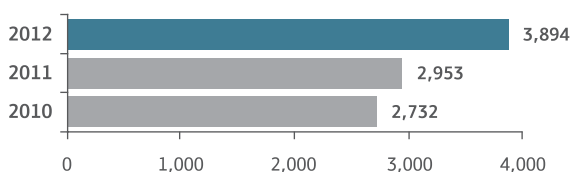
of production efficiency. The share of production wells out of use remained almost unchanged compared with the end of 2011 at 12.2% of the total. The average daily flow rate from oil wells in projects with LUKOIL participation was 13.0 tonnes.

Amounts of drilling work increased substantially (by 31.9%) in the reporting year, enabling the launch of 1,269 new production wells, including 268 horizontal wells. The average daily flow rate at new wells was 33.7 tonnes and the average for horizontal wells was 58.8 tonnes.

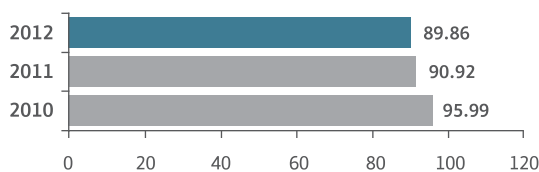
The Company is expanding the share of horizontal wells year by year and they accounted for 21.1% of total new wells in 2012.

Use of enhanced oil recovery methods enabled additional production of 23.1 million tonnes of oil (3.7% more than in 2011), accounting for 25.7% of total oil production. A particularly important role was played by drilling of horizontal wells with multi-zonal fracturing. These techniques were used at 99 wells in Western Siberia, the Urals and Timan-Pechora and gave an average oil production rate of 43.5 tonnes per day.

Production drilling, th. meters



Oil production, million tonnes



From 2012, the Group adopted a new methodology for calculating its production of hydrocarbons, which separates crude oil, liquid outputs obtained by gas processing, and marketable gas outputs. Beginning in 2012, liquid hydrocarbon production includes crude oil and liquid products obtained by gas processing, while quantities of gas dispatched to gas-processing plants for production

of liquid hydrocarbons are subtracted from the volume of marketable gas. The new methodology improves accuracy in calculation of hydrocarbon production by using appropriate coefficients for measurement of associated gas, which is sent for processing, in terms of barrels proportionate to its energy content.

<sup>1</sup> Including the Group share of production by affiliates.

<sup>2</sup> Including hydrocarbon liquids produced at the Group's gas-processing plants.

New technologies are much used for the down-hole section of well completions, including passive flow-regulation systems to prevent gas blowouts at the Yu Korchagin field.

Sidetracks were drilled at 377 (+56,4% more than in 2011) wells 362 in Russia during 2012 and gave average increase of flow rate by 16.9 tonnes per day. Consistently high efficiency of sidetracking has been achieved thanks to experiment-based mini-projects using hydrodynamic modeling, and also through improved accuracy in forecasting of geological structure and the structure of reserves. Drilling of sidetracks is mainly used at wells that are out of use, in order to extract residual oil.

Chapter 'Exploration & production technologies', p. 62

## RUSSIA

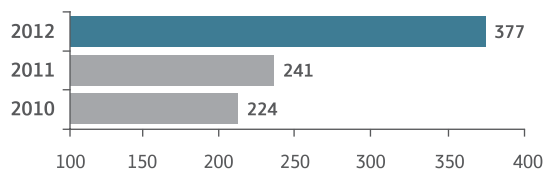
Oil production in Russia during 2012 was 84.2 million tonnes, of which 83.8 million tonnes were produced by LUKOIL subsidiaries.

LUKOIL subsidiaries and affiliates carried out hydrocarbon production at 369 fields in Russia during 2012. Commercial production operations began at 8 new oil fields in Russia during the course of the year (7 oil and 1 gas field). More than 20 Company fields in Russia increased oil production by more than 50 thousand tonnes in 2012 compared with 2011. Production growth was largest at the Yu. Korchagin field (increase by 454.8 thousand tonnes) and at the Urevskoye and Zapadno-Tugrovskoye fields in Western Siberia (343.3 thousand and 243.1 thousand tonnes, respectively).

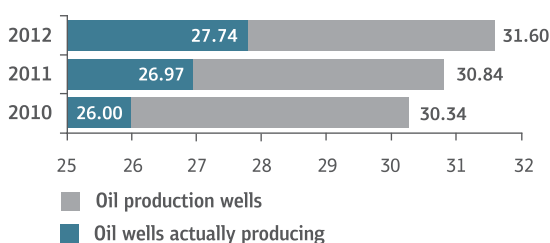
We substantially increased production drilling in Russia (by 36.0%) in 2012, mainly in the Urals and Volga regions. The Company had a total of 29.6 thousand production wells by the end of 2012, of which 25.9 thousand were actually in production.

Fact Book, p. 26  
Analyst Databook, p. 26

### Drilling of sidetracks, units



### Oil production wells, th. units



## INTERNATIONAL PROJECTS

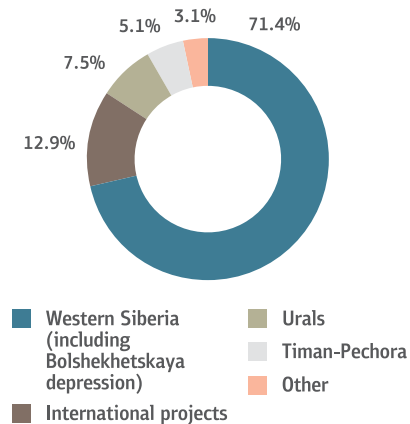
**The Company produced 5.6 million tonnes of oil outside Russia in 2012. We will significantly increase oil production in foreign projects in the near future by commissioning the West Qurna-2 field.**

The biggest increase of oil production outside Russia in 2012 compared with 2011 was in Uzbekistan, where output at the Kandym-Khauzak-Shady and South-West Gissar fields increased by 77.8% and 57.1%, respectively, in comparison with 2011.

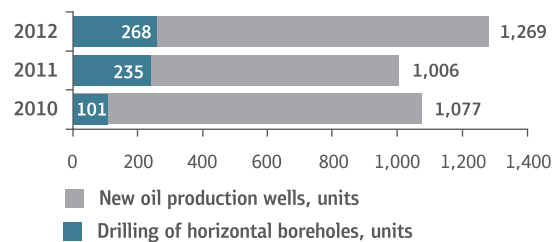
Production drilling in the Company's international projects increased by 9.3% compared to 2011, reaching 503 thousand meters. The number of oil production wells increased by 7.5% to 2,048 wells, of which 1,864 were in operation. A total of 263 new production wells were commissioned as part of international projects, in which the Group was a participant.

Fact Book, p. 42  
Analyst Databook, p. 34

### Production drilling by regions in 2012

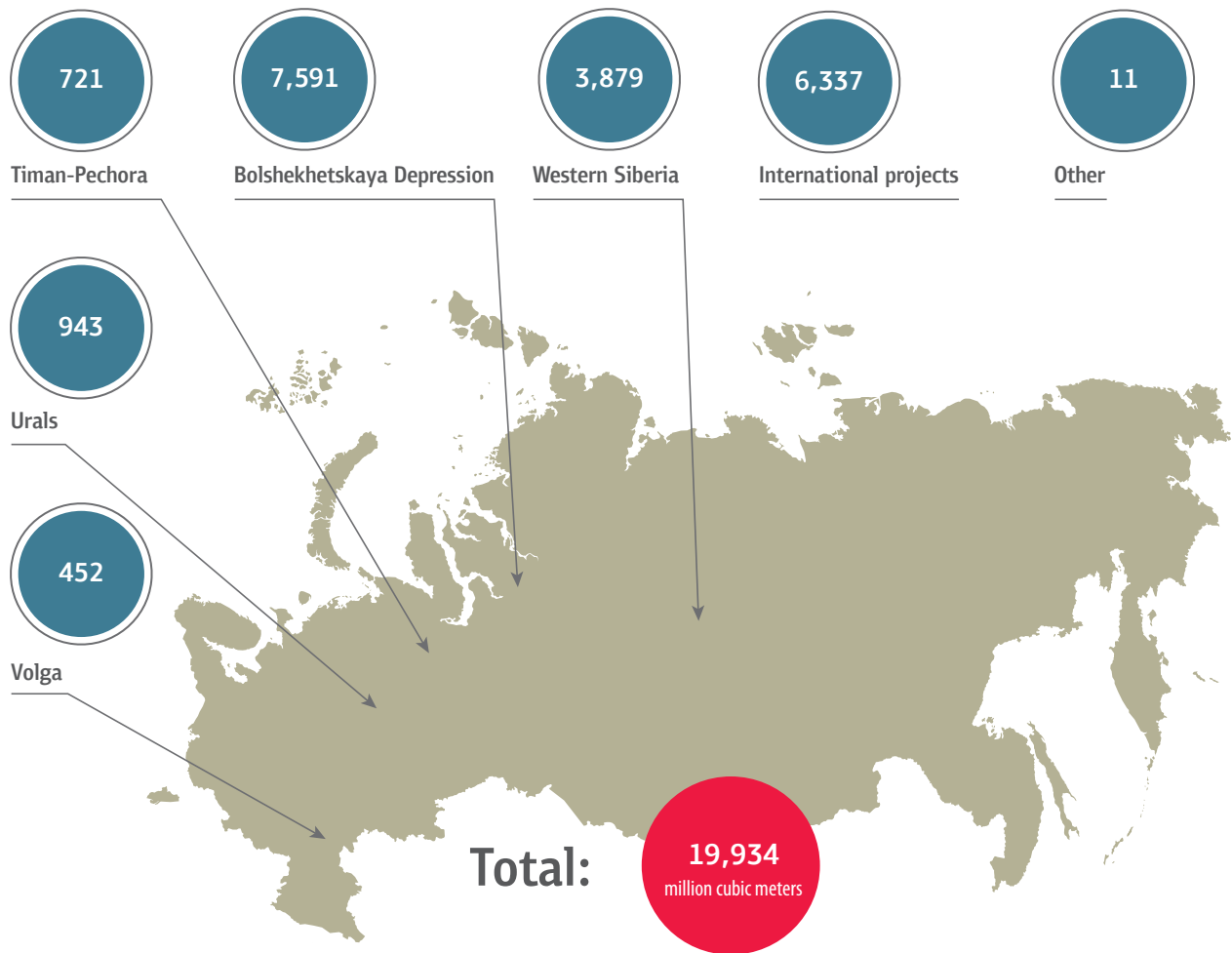


### Oil production wells, units



# Gas Field Development and Gas Production

LUKOIL production of marketable gas by regions, million cubic meters





**LUKOIL's gas program aims to achieve rapid increase of gas production both in Russia and abroad in order to raise the share of gas to a third of total hydrocarbon production by the Group.**

**24,606** million cubic meters  
**Total gas production by LUKOIL Group**

Total production of gas by LUKOIL Group (including the Group share in production by affiliates) increased by 11.9% in 2012 to 24,606 million cubic meters.

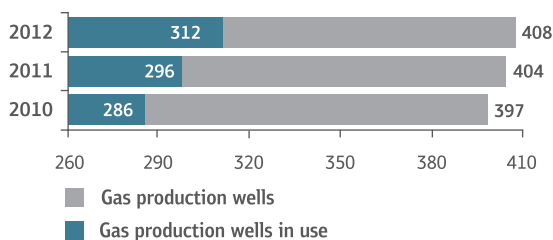
Output of marketable gas (net of own consumption, re-injection to strata and transport losses) amounted to 19,934 million cubic meters (117.3 million boe), which is 10.5% more than in 2011. Production of marketable gas in Russia rose by 2.9% and

outside Russia by 31.3%. Revenue from natural gas sales rose by \$422 million or 48.8% in 2012, with rises shown both inside and outside Russia. Growth of revenue on the domestic market was due mainly to increase in pricing of sales to Gazprom and its affiliates by 37.0%. Revenue growth abroad reflected increase in volumes and pricing of natural gas in Uzbekistan.

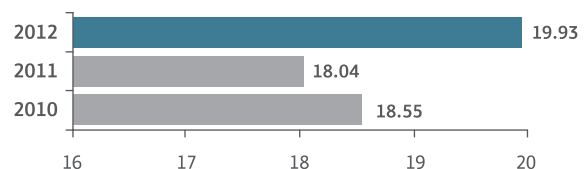
Production of liquid hydrocarbons in 2012 at the Group's gas-processing plants in Western Siberia, the Urals and the Volga region rose by 13.6 million boe compared with 2011 to 13.1 million boe.

The main achievement in the Company's gas business during 2012 was attainment of plateau production (1.1 billion cubic meters of natural gas) at the Dzharkuduk field as part of the South-West Gissar project in Uzbekistan. A final investment decision was taken on the next stage of the project, which will include the launch of a gas preparation complex at Dzharkuduk and commissioning of the new Adamtash and Gumbulak gas-condensate fields.

Gas production wells, units



Marketable gas production, billion cubic meters



**Total natural gas production** increased by 10.8% in 2012 to 15,605 million cubic meters, due mainly to increase of production as part of the Gissar and Khauzak projects in Uzbekistan. Natural gas production outside Russia grew by 31.7%.

**Total output of associated petroleum gas** increased by 13.4% to 9,001 million cubic meters. Associated gas is re-injected to maintain formation pressure at Company fields, as well as being used to produce electricity at gas power stations and for other production purposes. Marketable associated gas is delivered to gas-processing plants and local consumers.


**87.6** %  
associated gas  
utilization

LUKOIL is raising the share of associated gas, which it utilizes,<sup>1</sup> year by year and achieved a figure of 87.6% in 2012 against 79.3% in 2011, 77.5% in 2010 and 71.1% in 2009. The growth reflects development of systems for utilization of gas at fields (construction of compressor stations and gas pipelines). Associated gas utilization at major fields in Western Siberia is in excess of 95%.

LUKOIL is building gas-fired generating stations at its fields in order to increase utilization of associated gas. This small-scale generating program reduces gas flaring and also reduces spending on electricity, providing savings in lifting costs. The Company is implementing a program for the period 2011-2013 to increase levels of associated gas utilization throughout LUKOIL Group organizations. During 2012 work was completed as part of the program on construction and reconstruction of 53 facilities for associated gas utilization

## RUSSIA


Marketable gas production in Russia in 2012 totaled 13,597 million cubic meters, which is 2.9% more than in 2011. LUKOIL had 293 gas production wells in Russia by the end of 2012, of which 218 were in production. The bulk of the Company's natural gas production in Russia (about 95%) is at the Nakhodkinskoye field in the Bolshekhetskaya depression, which produced 8.1 billion cubic meters of natural gas in 2012.

 [Fact Book, p. 31](#)  
[Analyst Databook, p. 33](#)

## INTERNATIONAL PROJECTS

**31.3** %  
increase of marketable  
gas production outside  
Russia

Marketable gas production outside Russia grew by 31.3%, due mainly to increase of production in the Gissar and Khauzak projects in Uzbekistan, and the share of natural gas in total output increased to 91.5%. LUKOIL had 115 gas production wells outside Russia at the end of 2012, of which 94 were actually producing.

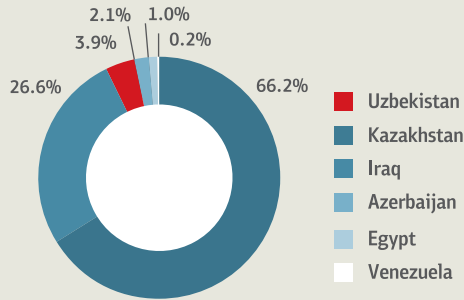
 [Fact Book, p. 42](#)  
[Analyst Databook, p. 34](#)

<sup>1</sup> The share of associated gas, which is used, as a share of total associated gas extracted from strata. The remainder is flared off.

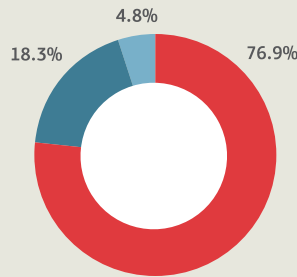
## Uzbek Projects as Business Drivers

### Uzbek projects as a share of total proved reserves in projects outside Russia

Proved oil reserves



Proved gas reserves



### Reference

- Uzbekistan is a Presidential Republic and is part of the Commonwealth of Independent States (CIS). The country covers an area of 447.8 thousand km<sup>2</sup> and its administrative divisions consist of 12 provinces and the Republic of Karakalpakstan. Population – 30 million. GDP – \$52 billion. 80% of population are Uzbeks, 5.5% – Russians.
- Uzbekistan is rich in mineral resources, which are one of the main sources of foreign currency inflows to the national economy. Proved gas reserves at the end of 2011 were 1.6 trillion cubic feet and gas production in that year was 57 billion cubic meters.
- Hydrocarbons produced in Uzbekistan are sold to Europe (via the the Central Asia–Center pipeline) and to China (via a transport route connecting Turkmenistan, Uzbekistan, Kazakhstan and China).

### LUKOIL in Uzbekistan

- Year of arrival in Uzbekistan – 2004
- Total assets, measured by the Group's interest in projects at the end of 2012: 792 million boe of reserves, 4,251 million cubic meters annual production of marketable gas, and 138 thousand tonnes of annual oil production.
- Total investments by the Group in Uzbek projects since entering the market are about \$2 billion.
- LUKOIL's net income per boe in Uzbekistan is about \$18 and IRR notably exceeds the level of 15%, which is average for the Company.

Assets in the Republic of Uzbekistan are the foundation of our strategy for expanding LUKOIL's gas business.


Gas production by LUKOIL in Uzbekistan will grow by at least four times in the next five years.



**KANDYM-KHAUZAK-SHADY****Agreement signing** – 2004**Agreement period** – until 2039**Agreement type** – PSA, exploration & production of gas**Company share of profit** – 90% (operator)**Other project participants:** Uzbekneftegaz (10%)**Company investments from 2004 to 2012** – \$1.27 billion**Peak gas production** – 12 billion cubic meters per year**Hydrocarbon reserves at the end of 2012** – 558 million boe**Marketable hydrocarbon production in 2012** – 19 million boe

Kandym-Khauzak-Shady is the most efficient gas project in LUKOIL's portfolio. Gas outputs are dispatched via the Central Asia–Center pipeline or the pipeline connecting the Bukhara gas production region with Tashkent, Bishkek and Almaty as far as the Uzbek border, where they are sold under contract to Gazprom. According to the PSA, a royalty is paid on the gas at a rate of 30%. LUKOIL enjoys a seven-year income tax holiday from the start of production. The target annual production level at the Kandym group of fields is 8.1 billion cubic meters of gas.

Kandym-Khauzak-Shady accounted for more than 51% of marketable gas production in LUKOIL's international projects during 2012.

 **Fact Book, p. 51**  
**Analyst Databook, p. 37**

**Khauzak-Shady**

The Khauzak-Shady project was commissioned in late 2007 and provided the greater part of LUKOIL's gas production outside Russia in 2012 (51.4%), when marketable gas production from the project was 3.26 billion cubic meters. A booster compression station with 15 megawatt capacity is to be commissioned in December 2013 in order to maintain annual production levels in the project.

**Kandym**


The Kandym project is now being prepared for production launch: the Kuvachi-Alat area, with target annual production of 1.5 billion cubic meters of gas, and the northern part of the Shady area, with target annual gas production of 0.7 billion cubic meters, are to be commissioned in 2014.

The Kandym project includes 126 wells, a gathering system for well outputs with total length of more than 500 km, a gas-processing plant (three production lines), a gas export pipeline (90 km), a shift camp with capacity for 1,380 workers and other other infrastructure.

**SOUTH-WEST GISSAR****Agreement signing** – 2007**Acquisition of shares** – 2008**Period of the agreement** – to 2043**Type of agreement** – PSA, exploration and production of oil & gas**The LUKOIL share** – 100%**Other participants** – Uzbekneftegaz**Company investments from 2008 to 2012** – \$1.29 billion**Peak annual gas production** – 4.2 billion cubic meters**Hydrocarbon reserves at the end of 2012** – 235 million boe**Hydrocarbon production in 2012** – 6.8 million boe

The South-West Gissar contract territory consists of 7 fields (5 gas-condensate and 2 oil). Oil production under the Gissar PSA has been underway since 2007 at 2 oil fields – Kushkuduk and Okkul. Gas has also been produced since the end of 2011 at the Dzharkuduk – Yangi Kyzylcha field. The initial annual production target for Dzharkuduk is 1.1 billion cubic meters of natural gas.

The Gissar block reached its target production level of 1.1 billion cubic meters in 2012 and a final investment decision was taken in December to proceed with the next stage of project development, including the launch of a gas preparation facility at Dzharkuduk and commissioning of the new Adamtash and Gumbulak gas-condensate fields. Plans for the next phase include drilling of 40 wells, construction of a gathering system for well outputs and of a preliminary gas preparation unit at the Adamtash field, as well as complex gas preparation units at the Dzharkuduk – Yangi Kyzylcha field and construction of other infrastructure.

 **Fact Book, p. 52**  
**Analyst Databook, p. 37**



2

# OIL REFINING, GAS PROCESSING AND PETROCHEMICALS





## Strategy 2012–2021

- Significant increase of light products yield at Russian refineries
- Increase in gasoline production at Russian refineries
- Increase in average daily sales at Russian filling stations by 27%
- Installation of new secondary refining units at Russian refineries
- Upgrading of foreign refineries to match the best international standards
- Reduction in output of dark petroleum products at Russian refineries

### Refining & Marketing, main indicators

Indicator, \$ million	2012	2011	Change, %
Revenue	134,877	128,549	4.9
EBITDA	5,199	5,794	-10.3
Net income	3,639	3,687	-1.3
Capital expenditures	2,078	1,354	53.5

## All of our gasoline production meets Euro-5 requirements

We have continued rapid development of the Refining & Marketing segment, with particular focus on improvement of operating efficiency and achievement of greater refining depth. Changes to Russian legislation are stimulating output of premium, environmentally friendly fuels. Current modernization of the Perm and Ukhta refineries and installation of a catalytic cracker at the Nizhny Novgorod Refinery will help the Group to substantially improve its financial results in the segment. In 2012 all automotive gasoline outputs at all of the Group's Russian refineries met Euro-5 requirements.

## LUKOIL has therefore met the criteria of the Russian Government's Technical Requirements for fuel quality matching Euro-5 significantly ahead of time.

This has been possible thanks to a broad program for the modernization of LUKOIL's oil refineries.

**66.1** million tonnes  
oil and of petroleum product refined

Total crude oil throughput at Company refineries grew by 5.1% in 2012 to a level of 1,128 thousand barrels per day.

## PRICE

### More than

**\$65** per tonne  
savings from reduction of excise rates on Euro-5 fuels

There was a gradual recovery in demand for petroleum products during 2012 thanks to growth of the world economy. Product prices on the domestic and export markets grew significantly as a result. Average prices for fuel oil in Europe rose by 3.5% (FOB Rotterdam), and prices for high-octane gasoline were 5.3% higher. On the domestic market prices for heating fuel oil rose by 0.4% and prices for AI-95 gasoline fell by 3.2%.

## TAX ENVIRONMENT AND IMPROVEMENTS TO TAX LEGISLATION

There has been a substantial increase in Russian consumption of high-octane automotive gasoline in recent years due to the increasing number of automobiles. The Government has therefore taken a number of steps to stimulate production of premium fuels with excellent environmental features:

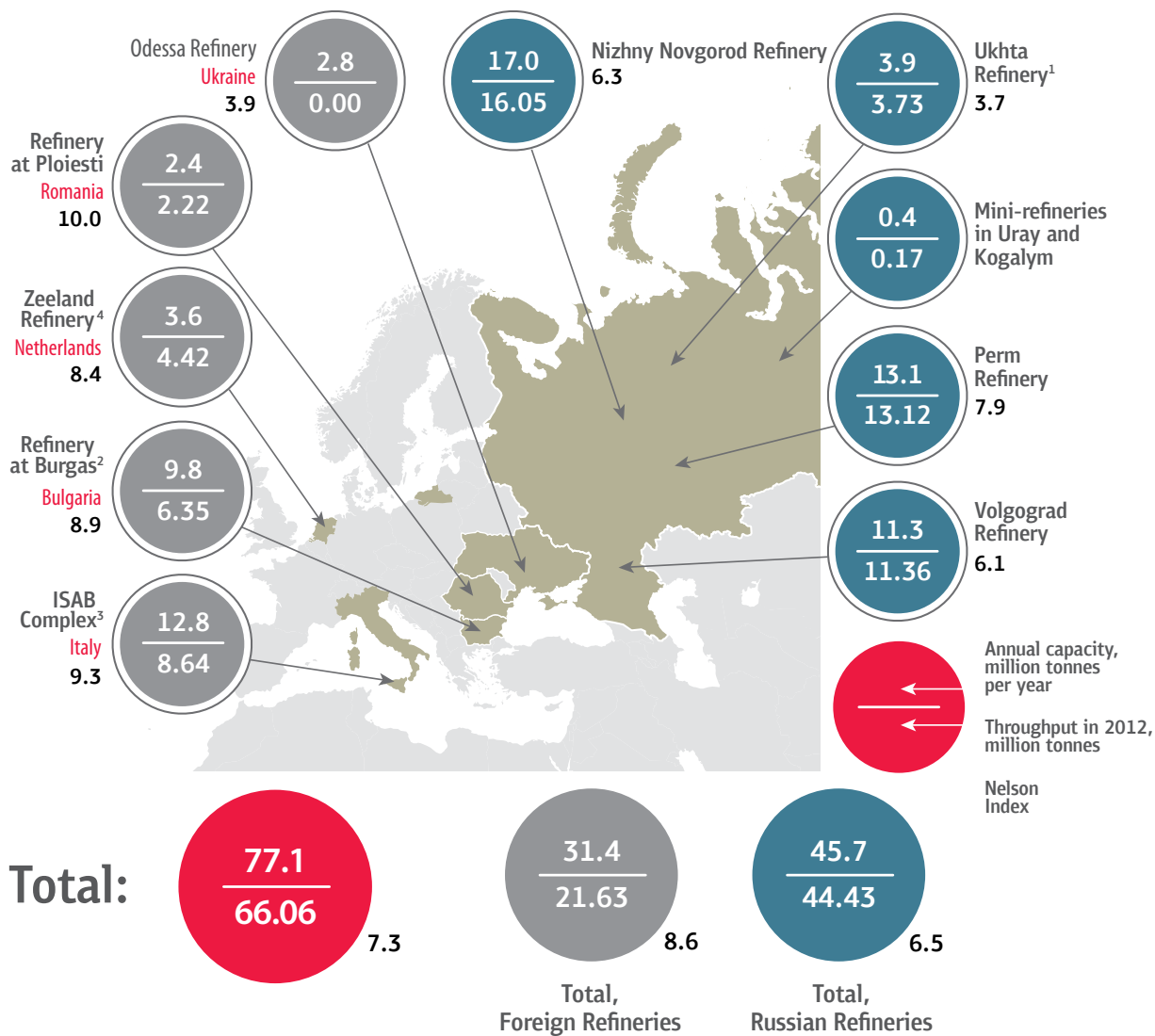
- The '60-66' system has been introduced, which unifies export duties for light and dark oil products at 66% of the duty level for crude oil while keeping a higher rate of 90% for exports of gasoline. This system encourages deeper refining of crude oil, which the Group has been working on for a number of years and will continue this work in the future.
- Differentiation of excise rates for petroleum products. Excise rates for Euro-5 fuels were lowered by 25% as from July 1, 2012.



Fact Book, p. 110  
Analyst Databook, p. 69

# Oil Refining

## Oil Refineries of LUKOIL Group



<sup>1</sup> Excluding vacuum distiller capacity of Atmospheric-vacuum distillation unit.

<sup>2</sup> Including refining of 0.48 million tonnes of fuel oil in 2012.

<sup>3</sup> Capacity and refining volumes at ISAB (for oil and fuel oil) represent the Company share (80%).

<sup>4</sup> Capacity and refining volumes at Zeeland (for oil) represent the Company share (45%).

1.63 million tonnes of vacuum gasoil were also processed at Zeeland in 2012.

LUKOIL Group continued rapid development of its oil refining business in 2012 through modernization and expansion of refining capacities. Group refineries processed 66.1 million tonnes of crude oil during the year (the figure includes the Company's share of refining at the ISAB and Zeeland complexes).

**99.3** %  
 Share of high-octane gasolines in total output of automotive gasolines

We are continuing modernization of existing capacities. Main works on refining facilities, scheduled for completion in 2015–2016 are as follows:

<b>Perm Refinery</b>	- Complex for refining of oil residues
<b>Nizhny Novgorod Refinery</b>	- Catalytic cracking of vacuum gasoil - Vacuum block - Isomerization unit
<b>Burgas Refinery</b>	- Complex for refining of heavy residues
<b>Volgograd Refinery</b>	- Atmospheric-vacuum distillation unit - Hydrocracking of vacuum gasoil - Isomerization unit

Fact Book, p. 63  
 Analyst Databook, p. 39

## RUSSIAN REFINERIES

Crude oil refining at refineries owned by the Group in Russia (including mini-refineries) totaled 44.4 million tonnes in 2012. Reduction of the figure by 1.9% from the 2011 figure was due to major repair work at the Nizhny Novgorod Refinery.

The share of high-octane gasoline in total output of gasoline at Group refineries in Russia (not including mini-refineries) rose to 99.1% in 2012 (from 96.2% in 2011). Light-product yield was 54.0% (not including mini-refineries). Irrecoverable losses were 0.53% (not including mini-refineries).

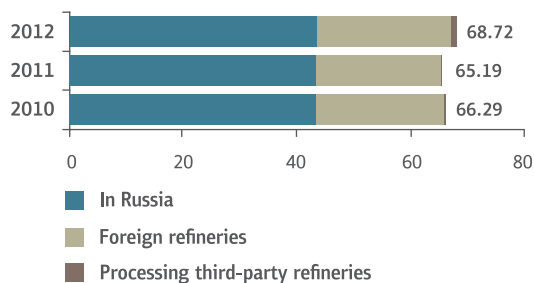
Capital expenditures at the Group's refineries in Russia in 2012 were \$988 million, up from \$586 million in 2011. The growth reflects commissioning of new capacities and the start of construction and assembly work as part of refinery modernization projects.

## The most important events in 2012 as regards upgrading of LUKOIL's refineries in Russia were

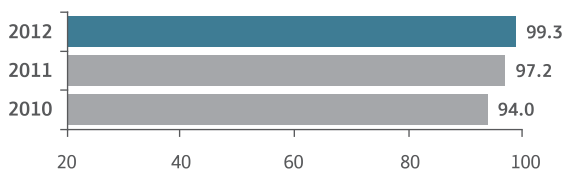
the completion of reconstruction work on atmospheric-vacuum distillation unit №5 at the Nizhny Novgorod Refinery and commissioning at the Volgograd refinery of a diesel fuel hydrotreatment facility with 3 million tonnes annual capacity. At the Ukhta Refinery modernization work was completed on the reaction section of a GDS-850 unit for hydrotreatment of diesel fuel, and work on the atmospheric-vacuum distillation unit increased annual capacity of its vacuum block to 2.0 million tonnes.

Fact Book, p. 65  
 Analyst Databook, p. 41

Oil refining by the Company, million tonnes



Share of high-octane gasoline in total output of gasoline, %<sup>1</sup>



<sup>1</sup> Excluding mini-refineries and the ISAB and Zeeland complexes.


**FOREIGN REFINERIES**

Refinery throughputs in 2012 at LUKOIL Group’s international refineries, including the Group’s share of refining at the ISAB and Zeeland complexes, were 21.6 million tonnes, which is 10.1% more than in 2011, due to increase of the Group’s share of refining at the ISAB complex from 60% to 80% .

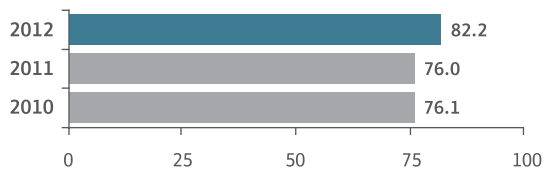
Light product yield (not including ISAB and Zeeland) rose to 69.8% (67.7% in 2011). Irretrievable losses at foreign refineries in 2012 were 0.56% (not including ISAB and Zeeland).

Capital expenditures at Group refineries outside Russia in 2012 were \$418 million, compared with \$197 million in 2011. The major increase of capex levels at foreign refineries was due to construction of a complex for refining of heavy residues at Burgas Refinery.

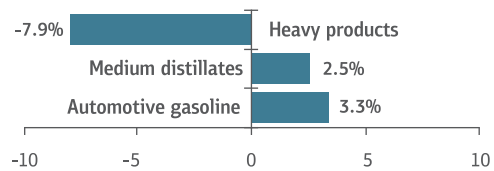
The main achievements as part of upgrading work at foreign refineries in 2012 were upgrade of metering aggregates for petroleum products at the Burgas Refinery and completion of reconstruction of the amine block at the Ploiesti Refinery.

 [Fact Book, p. 73](#)  
[Analyst Databook, p. 46](#)

Share of diesel fuel with sulphur content below 50 ppm in total production of diesel fuel, %<sup>1</sup>



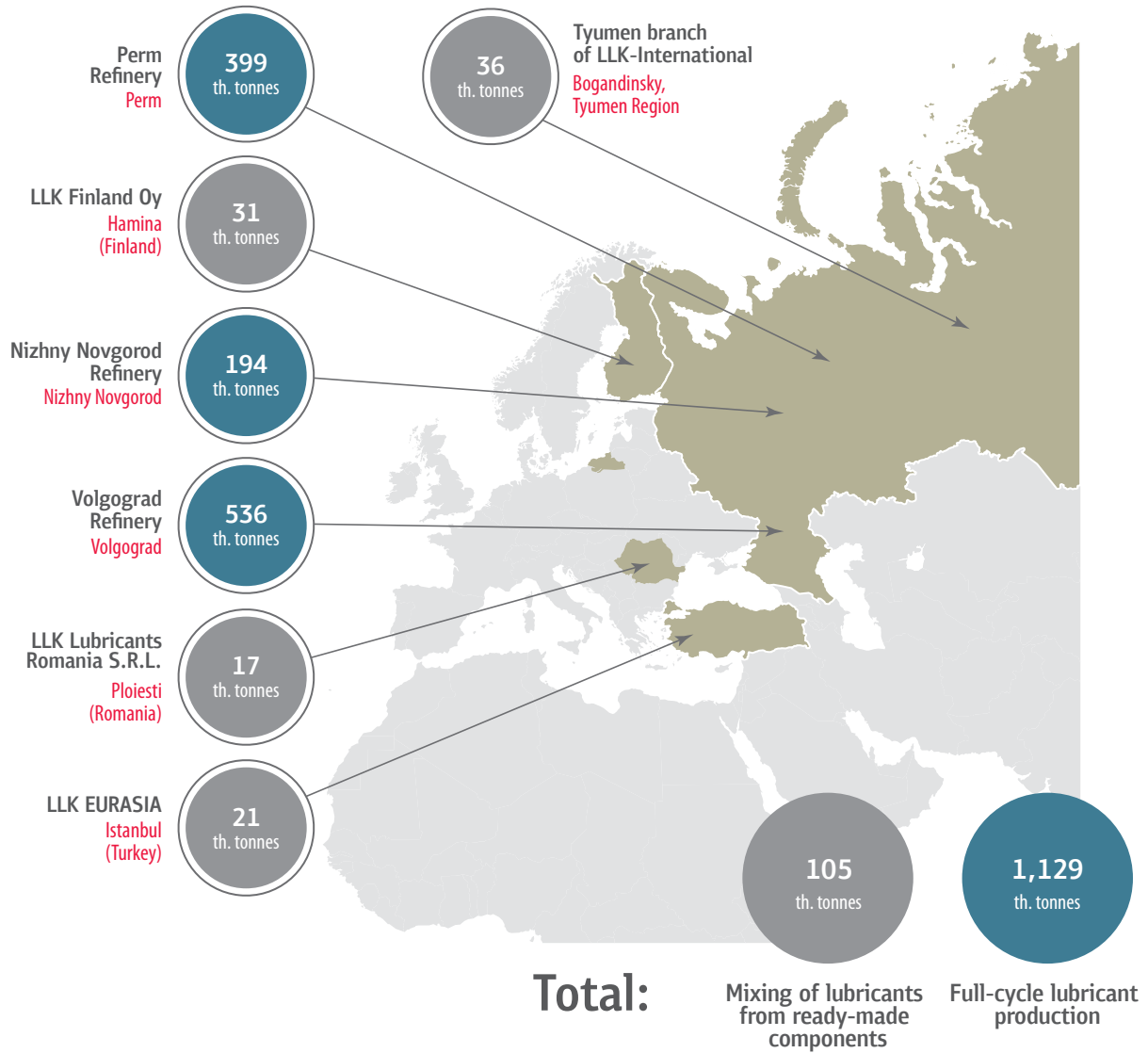
Change in output levels of petroleum products at Company refineries in 2012 compared with 2011, %<sup>1</sup>



<sup>1</sup> Excluding mini-refineries and the ISAB and Zeeland complexes.

# Production of Lubricants

## Lubricant production at LUKOIL Group refineries



## LUKOIL is the leader on the Russian market for lubricants

Around

**48** %  
Group share in Russian lubricant production

Lubricant production totalled 1,129 thousand tonnes in 2012 (including mixing from ready-made components). Branded lubricant production was 358 thousand tonnes in 2012, which is a 13.3% more than in 2011.

Lubricants are produced at Group refineries in Perm, Volgograd and Nizhny Novgorod. The Company also mixes lubricants from ready-made components (both produced by the Company and bought from third parties) at facilities in Russia, Finland, Romania and Turkey.

More than

**250** lubricant products

Work is underway to launch production of 39 newly designed products, including synthetic oils for automatic gearboxes, and 93 OEM approvals have been obtained. LUKOIL lubricants have more than 400 currently valid official approvals from machinery and equipment manufacturers.

LUKOIL continued its program to develop import-substituting lubricant products in 2012. LUKOIL lubricants became the first Russian-made products to be used for first-fill of new vehicles at the SAMAVTO plant, which assembles ISUZU buses in Uzbekistan. Company lubricants will also be supplied for first-fill of Chance automobiles (based on the Chevrolet Lanos) and agricultural machinery under an agreement with the Kazakhstan automotive assembly company, Agromashholding.

LLK-NAFTAN, the joint venture of LUKOIL and the Naftan Refinery (Belarus), met 44.4% of LUKOIL's requirements for additives used in lubricant production in 2012. The JV has increased output by several times since its creation in 2006.

The Company continued its expansion on the international market for marine engine lubricants during 2012. Tests were carried out and approvals obtained from MAN/B&W for the high-alkali oil, LUKOIL NAVIGO MCL100, which was launched on the market in 2012. It was established that amounts of lubrication required when using LUKOIL NAVIGO are less than for other competing products, making LUKOIL products the lubricant of choice for use in the most up-to-date and powerful ship engines.

in

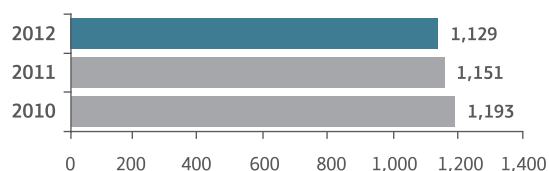
**103** countries around the world  
Company lubricants are sold

Entry to new markets in South Korea, Taiwan, Saudi Arabia, India and Bangladesh, together with expansion of the global distribution network, enabled increase of sales volumes by 75% in 2012 and increased the number of countries where LUKOIL maritime engine lubricants are available to 64.

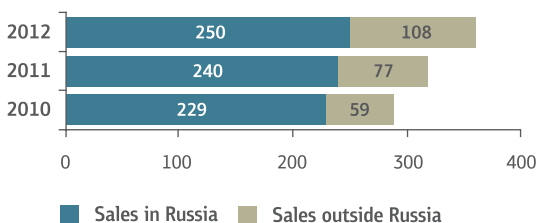
In 2012 the Company launched a new range of oils for vehicle engines, LUKOIL GENESIS, on the European market. The oils are produced at the Company's production platforms in Europe (Finland and Romania). The LUKOIL GENESIS PREMIUM and LUKOIL GENESIS FE products were the first lubricants made by a Russian company to obtain approval from the international automotive industry leader, General Motors, compliant with the GM dexos™ standard.

Cooperation with foreign vehicle manufacturers plays an important role in Company business. As well as producing lubricants for sale to vehicle users, LUKOIL is strengthening its positions as a supplier of first-fill lubricants to manufacturers. Work to develop this business led to the signing of contracts in 2012 for supply of LUKOIL GENESIS FE oils to Opel and Chevrolet assembly plants in Kaliningrad and to the GM Powertrain engine-building plant in Tashkent (Uzbekistan). LUKOIL also worked with technical specialists from Renault to develop the new LUKOIL GENESIS RN 5W-40 oil for first-fill of Renault engines at the Russian car maker, AvtoVAZ. Work with vehicle manufacturers will continue in 2013 in order to develop new products and to arrange the production and supply of LUKOIL lubricants to service networks.

Lubricant production at Company refineries, th. tonnes



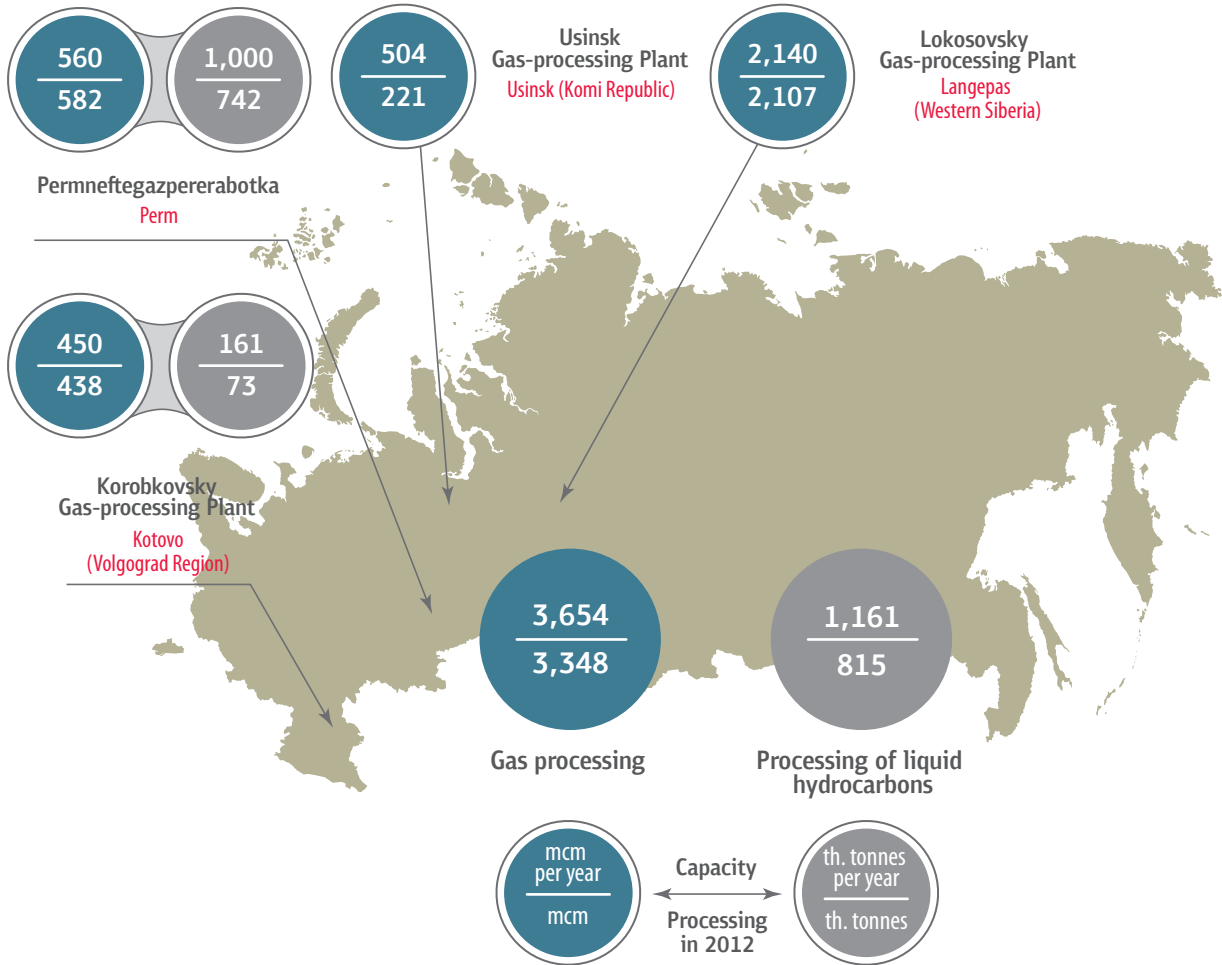
Sales of branded lubricants, th. tonnes





# Gas Processing

## Gas-processing plants of LUKOIL Group





LUKOIL's gas-processing plants process associated petroleum gas from fields in Russia into marketable gas (fed into the Gazprom gas pipeline system) and liquid hydrocarbons.


**3,348** million cubic meters  
gas processing

In 2012 the Group's gas-processing plants processed 3,348 million cubic meters of gas feedstock (+4.7% to 2011) and 815 thousand tonnes of liquid hydrocarbons (+9.8% to 2011). The increase in gas processing was due to higher demand for outputs.

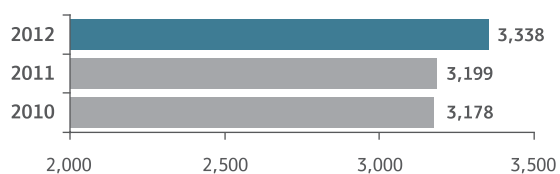
Company plants produced 2,652 million cubic meters of stripped gas, 978 thousand tonnes of liquefied gas, 696 thousand tonnes of natural gas liquids and 190 thousand tonnes of liquid hydrocarbons (stable gas naphtha, isopentane, propane-butane-pentane and hexane-heptane fractions).

Work began at the **Usinsk Gas-processing Plant** on reconstruction of an input compressor station and installation of a sulphur-removal unit.

Reconstruction of the low-temperature condensation and rectification unit is planned at the **Perm Refinery**.

 [Fact Book, p. 81](#)  
[Analyst Databook, p. 51](#)

Processing of petroleum and fat gas, million cubic meters



# Petrochemicals

## Petrochemical Plants of LUKOIL Group

### PETROCHEMICAL PLANTS

**Saratovorgsintez** **Saratov (Russia)**  
 Acrylonitrile, sodium cyanide  
 and other organic synthesis products

**Stavrolen** **Budennovsk  
 (Stavropol Region, Russia)**  
 Polyethylene, polypropylene  
 and other products

**Karpatneftekhim** **Kalush (Ukraine)**  
 Polyethylene, caustic soda  
 and other products

### REFINERIES WITH PETROCHEMICAL UNITS

**Neftokhim  
 Burgas** **Burgas (Bulgaria)**  
 Polymers





**LUKOIL’s strategy in the petrochemicals segment is to achieve value-added through synergies with gas production and oil refining businesses.**

Company plants in Russia, Ukraine and Bulgaria produce pyrolysis and organic synthesis products, fuel fractions and polymer materials. LUKOIL meets a large share of Russian domestic demand for various chemicals and is a major exporter of chemicals to more than 30 countries worldwide

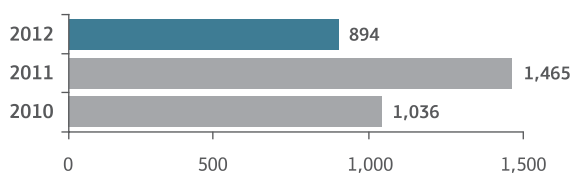
Output volumes at LUKOIL’s petrochemical plants in 2012 totaled 894.4 thousand tonnes, which is 39.0% less than in 2011. The output decline was due to downtime at the Stavrolen plant due to repair work and lower levels of production by Karpatneftekhim in response to a weak market environment.

Work was carried out in 2012 for modernization of existing production capacities and the creation of new capacities as part of LUKOIL’s strategy for development of its petrochemical business.

Planning work began for installation of a second sodium cyanide production line at **Saratovorgsintez**. A highly important project at **Stavrolen** is for creation of a processing complex, which will receive gas inputs from fields in the Northern Caspian. The first line of a gas-processing plant with capacity for 2 billion cubic meters of gas is scheduled for launch in 2015, when modernization of existing ethylene and polyethylene units should also be completed. Preparation of project documents and working documents has begun for re-equipment of existing ethylene capacities in order to ensure maximum processing of liquefied gases.

 **Fact Book, p. 83**  
**Analyst Databook, p. 57**

Production of petrochemicals, th. tonnes



3

# POWER GENERATION






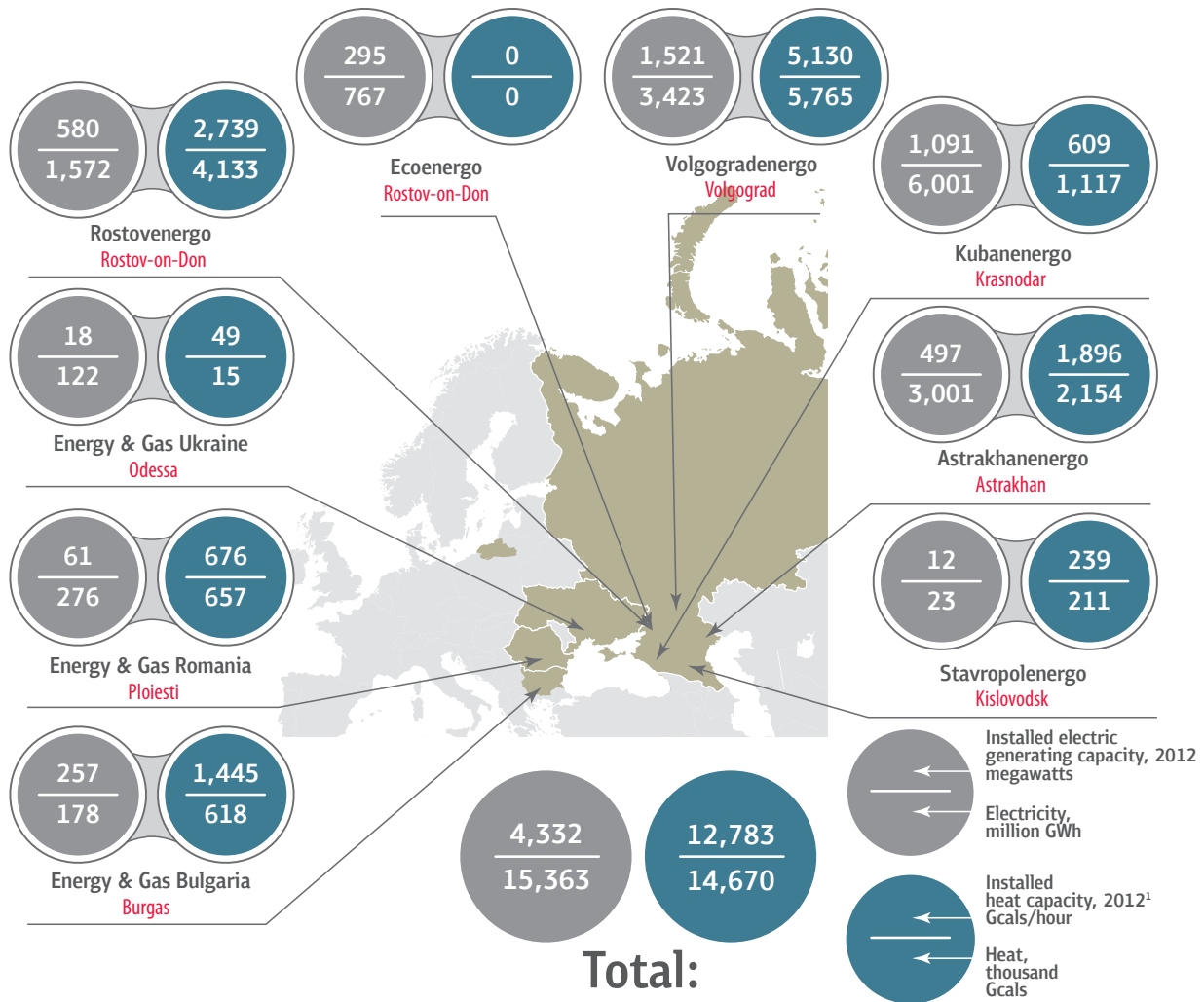
**LUKOIL's power business comprises generation as well as delivery and sale of electrical energy and heat produced at power plants.**

The nucleus of the segment is the Russian power generating company, UGK TGK-8, which was acquired by LUKOIL in 2008, but it also includes companies producing electricity and heat at Company refineries in Bulgaria, Romania, and Ukraine.

This business sector provides energy both for the Company's own needs (in the exploration & production and refining & marketing segments) and for the needs of external power and heat customers in the Southern Federal District of Russia.

 **Fact Book, p. 86**  
**Analyst Databook, p. 54**

## LUKOIL power generating companies



<sup>1</sup> With accounting of boiler stations.

### GENERATION OF ELECTRICITY AND HEAT ENERGY

Total electricity output in 2012 by companies in LUKOIL's electricity division was 15.4 billion kWh and heat output was 14.7 million Gcal, of which 13.4 million Gcal in Russia. Levels of electricity and heat production were dictated by conditions on the electricity market.

Main achievements by the division in 2012 were as follows:

- Combined cycle gas turbine-410 at LUKOIL-Kubanenergo entered the wholesale market for electrical energy and capacity.
- LUKOIL-ENERGOSERVICE entered the wholesale market for electrical energy and capacity in Western Siberia and Nizhny Novgorod regions.
- The Cherga wind generating station in Bulgaria (40 megawatts capacity) was acquired.
- Switching unit-110 was commissioned at the Krasnaya Polyana hydroelectric station to ensure dependable supplies of electricity to Olympic facilities.



**SMALL-SCALE GENERATING**

Development of the Group’s own small-scale electricity generating facilities at fields enables substantial reduction of electricity purchases and increases the rate of use of associated gas through gas-fired electricity generation. The Company has small-scale generating capacity amounting to 661 megawatts. Electricity generation at company facilities in this segment were 2,349 kWh in 2012.

**ENERGY-SAVING TECHNOLOGIES**

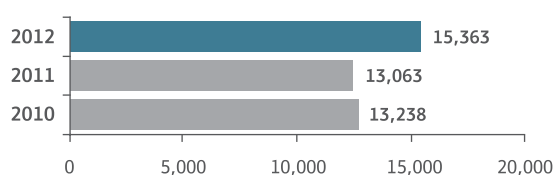
The Company’s energy management program represents a permanent mechanism, which helps LUKOIL enterprises to improve their energy efficiency. The system should be extended to all LUKOIL Group organizations by the end of 2015, by which time it will also be ISO 50001 certified.

**RENEWABLE ENERGY**

During 2012 LUKOIL continued to develop its partnership in the field of renewable energy with the Italian company ERG, which has long experience in the construction and operation of renewable energy facilities. The joint venture, LUKERG Renew GmbH, acquired 100% of the Romanian company Land Power SRL, which has rights to build a wind generating plant in Romania. Construction of the plant, consisting of 42 wind generators with total capacity of 84 megawatts, is due to begin in 2013, and annual output from the plant will be in excess of 200 thousand mWh.

Also in the reporting year LUKOIL completed the acquisition of two wind plants in Bulgaria – Kavarna (32 megawatts) and Long Man (8 megawatts) – from Raiffeisen Energy Environment. The plants operate 20 wind turbines (each 2 megawatts) built by the company Vestas. Total output in 2012 was 101,882 kWh (121% of the annual target).

Electricity output, mln KWh





SALES OF CRUDE OIL

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GAS SALES

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GAS PRODUCTION  
AND SUPPLY  
STRUCTURE

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PETROLEUM PRODUCT  
MARKETING

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PRODUCTION AND SUPPLY STRUCTURE  
OF LUKOIL SUBSIDIARIES

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## SALES AND MARKETING





## Strategy:

- **Logistics optimization: reduction of transportation expenses**
- **Efficient management of trade flows**
- **Increase of efficiency in trading operations**
- **Increasing retail sales of fuel and of related goods and services**
- **Retail network optimization**

## Development of the Company's own transport infrastructure substantially reduces cost inflation.

The positive effect in 2012 from use of LUKOIL's own transport and logistics facilities for export of crude and petroleum products from Russia, as compared with alternative delivery routes, is estimated at about \$650 million in current market conditions.

**Completion in 2012 of the Kharyaga-Yuzhnoye Khylichuyu pipeline, which connects Company fields, represents an important step in development of LUKOIL's transport infrastructure.** Launch of the pipeline will shorten the payback period for the Varandey terminal by substantially increasing capacity use at Varandey. The new pipeline will also enable LUKOIL to cut its costs on transport of crude oil through the Baltic Pipeline System, as well as reducing load factors in the Kharyaga-Usa field-to-field pipeline and the Usa-Ukhta and Ukhta-Yaroslavl trunk pipelines, all of which are currently operating close to their capacity.

Construction work was also completed on the main compressor station for the gas transport system from fields in the Bolshekhetskaya Depression. Pre-commissioning work is now being carried out.

**Fact Book, p. 93**

As part of its efforts to expand transport infrastructure LUKOIL launched a new petroleum product terminal during 2012 in the port of Barcelona in Spain. The terminal will be used for re-export and distribution of diesel and jet fuel in Spain, and also for transshipment of biofuels. Substantial reservoir facilities make the terminal a major Mediterranean hub for transshipment of petroleum products with 1 million cubic meters capacity.

**Fact Book, p. 92**

## Pipeline Kharyaga–Yuzhnoye Khylichuyu

### FEATURES

Total length – 158 km.  
Throughput capacity – 4 million tonnes per year.

### PURPOSE

The pipeline is intended for transport of marketable crude oil from the Sever-TEK terminal (Kharyaga) to the Yuzhnoye Khylichuyu oil delivery point for subsequent transportation via the Yuzhnoye Khylichuyu–Varandey pipeline.

### TECHNOLOGY

The Kharyaga-Yuzhnoye Khylichuyu pipeline is fitted with the LeakSPY leak-detection system, which has already shown its efficacy in use on other pipeline routes. A high-strength anti-corrosion covering is used on underground sections of the pipeline. Surface sections are covered with reinforced heat insulation. Regular internal diagnostics will be carried out when the pipeline is in use.



Oil type	API density	Sulphur content	Tonnes-to-barrels conversion ratio
Kharyaga	39	0.3%	7.6
Brent	39	0.4%	7.6
Urals	31	1.2%	7.2

## Sales of Crude Oil

### Total volume of crude oil sales by the Company in 2012 including deliveries to the Company's own and third-party refineries, was 105 million tonnes.

Substantial volumes of oil were reallocated from export to the Company's Russian refineries and the domestic market due to increased efficiency of domestic crude sales in comparison with most non-CIS export markets. As in previous periods, the most efficient use of crude oil produced by the Company was refining at Russian refineries. Deliveries to Group refineries in Russia during 2012 totaled 44.4 million tonnes.

A total 162 thousand tonnes of crude oil were purchased from third-parties and delivered to the Nizhny Novgorod and Ukhta Refineries, enabling the Company's own oil to be reallocated to the most efficient export routes.


Deliveries of crude oil to LUKOIL's foreign refineries and to the ISAB and Zeeland complexes amounted to 21.6 million tonnes in 2012, which is 10.1% more than in 2011. Most of the growth was attributable to an increase of the Group's share in ISAB. A total 2.66 million tonnes of oil were delivered to third-party refineries, representing an increase of several times in comparison with 2011 due to growth in volumes processed at refineries in Belarus.

Some 4.5 million tonnes of crude oil were sold on the domestic market in 2012, representing an increase of 1.7% over 2011. This oil is sold on the basis of formulas, which provide a premium in comparison with the export alternative.

Export of crude oil from Russia by LUKOIL subsidiaries (including oil obtained from third parties) amounted to 34.7 million tonnes in 2012. The share of deliveries via the Transneft pipeline system grew to 87.7%, due mainly to decline of output at the Yuzhno-Khkhylchuyuskoye field, which dispatches its oil via the Company's own terminal at Varandey.

A total of 4.2 million tonnes of crude oil were exported via the Company's own terminals (3.2 million tonnes through Varandey and 1.0 million tonnes through the port of Svetly).

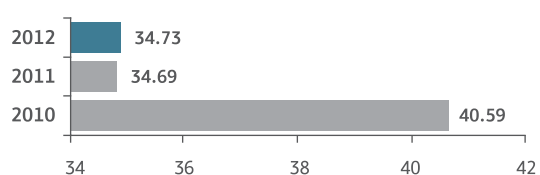
Crude oil sales on the international market (including exports) were 34.7 million tonnes, of which 4.3 million tonnes in the CIS and the remainder outside the CIS. Total crude oil sales on Russian and international markets in 2012 were 39.2 million tonnes, which is 18.8% less than in 2011.

 [Fact Book, p. 94](#)  
[Analyst Databook, p. 62](#)

Structure of crude oil sales, %



LUKOIL crude oil exports from Russia, million tonnes



<sup>1</sup> Including petroleum products delivered to ISAB and Zeeland.

## Gas Sales

### Volumes of natural, associated and stripped gas sold by LUKOIL Group in 2012 were 19.934 billion cubic meters, which is 10.5% more than in 2011.

The figure includes 9.646 billion cubic meters of gas sold to Gazprom and its affiliates (of which more than 8.0 billion cubic meters of natural gas from the Company's Nakhodkinskoye field) and 4.611 billion cubic meters to other consumers (including deliveries to the Group's gas-processing plants).

Growth of prices and of the share of gas sold to end-users via highly efficient channels led to rise of the average-weighted selling price by 29% in comparison with 2011 to 1,665 rubles per 1000 cubic meters (1,590 rubles per 1000 cubic meters in sales to Gazprom and 1,857 rubles per 1000 cubic meters in sales to end users).

#### Cooperation with Gazprom

LUKOIL reached agreement with Gazprom in the reporting year on deliveries of 8.35– 12.11 billion cubic meters of gas from fields in the Bolshekhetskaya Depression during 2012–2016. The agreement will enable prices for gas deliveries to be indexed starting from 2012 in accordance with rates and periods of change in the average regulated wholesale gas price for all categories of

consumers in Russia (except households). Gas was previously delivered at fixed prices without indexation. The agreement also states that Gazprom will make every effort to accept all of LUKOIL's gas output from fields in the Northern Caspian into its gas transport system after LUKOIL begins production in that region and will deliver equivalent amounts to LUKOIL enterprises.

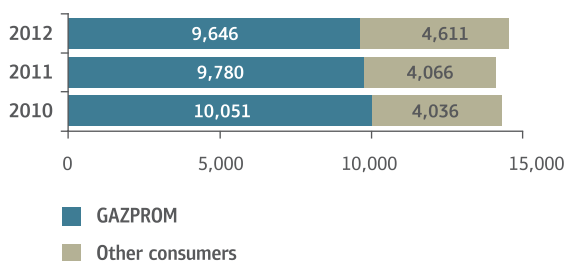
A protocol was signed in 2012, by which starting from the fourth quarter Gazprom's regional gas sales companies will supply additional volumes of gas for LUKOIL's generating needs at prices equal to the minimum set by the Federal Customs Service, without any price-raising coefficients.

Thanks to intensive work by Company specialists, amendments have been made to the principles by which gas transportation tariffs via the Gazprom pipeline system are calculated for external producers. The amendments enable efficient transportation of gas over large distances.

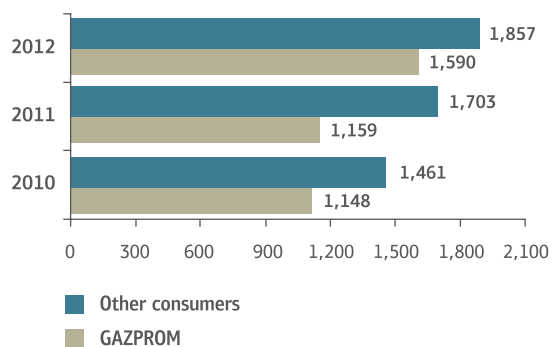
#### Supplies of associated petroleum gas

A long-term agreement (2013–2022) has been signed with OJSC E.ON Russia for delivery by LUKOIL-PERM of 2.4 billion cubic meters of associated gas to the Yayvinsky Power Station. This represents a major step towards meeting targets for use of associated gas production in Perm Territory.

Structure of gas sales by LUKOIL, million cubic meters



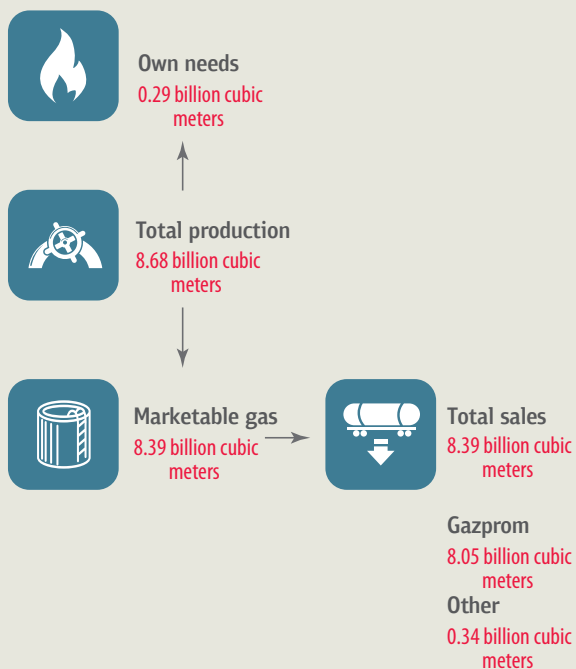
LUKOIL selling price for gas, rubles per th. cubic meters



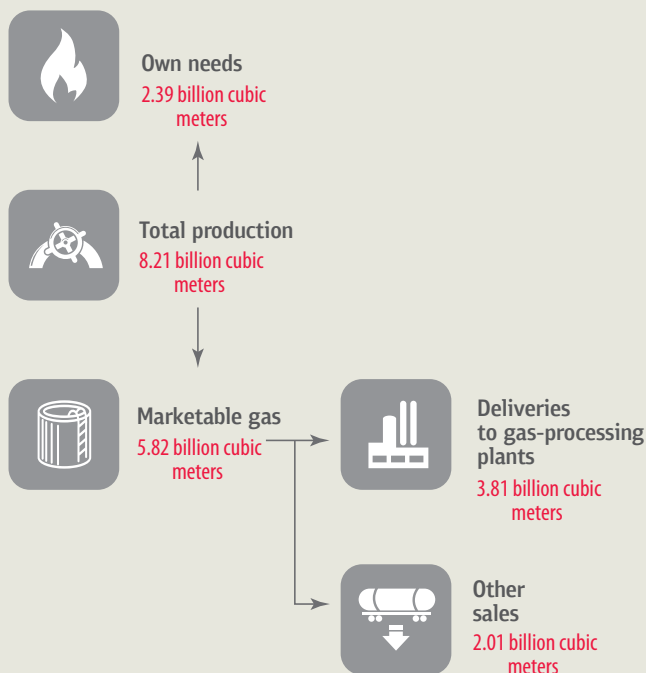
# Gas Production and Supply Structure

## RUSSIA

### Natural gas

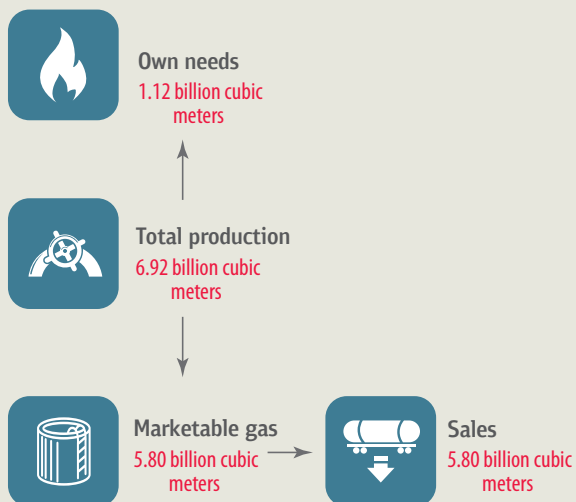


### Associated gas

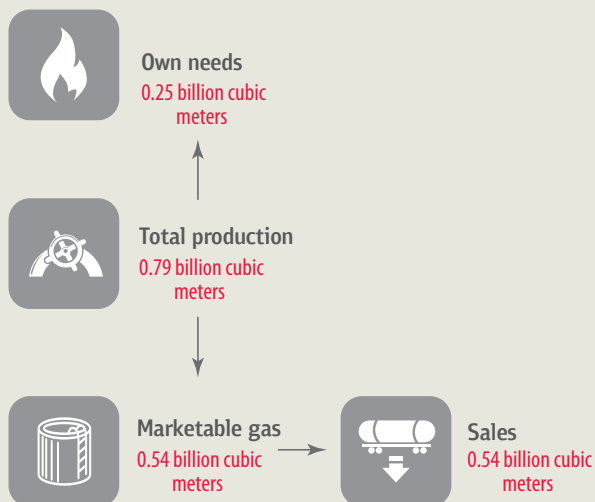


## INTERNATIONAL

### Natural gas

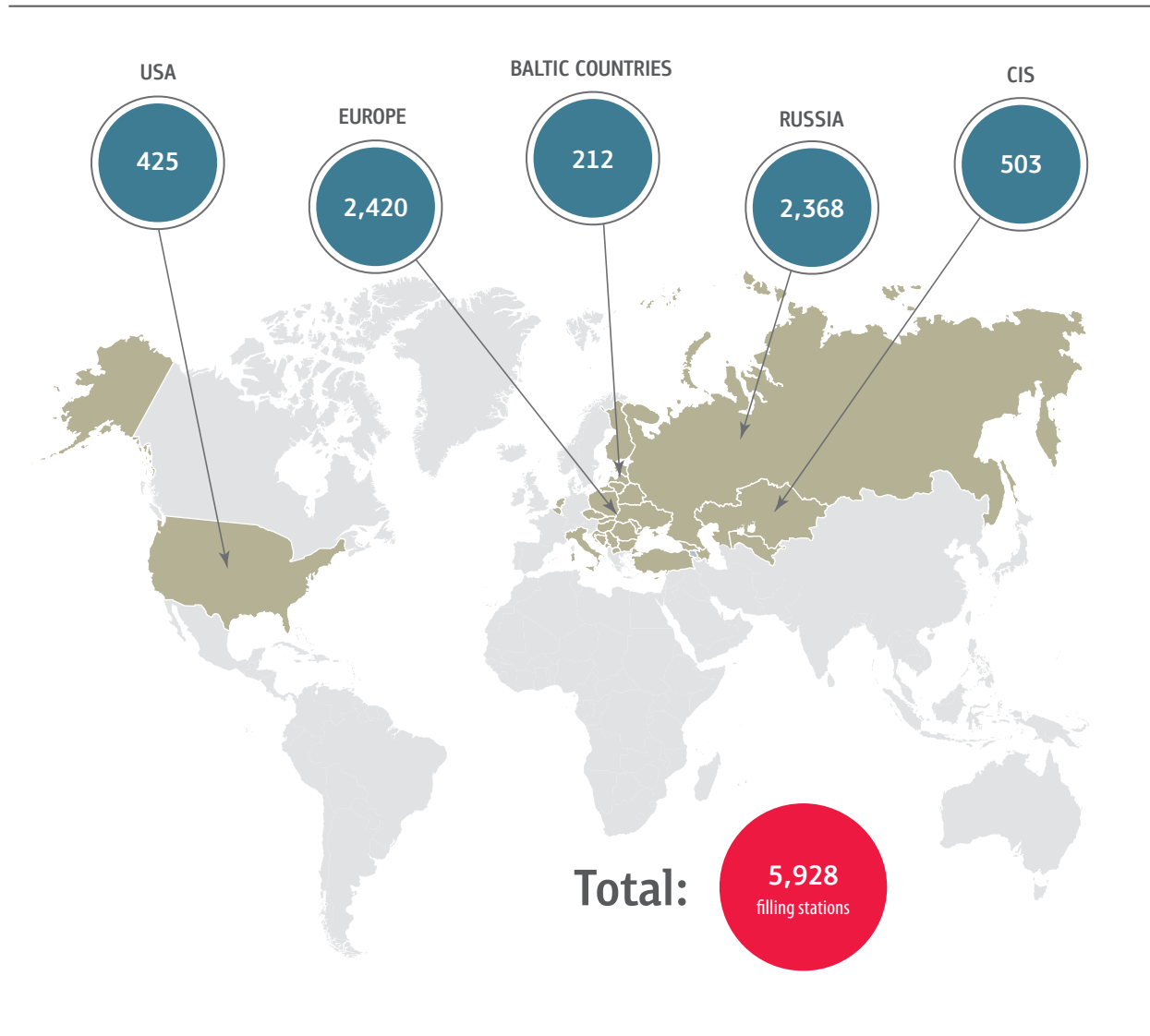


### Associated gas



## Petroleum Product Marketing

LUKOIL retail network (number of filling stations)



**PETROLEUM PRODUCT AND PETROCHEMICAL WHOLESALE**

LUKOIL sold 11.6 million tonnes of petroleum products to wholesale customers on the **domestic market** in 2012, representing an increase of 5.6% compared with 2011.

**Export of petroleum products** declined by 6.2% in 2012 to 22.5 million tonnes as deliveries of medium distillates to the domestic market were increased. The structure of exports remained unchanged in the reporting year: company exports were dominated by diesel fuel, fuel oil and gasoil, which together accounted for 89% of total product export volumes. The Company’s petroleum product export structure mainly corresponds to the structure of product exports from Russia as a whole.

Railway remained the chief means of transport for Group exports of petroleum products (about 77% of the total). Products were carried by railway to the Vysotsk terminal,

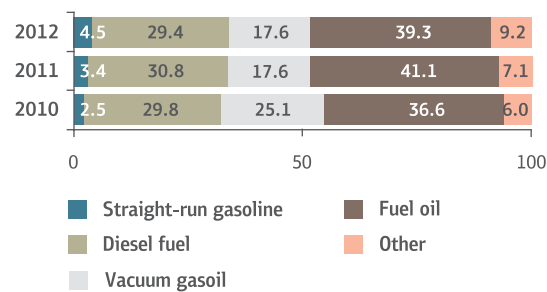
via which 10.5 million tonnes of products were dispatched in 2012 (including 0.01 million tonnes of vacuum gasoil, 2.0 million tonnes of diesel fuel and 6.9 million tonnes of fuel oil).

Exports of petroleum products were also carried by river and sea transport, and by pipeline (13 and 10% of export volumes respectively).

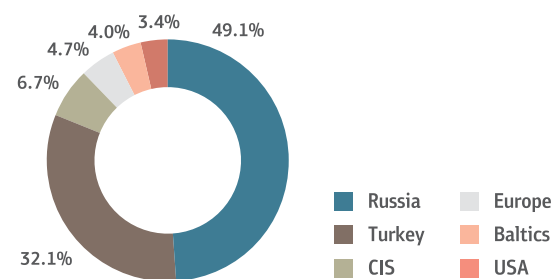
LUKOIL is rapidly developing its **international petroleum product trading business**, increasing both scale of the business and international diversification. LUKOIL has trading offices in nine countries worldwide and makes deliveries of crude oil and petroleum products to markets in Europe, the USA and the Asia-Pacific region, as well as increasing its sales volumes in new regions (Africa, Latin America and the Middle East). The Company had trading business in 90 countries worldwide during the reporting year.

 [Analyst Databook, p. 63](#)

Structure of petroleum product exports, %



Structure of petroleum product sales in 2012 (own production, wholesale and retail)





## BUNKERING

Nearly  
**30** %  
 Group share of bunker fuel volumes sold in Russia

The Group subsidiary, LUKOIL-BUNKER, carries out refueling of ships at Russian sea and river ports, wholesale supplies of ship fuel. Volumes in this business increased by 17% in 2012 compared with 2011 to a level of 2.5 million tonnes.

LUKOIL has bunkering operations at ports in five regions of the Russian Federation. Most of the business is at ports on the Baltic, Barents and Black seas, and also on Russia's inland waterways.

 Fact Book, p. 98

## AIRCRAFT REFUELING

Nearly  
**26** %  
 Group share of jet fuel supplies on the Russian market

The group subsidiary LUKOIL-AERO supplies jet fuel (mainly into-plane refueling at airports in Russia and in other countries) via a network of its own subsidiaries or through contracts with refueling companies. Into-plane refuelling grew by 16% in 2012 to a level of 1.3 million tonnes.

LUKOIL-AERO manages the allocation of all the jet fuel produced at LUKOIL group refineries in Nizhny Novgorod, Volgograd, Perm and Ukhta. LUKOIL also purchases jet fuel from third parties for resale if production at its own refineries is insufficient to meet the needs of customers.

The main customers of LUKOIL-AERO for many years have been leading Russian airlines and civil aviation companies.

## Into-plane refueling



## RETAIL FUEL SALES

**9.1** tonnes per day  
 average sales volume per filling station

LUKOIL's retail network operated in 27 countries at the start of 2013, including Russia, CIS and European countries, as well as the USA. The network included 183 storage facilities with total reservoir capacity of 2.7 million cubic meters and 5,928 filling stations (including franchised).

**Retail sales of petroleum products through owned and leased filling stations increased by 1.1% in the reporting year compared with 2011 to a level of 15.9 million tonnes.**

Increase of overall retail sales volumes of petroleum and gas products was due to 6.5% increase of volumes on the Russian market in comparison with 2011, caused by growth of demand for high-quality fuels as vehicle ownership in Russia increases.

Investments in development of the retail distribution chain totaled \$388 million in 2012.

The Company continued to implement its program for development of a marketing and sales network for liquefied and compressed gas in 2012. Total Group sales of these products were 910 thousand tonnes, which is 2.1% more than in 2011.

### Optimizing the retail chain

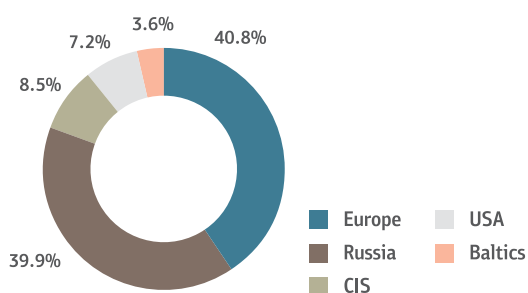
During the reporting year the Company pursued its efforts to optimize the retail chain with the objective of reducing costs and raising efficiency. These actions affected 93 filling stations in Europe and the CIS countries, except Russia, during 2012 (38 stations were leased, 8 were closed down, 39 were transferred to dealer management and 8 were sold).

In Russia itself, 46 stations were affected (19 were leased, 3 closed down and 24 sold) as well as 6 storage sites (1 was leased, 3 sold, 2 were mothballed). Work also continued on construction and acquisition of highly efficient stations and reconstruction of those already in ownership. In Europe and the CIS countries, except for Russia, LUKOIL built 7 new stations, acquired 61 and refurbished 92. In Russia the Company built and opened 28 new filling stations, refurbished 73 existing stations and made 43 acquisitions.

### Non-cash payment

The Company continued to develop its system for non-cash payment by customers at its filling stations in 2012, using the LICARD fuel card system. A total of 2,738 filling stations in Russia (including franchises) were capable of accepting the cards for payment at the start of 2013. There were 1,004 stations using the cards outside Russia. The total volume of fuel sales using LICARD was 6.3 million tonnes in 2012 with total value of \$6.1 billion, including about 4.6 million tonnes sold in Russia.

LUKOIL retail network



### Customer loyalty

LUKOIL has implemented a loyalty program for its retail customers since the middle of 2010. The program had 2.9 million participants in Russia by the start of 2013. Total fuel sales using loyalty cards in 2012 were about 2 million tonnes of petroleum products.

### Non-fuel sales

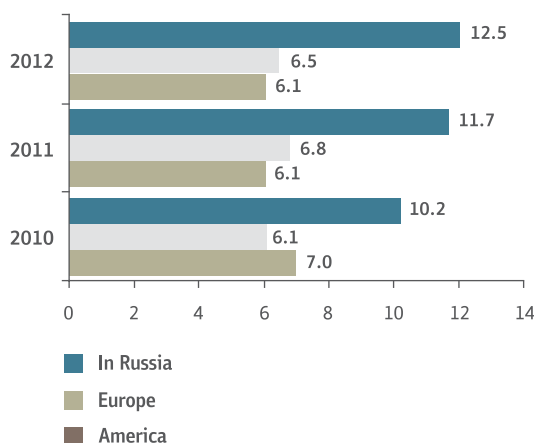
Revenue from non-fuel sales and services at the Company's filling stations in Russia amounted to \$253 million in the reporting year, which is 9% more than in 2011. The corresponding sum in Europe and the CIS was \$456 million. The Company plans to further increase non-fuel revenues through marketing, optimization of the product range, improvement of fast-food services at filling stations, new service additions, work with major suppliers, use of best trading practices, and better standards of customer service.

### EKTO fuel

Work continued to promote the Group's EKTO fuel brand on foreign markets (in Lithuania, Latvia, Estonia, Ukraine, Romania, Turkey, Moldova, Bulgaria, Macedonia and Croatia). The geography of EKTO sales is expanding year by year. Total sales of EKTO fuel (diesel and gasoline) outside Russia in 2012 were about 1 million tonnes, via more than 1,128 filling stations.

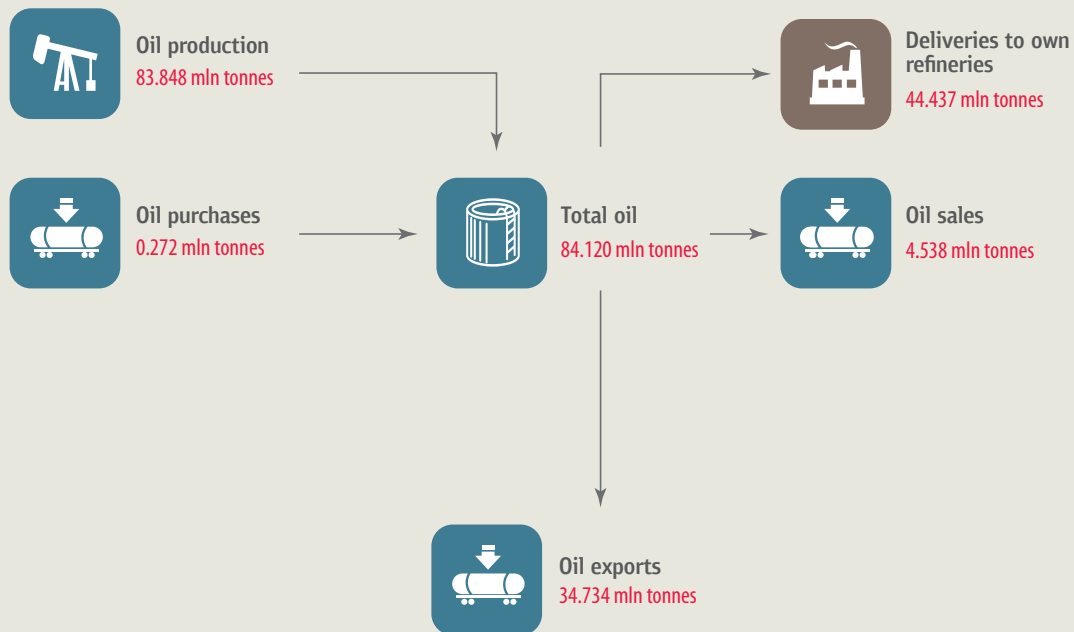
[Fact Book, p. 96](#)  
[Analyst Databook, p. 64](#)

Average sales of petroleum products per filling station, tonnes per day

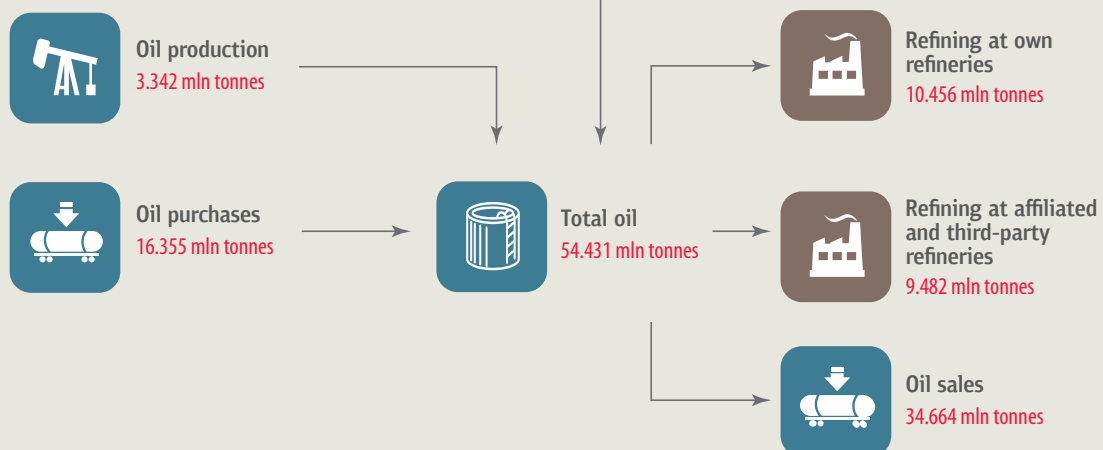


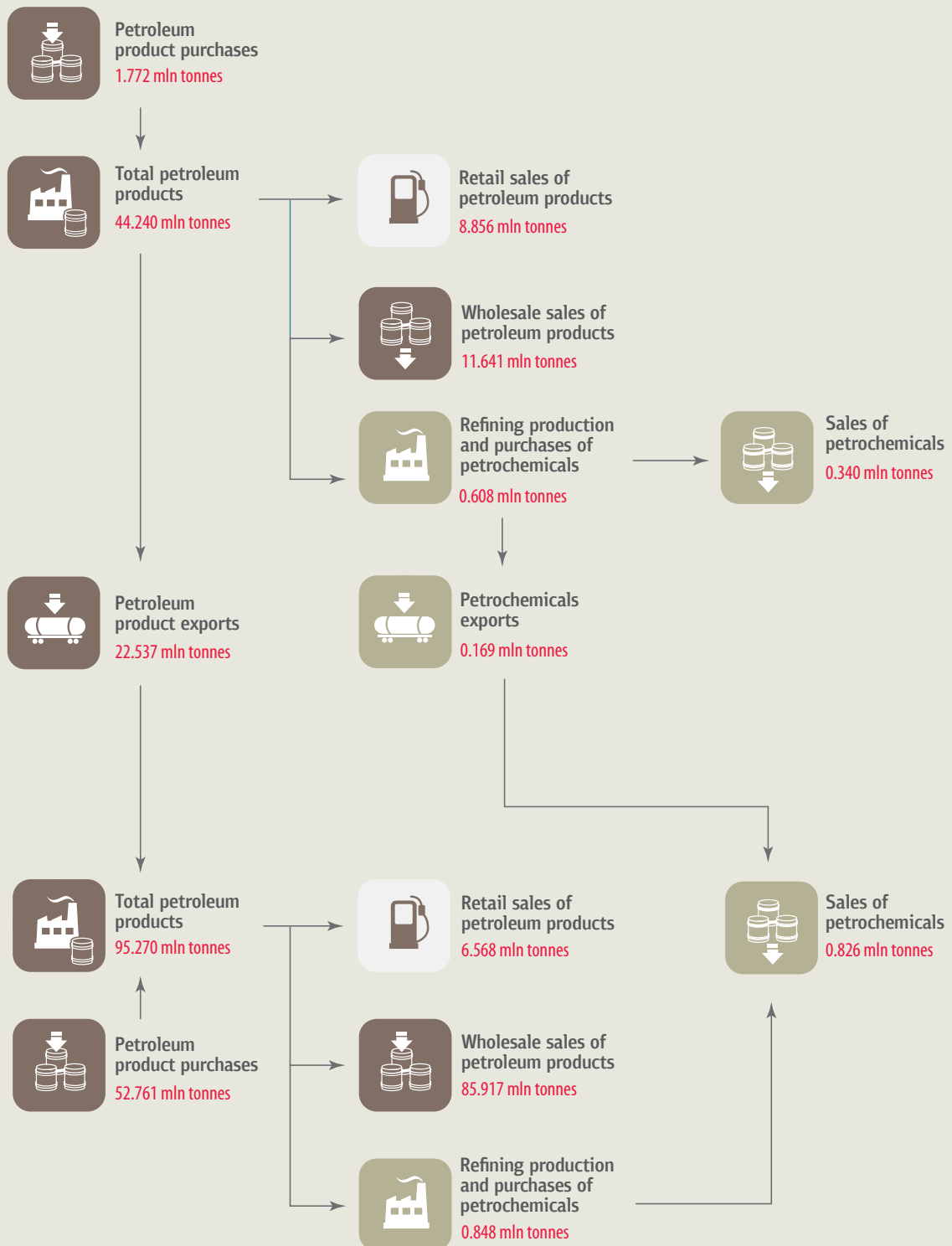
# Production and Supply Structure of LUKOIL Subsidiaries

## RUSSIA



## INTERNATIONAL





5

# TECHNOLOGY AND INNOVATION





More than  
**\$ 157** million  
 R&D financing in 2012

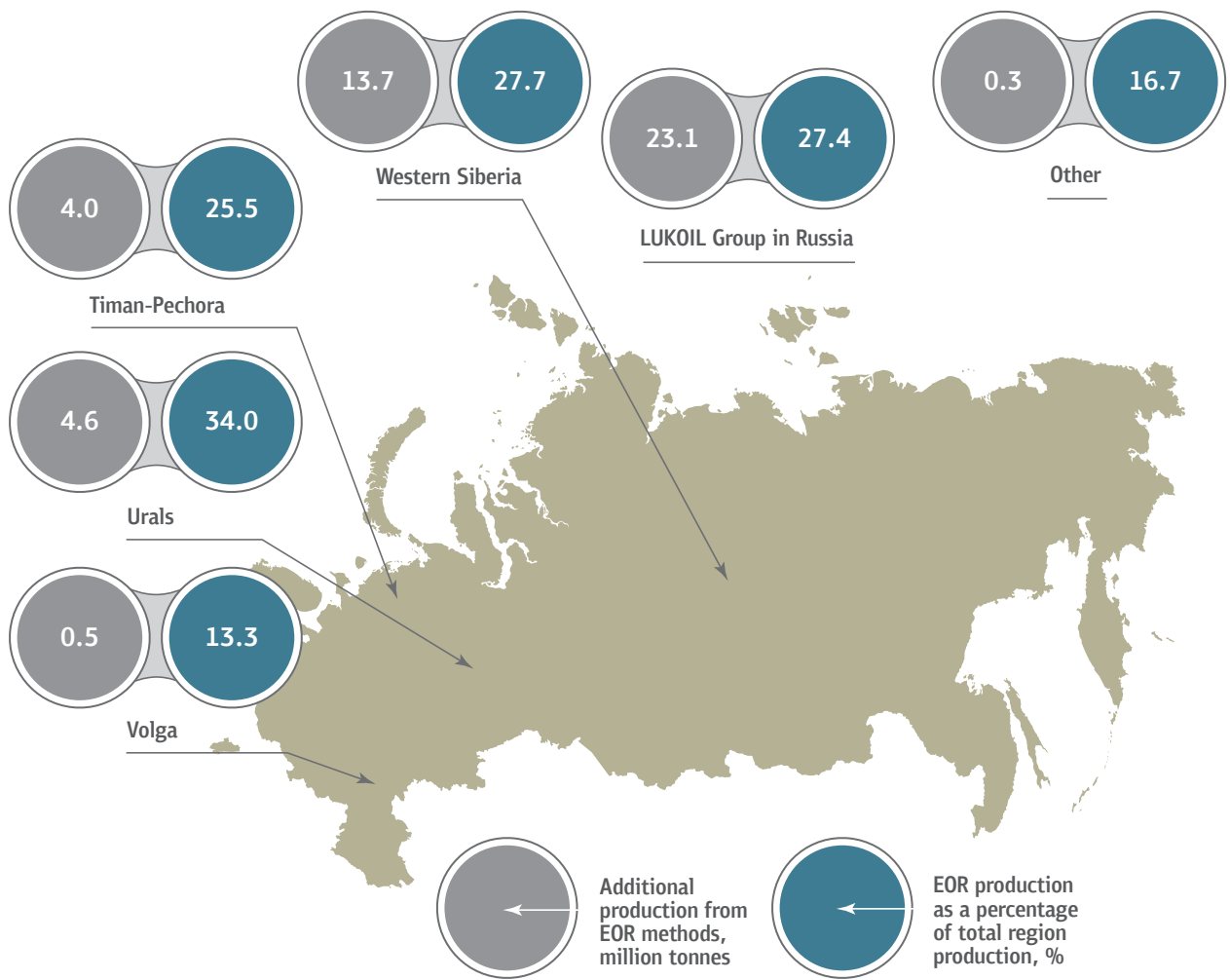
**Innovation and the use of new technologies are among the main competitive strengths of LUKOIL. Company specialists both design new technologies and work to modernize existing technologies.**

A project to create innovative technologies for improvement of oil recovery rates through integration of heat and gas methods was presented in 2012 in the framework of cooperation between RITEK and the Skolkovo Foundation. A RITEK subsidiary, RITEK-ITs, was set up for purposes of project implementation and became a participant of the Skolkovo Foundation in 2012.

The Group continued to work closely in 2012 with the Russian Corporation of Nanotechnologies (RUSNANO) on commercialization of nanotechnologies with applications in the oil & gas industry. RITEK carried out joint work with RUSNANO during the accounting year on innovative developments for extraction of difficult reserves in Bazhenov formations. Testing of mini-GTL technologies was also carried out as part of R&D work on techniques for refining of associated petroleum gas into liquid hydrocarbons.

# Exploration and Production Technologies

## Effect from EOR in Russia



## LUKOIL is the Russian oil & gas industry leader in efficient application of new technologies in the upstream segment

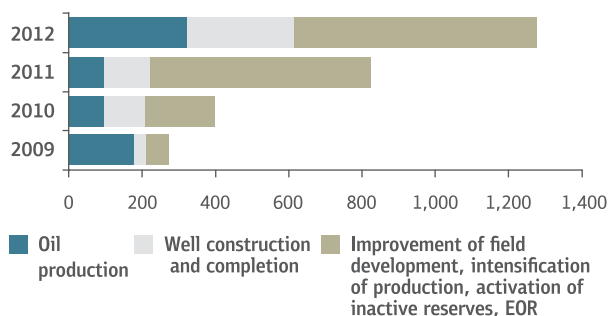
R&D work in the business segment during 2012 was focused on development of geological and geophysical study techniques, improvement of reserve assessment methods (work continued on a methodology to assess hydrocarbon reserves in reservoirs with complex structure), as well as design and improvement of methods for increasing oil recovery and optimal technology solutions for the development of new areas and deposits. The Company is keen to develop technologies that ensure environmental safety during field development, particularly in development of offshore fields.

### NEW DRILLING TECHNOLOGIES

As well as expanding technology uses and the number of regions where they were applied, the Company worked in 2012 to adapt technologies that enable maximum contact with the reservoir and technologies for horizontal well completion with multi-zonal hydrofracturing at locations with carbonaceous and terrigenous formations. Good results were obtained from the use of these technologies during 2012 in the Urals region near Perm, the Komi Republic and in Western Siberian gas projects.

Breakthrough technologies used by LUKOIL in 2012 included drilling of horizontal wells with multi-zonal hydrofracturing of strata. A total of 99 wells with multi-zonal hydrofracturing were brought into operation in 2012 and gave average daily oil flows of 43.5 tonnes. Use of the technique was limited to Western Siberia in 2011, but it was extended to fields operated by LUKOIL-PERM and LUKOIL-Komi during 2012.

Number of actions at fields using new technologies



The latest technologies for down-hole well completion were increasingly used in construction of new wells during 2012. Production wells at the Yu. Korchagin field have been equipped with passive flow regulation systems (ResFlow) in order to prevent gas blowouts.

Scheduled work was carried out to equip wells with fiber-optic systems, which enable non-stop monitoring of the development process. To date fiber-optic systems have been installed at several wells producing from the permian-carbonaceous deposit at the Usinsk field, Well № 113 at the Yu. Korchagin field and at other wells.

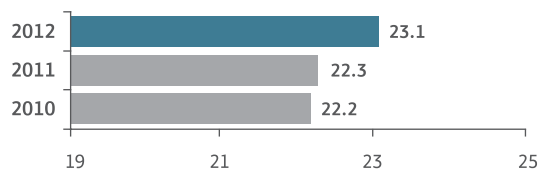
Analyst Databook, p. 24

### ENHANCED OIL RECOVERY TECHNIQUES

**27 %**  
 LUKOIL's crude oil production in Russia uses enhanced oil recovery techniques

One key outcome of the Company's technology drive is ever greater application of methods for intensification of oil production and of enhanced oil recovery (EOR) techniques. These methods offer significant increase of recoverable reserves and oil production, enabling commercial development of high-viscosity oil, oil in low permeability reservoirs, and hard-to-recover reserves at late stages of field development. The Company uses physical, chemical, hydrodynamic and heat methods to stimulate extraction.

Additional production from EOR in Russia, million tonnes





The Group carried out 5,605 EOR operations in 2012, which is 15% more than in 2011. Additional production obtained in Russia during the reporting year through the use of EOR techniques was 23.1 million tonnes. Most of the additional production (more than 15.1 million tonnes) was obtained using physical methods, primarily hydrofracturing.

The Group carried out 867 hydrofracturing operations at fields in 2012, achieving average additional oil flows of 8.1 tonnes per day.

Use of other EOR methods (hydrodynamic, heat, chemical methods and oil production intensification) gave 8 million tonnes of production. The Company continued to make extensive use of the latest chemical technologies in 2012 (there were 1,602 operations using chemical technologies in 2012 compared with 1,417 in 2011).

Drilling of sidetracks at existing wells has also proved a highly-efficient form of EOR. The Company continued to make extensive use of sidetracks in 2012, when 377 sidetracks were drilled with average daily output of 16.7 tonnes. Consistently high efficiency was achieved through experimentally-proven mini-projects with use of hydrodynamic modeling, as well as greater accuracy in forecasting of the geological structure of reserves at locations where sidetracks were drilled. Sidetracks are mainly used to extract residual oil reserves at wells, which have been taken out of operation.

### PRODUCTION OF HIGH-VISCOSITY OIL

LUKOIL is rapidly developing and applying new technologies for production of high-viscosity oils. The Russian Government

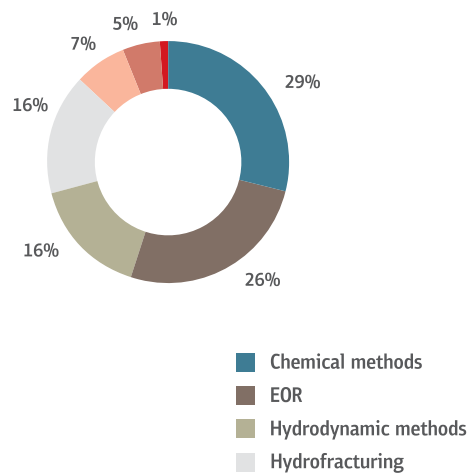
is taking steps to encourage production of high-viscosity oil, making it more profitable by means of preferential taxation. Work with high-viscosity oil extraction in Russia is concentrated in the Komi Republic, where LUKOIL is developing the Yaregskoye and Usinskoye fields. Thermal methods are used at both fields to increase oil recovery and annual production is in excess of 3 million tonnes.

The **permian-carbonaceous deposit at the Usinskoye field** is being developed using steam-heating and cyclic-steam stimulation across extended areas. Wells were completed in 2012 and injection of the heat medium to the target area was begun. Work continued in the south-eastern part of the field on a test-production program for drilling of horizontal injection and slanted production wells to be completed above the natural screen (datum R-4).

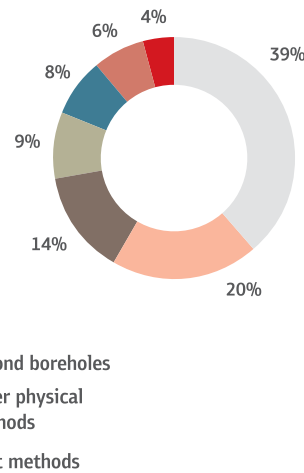
The **Yaregskoye field** is being developed using a thermal mineshaft technology (production at the field mainly uses a mining technique). Boring combines have been mobilized at the field to prepare sloped mine-shaft blocks for development, offering significant savings on construction costs. The company Scientific Drilling Controls Limited carried out work for the first time to study 125 underground boreholes at the field. A program of remedial cementing (prevention of water inflow) was designed and implemented using the study results.

Five steam injection wells were put under pressure in 2012 at test production area № 5 at the Lylaevskaya area, enabling implementation for the first time in the world of a project for reciprocal thermogravitational formation drainage. Further use of this technique will enable up to 16.4 million tonnes of oil to be brought into production.

Structure of EOR techniques used by LUKOIL Group in 2012



Shares of additional production obtained by use of various EOR techniques in 2012

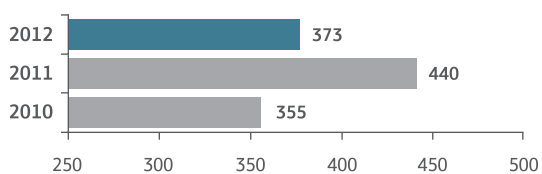


### GEOLOGICAL HYDRODYNAMIC MODELS

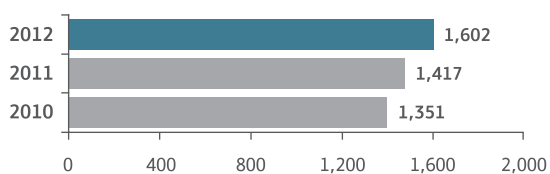
Oil & gas production subsidiaries of LUKOIL produced oil & gas at 369 fields in the Russian Federation during 2012. Geological and hydrodynamic modeling is used for monitoring of development processes, choice of technologies, and for measuring efficiency in secondary and tertiary production of reserves. Modeling leads to improvement of oil recovery rates and reduces expenditures on field development. Although reserves in traditional

production regions have been in development for long periods of time, use of modeling has enabled the Company to keep output levels steady and in some cases to increase output. This result reflects improved quality of the models and ever greater use of such models during production drilling, as well as continued work to improve well-completion techniques, and techniques for primary and secondary drilling into productive strata.

Number of updated geological-hydrodynamic models



EOR using chemicals, number of wells



## Refining Technologies

LUKOIL places much emphasis on the development, modernization and construction of high-tech equipment that reduces costs in refining operations and enables production of new, high-quality product types. Constant improvement of quality serves the interests of customers and protects the environment, and sale of products with a large share of value-added generates additional income for the Group.

Since July 2012 all of the Russian refineries of LUKOIL Group have switched to production of automotive gasolines, which fully meet Euro-5 specifications. This enabled savings on excise rates in 2012 (the rates are differentiated according to fuel quality).

The Company is now carrying out construction of new equipment and modernization of its refineries. At the Ukhta Refinery work was completed in 2012 for modernization of the reactor block on the GDS-850 hydrodewaxer and of the furnace unit for catalytic reforming. Annual capacities of the two units were raised to 1.1 and 0.4 million tonnes, respectively, as a result.

At the Nizhny Novgorod Refinery reconstruction of atmospheric-vacuum distillation unit № 5 was completed in 2012. At the Volgograd Refinery a new improved management system was installed in 2012 on the isomerization unit, enabling increase of marketable outputs.

Studies are also being carried out to find ways of improving energy efficiency and levels of safety in operations at oil refineries, gas-processing plants and petrochemical facilities.

LUKOIL is devoting much attention to development of the latest technologies for production of lubricants and additives, and a science and technology unit focused on this issue has been set up within the Company. Its main functions are development and marketing of high-quality products for proper operation of modern machinery, as well as development of new technologies and blends. This work is being carried out by Company specialists in collaboration with scientific centres in Russia.



## Information Technologies

More than

**14** thousand  
users of the Company's Integrated  
Management System

**We fully appreciate the importance of information technologies for efficiency gains in industrial operations and business management.**

LUKOIL has therefore expanded the functionality of all its software programs and applied them at an ever increasing number of Group organizations.

Consistent work to create and develop the Company's Integrated Management System with SAP architecture had enabled installation of 24 modules at nearly 114 Group organizations by the end of 2012. Local regulatory rules for asset and project portfolios and for business processes have been designed on the basis of LUKOIL's corporate governance documents to assist in transition to the Global Integrated Management System. A process management model for the Group has been designed, enabling harmonious interaction between business processes.

6

# SOCIAL RESPONSIBILITY





## Protecting the Environment

## The Group's 2012-2021 strategy includes:

- Achievement of 95% utilization of associated petroleum gas;
- Ending discharge of effluent into natural water bodies;
- Reducing greenhouse gas emissions and obtaining additional income through implementation of the mechanisms of Article 6 of the Kyoto Protocol;
- Fully overcoming the aftermath of previous environmental damage;
- Obtaining a ratio no higher than 1x between waste accumulation and use/recycling of waste;
- Payments for negative environmental impact should not exceed the standard rate of such payments by more than 15%;
- Reduction of pipeline failures and purification of land that has been damaged as a result of such failures



LUKOIL acknowledges its responsibility to society for rational use of natural resources and preservation of the environment. The Company therefore observes the highest standards of care for the environment and of industrial safety in its operations.

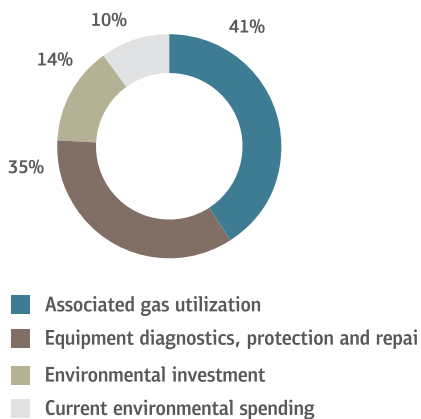
More than  
**\$754** million  
 were spent on  
 environmental measures

A significant share of this money (more than 50%) was spent to protect air quality, including increased levels of associated gas utilization. A further 35% of the total were spent to address the consequences of accidents.

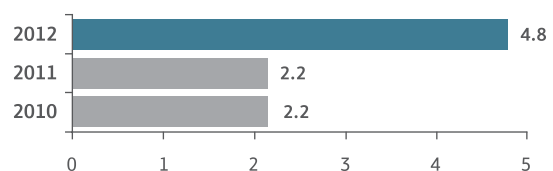
The Company achieved reduction of per unit environmental impact indicators in nearly all business sectors during 2012:

- Release of pollutants into the atmosphere was reduced by nearly 14%, thanks mainly to steps as part of the corporate program to increase utilization of associated gas, thereby reducing combustion of the gas at field flares;
- The area of polluted land was reduced by 17% thanks to reclamation work;
- The number of incidents that caused damage to the environment was reduced by 12.5%. Nearly all of the accidents were caused by pipeline failures. Major repairs to pipelines are being carried out in order to minimize such failures.

Environmental spending in 2012



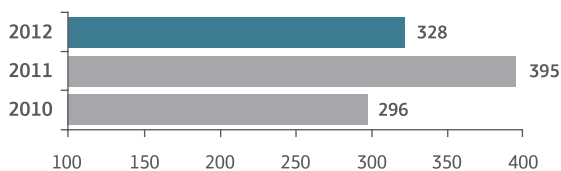
Foul water discharge, million cubic meters



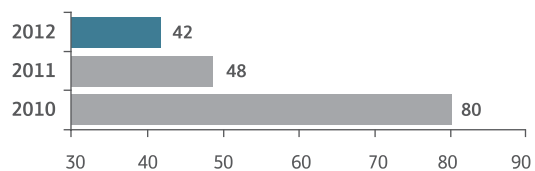
**Main environmental actions by LUKOIL Group organizations in 2012 are presented in the following table:**

Objective	Main actions in 2012
Rational use of water resources, preventing water pollution	<ul style="list-style-type: none"> <li>• Diagnostics and major repairs to pipelines (905 km, +36% compared with 2011) and application of corrosion inhibitors to pipelines.</li> <li>• Building preliminary water-discharge systems and systems for utilization of formation water.</li> <li>• Checking the condition of pipeline crossings over water.</li> <li>• Purification of polluted ground water from drainage systems.</li> <li>• Modernization of existing purification facilities and installation of new facilities.</li> </ul>
Reduction of atmospheric pollutant emissions	<ul style="list-style-type: none"> <li>• Modernization and construction of facilities to increase the rate of utilization of associated gas.</li> <li>• Modernization and construction of new, more efficient combined-cycle turbines at generating facilities.</li> <li>• Replacement of equipment for the reduction of pollutant emissions: replacement of lateral seals, modernization and replacement of furnaces, replacement of pumping equipment.</li> <li>• Better use of technologies: timely regulation of combustion in furnaces, boilers, etc.</li> </ul>
Utilization of accumulated waste containing oil	<ul style="list-style-type: none"> <li>• Increase of sub-contractor works to neutralize waste.</li> <li>• Construction of a complex for processing of waste containing oil.</li> <li>• Construction of specialized zones for utilization of production waste.</li> </ul>
Preventing pollution and ensuring rational use of land	<ul style="list-style-type: none"> <li>• Reclamation of disturbed land and land polluted by crude oil (2,464 and 159 hectares, respectively).</li> <li>• Diagnostics and major repairs to pipelines, and application of corrosion inhibitors.</li> </ul>
Preserving biodiversity	<ul style="list-style-type: none"> <li>• Financing of work to replenish fish stocks.</li> <li>• Monitoring of environmental components.</li> </ul>

Polluted land, hectares



Number of accidents causing environmental damage





## Health and Safety

### Ensuring safe and decent working conditions is a priority for LUKOIL.

Thanks to the efforts carried out by the Company in this direction, there are no work places at the Company which are classified as hazardous (high-risk).

Improvements were made to conditions at 5,952 work places during 2012. Incidence of minor injuries to Company employees in the work place declined by 12.5% in comparison with 2011, and registered cases of work-related sickness declined by 2.7 times.

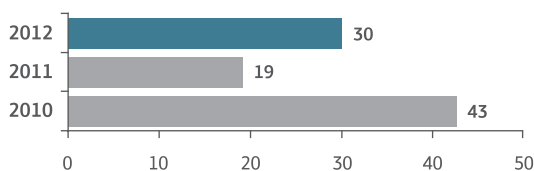
A total of 56 command-system and staff trainings and drills were carried out in 2012, as well as 72 complex drills, 177 tactical and specialized drills, and more than 150 drills and trainings in proper actions to address oil and product leakages.

Scheduled preventative measures ensured that there were no incidents during 2012 within LUKOIL, which could be classed as emergencies. Safety drills and training sessions are held regularly at sea and river terminals, and at production, refining and storage sites, to ensure that the Company's special teams and equipment remain in a high state of readiness to deal with any oil or petroleum product leakages.

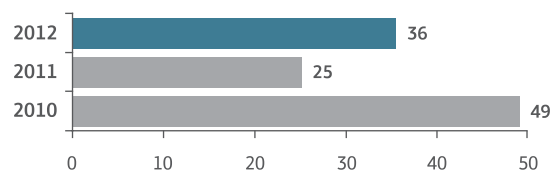
The structure of spending on industrial safety in 2012 was as follows

Actions	%
Ensuring that tasks are carried out using the latest technologies	0.2
Teaching, training and raising of employee qualifications in the field of health and safety	2.0
Making work places compliant with legal requirements	4.8
Providing staff with protective gear and ensuring that work places meet appropriate health and hygiene standards	13.3
Meeting government and corporate standards for health and safety	4.9
Improving the system for management of industrial, health and fire safety. Providing regulatory and legal support.	4.2
Preventing and dealing with emergencies	33.4
Ensuring that facilities comply with LUKOIL's own internal regulations for industrial, health and fire safety in the work place	37.2

Number of accidents



Number of people injured in accidents



# Personnel and Social Programs

**LUKOIL has become an industry leader thanks to the coordinated work of a high-class team of world-class professionals**

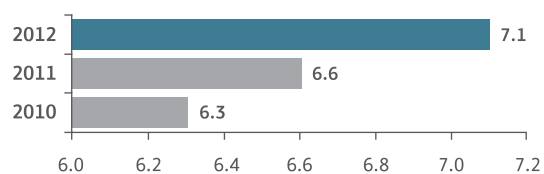
More than  
**112** thousand people  
 are employed by  
 the Group

LUKOIL's social policy is aimed at maximizing labor productivity, realizing the personal potential of employees to the full, and ensuring that they benefit from proper social protection. We are attentive to the interest and needs of our employees and try to ensure that each one of them takes a personal interest in achievement by the Company of the best possible results.

### MATCHING BEST INTERNATIONAL PRACTICE

LUKOIL aspires to a system of human resource management that matches best global practice. In 2012 LUKOIL carried out an optimization of its organizational structure, eliminating inefficient links and doubling of management functions. The number of LUKOIL's employees decreased by 7% compared with 2011, and there were gains in labor productivity and per-employee indicators: revenue per employee grew by 11.8% in the reporting year, and net income per employee by 14.1%.

Hydrocarbon production per employee, thousand boe



### SOCIAL PARTNERSHIP

The Company makes full use of social partnership in the labour sphere, expanding and strengthening cooperation with its trade union, government bodies and local communities. Since 2008 LUKOIL has been the official representative of the Russian Union of Industrialists and Entrepreneurs in the Tripartite Commission for Regulation of Social and Labour Relations, which is the most senior social partnership organization acting under the Labour Code of the Russian Federation. In 2012 the Company took part in 8 sessions of the Commission, at which 31 issues were considered.

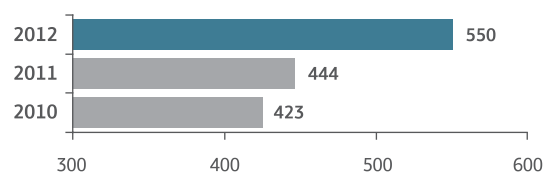
### APPRAISAL

Staff appraisal is of central importance for efficiency management at LUKOIL. The Company implemented 'appraisal and development center' technology in 2012, which helps to identify the individual potential of employees and prepare customized training programs to match their development needs.

The Company has carried out annual employee appraisals since 2007, which make it possible to draw overall appraisals together and make a proper assessment of competence.

Based on the appraisal results, employees receive detailed and coherent feedback, which helps them to understand what they must do in order to improve their performance at work. Annual appraisal of more than 1,787 employees was carried out in 2012 and the results were used to prepare personal development plans and to calculate annual bonuses for 2011.

Refinery output at refineries per employee, tonnes



## INCENTIVE SYSTEM

### Financial incentives

LUKOIL's system of remuneration is designed to strengthen the motivation and commitment of employee to further growth of the Company's shareholder value. Wage levels in the industry are constantly monitored, which enables timely decisions on adjustment of wages in order to make them competitive and to encourage highly qualified specialists to seek employment at the Company. As a result the Company's payroll has expanded in the last five year despite a substantial reduction in employee numbers.

### Non-financial incentives

In addition to material incentives, LUKOIL provides encouragement to personnel through marks of merit for outstanding achievements at work. Special events were held at all Group companies in 2012 at which workers and groups of workers received national awards, sectoral marks of distinction and LUKOIL awards. There were 39 winners of national awards among LUKOIL employees in 2012, while sectoral distinctions were earned by 510 workers and the Company's own awards were conferred on 1,480 employees and 13 groups of employees. Prizes were awarded to 2 LUKOIL employees by the Russian Union of Oil & Gas Workers in 2012

### Social provisions

An efficient system of social guarantees helps to attract highly-qualified specialists to the Company, reduce employee turnover rates and strengthen corporate morale, and is therefore of fundamental importance for the success of LUKOIL operations. Therefore, in addition to its financial and non-financial incentive schemes, the Company offers a broad range of programs and opportunities to its employees as part of the LUKOIL social package. These include:

- leisure and recreation provisions for employees and their families, organization of sport and fitness events,

- health care and medical treatment for Company employees, including voluntary health insurance,
- help to employees in acquiring housing,
- social support to women and families with children,
- social support to young specialists,
- non-state pension provision for employees, which has operated since 2004 on a principle of shared funding of non-state pensions by employee and employer. By the start of 2012 more than 37,6 thousand employees at LUKOIL organizations in Russia had entered the shared funding system, and the sum of their contributions during the year was over \$12.6 million. The Company's total contributions under non-state programs of pension provision in Russia and abroad for the reporting period were in excess of \$35.4 million.

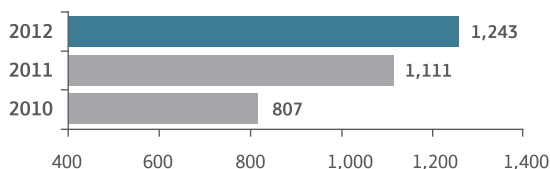
**\$384 million** were spent on implementation of social programs and infrastructure

Total spending in 2012 on implementation of social programs for employees, their families and pensioners was in excess of \$307.7 million, and spending on infrastructure for provision of social services totaled \$76.6 million.

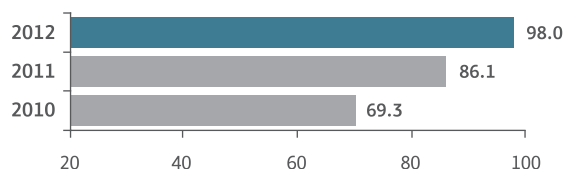
### YOUNG SPECIALISTS

Committees of young specialists operate at Company enterprises, and their functions include support to young specialists in adjustment to new working conditions, helping them to acquire and improve their skills, and work to encourage commitment to corporate values and corporate culture. The Company held its

Revenue per employee, \$ thousand



Net income per employee, \$ thousand



seventh competition in 2012 to find the Best Young Specialist of the Year, as a result of which the title was awarded to 51 of the Company's young specialists. Further trainings were organized and held as part of the Young Specialist's School, helping to reduce the amount of time needed for adaptation of new employees to the corporate environment and to raise their professional efficiency.

The tradition of providing work experience opportunities at the Company for students of leading Russian universities was continued in 2012 (3,000 students benefited from a period of work experience at the Company during the year). Work also continued on joint schemes with specialized oil & gas institutes around the country in the 'Start into the Future' program for selection of best students.

**EMPLOYEE TRAINING**

Our work with personnel is focused on skill levels. The Group has a system of continuous training, which is designed to ensure that LUKOIL personnel acquire the knowledge and skills, which they need for their jobs. LUKOIL uses the whole spectrum of modern training aids: workshops, seminars away from the work place, special training programs, work placements abroad, trainings, courses for improvement of qualifications, professional training days, distance learning and MBA programs. The Corporate Study Centre which was opened in 2010 in the city of Astrakhan trains workers for operations on offshore oil & gas platforms and at river and sea terminals, as well as teaching employees how to deal with emergency situations and ensuring that they are familiar with industrial fire safety procedures.

**COOPERATION WITH THE INTERNATIONAL LABOUR ORGANIZATION**

At the end of 2012 LUKOIL and the International Labour Organization (the ILO, which is a specialized institution in the United Nations Organization) signed a cooperation agreement in the field of youth employment, personnel exchange and training of personnel. LUKOIL will work with the ILO to develop and implement a project entitled 'Partnership for youth employment in the Commonwealth of Independent States'.

The purpose of the project is to create an international platform for CIS countries to exchange knowledge and mutual instruction, and to provide technical assistance to the Russian Federation in the sphere of employment, as well as to carry out technical cooperation initiatives in the CIS countries.

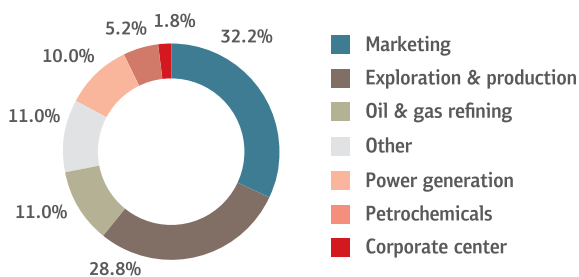
The parties will also explore the possibility of personnel exchange and organization of training for LUKOIL staff. A joint committee will be set up and will meet once a year to monitor agreement implementation.

The next step will be to design cooperation programs in the above-mentioned fields, and to organize visits by LUKOIL senior management to CIS countries for tripartite dialogue.

At present LUKOIL remains the only Russian company, which has signed a cooperation agreement with the International Labor Organization.



Employees by business segments in 2012



## Sponsorship and Charity



More than  
**\$ 83** million  
 were spent on charity and social programs

Social and charity programs are among the Company's most important strategic tasks, since they help to ensure constructive partnership with central and local government and with society. These initiatives by LUKOIL help to improve the social and economic situation in regions, where the Company has operations.

### SOCIAL INVESTMENT PROGRAMS

#### *Support for children's homes and schools*

Providing help to children is the main priority for LUKOIL in the charity sphere. The Company strives to achieve a balanced

approach, providing support both to children, who by virtue of their family circumstances or health find themselves in a worse situation than their peers, and to children with favourable family backgrounds by helping them to develop their natural abilities and talents. Assistance is provided to children's homes in the form of grants, holidays at summer camps and other support. LUKOIL helps these children to obtain an education, remain in good health, acquire a profession and find their place in life. The Company is also implementing a project to recruit and train young executives with backgrounds in children's homes and disadvantaged families.

#### *Education programs*

**Concern for the young generation and the preparation of qualified young specialists for the Russian oil industry is essential for meeting human resource challenges in the future**

More than  
**\$ 183** thousand  
 were spent on stipends

More than  
**\$ 308** thousand  
 were spent on grants

LUKOIL gives its support to 15 universities and 4 technical colleges, paying personal stipends and grants, and providing material and technical assistance. We have carried out much work to help education, science and industry to meet each other's needs. In 2012 LUKOIL scholarships were awarded to 200 students and 80 gifted young teachers received personal grants. The Company's stipend payments have risen significantly in the last five years (by 58.1%) and grant payments have increased by 26.0%.



#### *Support for medical institutions*

LUKOIL provides assistance to a number of major medical research centers (the Russian Cardiological Scientific and Production Complex and the A.V. Vishnevsky Institute of Surgery) as well as supporting development of medical services in its regions of presence.

#### *Social project competitions*

LUKOIL's social project competitions, which are held annually in 10 of Russia's administrative regions, are among the most efficient mechanisms for implementation of socially important programs. The Company budget for social project competitions in 2012 was nearly \$2.7 million, representing an increase of nearly two times over the last five years.

### **SPONSORSHIP AND CHARITY PROGRAMS**

#### *Preserving cultural and historical heritage*

The Company gives support every year to a number of leading Russian museums and arts groups, financing new exhibitions and productions, as well as contributing to the revival of religious traditions and spiritual culture. Several programs for the support of folk arts and crafts in the Kama region benefit from LUKOIL's assistance.

#### *Targeted assistance*

LUKOIL provides special payments each year to veterans of the Great Patriotic War (World War II) who have worked in the oil industry and also to labor veterans. The Company also provides assistance to families of members of the armed forces, who have lost their lives in more recent armed conflicts.

#### *Working with peoples of the Russian Far North*

The Company develops and implements special programs for work with the owners of kinship lands. LUKOIL makes agreements for socio-economic development of districts and locations inhabited by small indigenous people in order to preserve and develop the traditional way of life of the Khanti, Mansi, Nenets and Selkup peoples. Financing is made available for construction and repairs to housing in villages and areas traditionally populated by indigenous peoples, and apartments are provided for local people in nearby towns. The Company also contributes to ensuring that healthcare services are available to nomadic peoples who live in inaccessible regions beyond the Arctic Circle, including health checks and medical treatment for reindeer herders and their families.

LUKOIL views preservation of the lifestyle, language and culture of indigenous peoples as an important goal. The Company therefore works with local administrations in the Far North, helping to finance the construction of educational facilities, maintenance of places of worship, and holding of national festivals.

#### *Sport*

Sponsorship of various sports and the promotion of healthy lifestyles have been an important part of LUKOIL's social policy for many years. The Company contributes to the health and fitness of its employees and their families by organizing international 'Spartakiada' amateur sports competitions and by leasing sports facilities.

**LUKOIL provides sponsorship to leading Russian sports teams, including Moscow Spartak football club, the Caspian Dawn handball club in Astrakhan, the Volgograd Spartak water polo club, Torpedo hockey club in Nizhny Novgorod, the Dynamo-Krasnodar women's volleyball team and the Dynamo-Yantar volleyball club**

For many years the Company has been the general sponsor of the national ski-racing team and partner of the Russian Ski-Racing Federation. LUKOIL assists both in training of the national team and development of amateur ski sport in Russia. In 2012 the Russian men's national ski-racing team won the World Cup for Teams for the first time in its history. The Company is also the official sponsor of the VTB League, which is the largest basketball championship in the post-Soviet countries.

As part of its support to the Russian Olympic Movement the Company is cooperating with the Russian Olympic Support Foundation, which provides targeted support to sportsmen in Russian national teams practising Olympic sports.

In addition to its support for sports teams, LUKOIL also views sport as a way of testing the Company's own products to the limits. The successes and victories of LUKOIL Racing Team, which is the strongest car racing team in Russia, continue to prove the efficiency of the Company's fuels and lubricants at both circuit and rally competitions in prestigious Russian and international racing series.

The Company has provided support for more than 12 years to one of the biggest children's sport organizations in Russia, the Children's Football League. About 3,000 teams and more than 50,000 young football players from all parts of Russia – from Vladivostok to Kaliningrad – take part in League competitions each year. In 2012 competitions as part of the Children's Football League were also held in five countries outside Russia (Bulgaria, Latvia, Ukraine, Uzbekistan and Turkey).



**Blood donation**

**150** liters of blood  
were contributed by  
LUKOIL employees

Blood donation is an important type of corporate voluntary action and LUKOIL has carried out such actions since 2010. A total 150 liters of blood were collected in 2012. Blood donation is a valuable form of corporate voluntary action, which both helps society and helps to strengthen corporate culture by bringing members of staff together and forging links between them.

**LUKOIL corporate museums****More than**

**25** museums  
in Russia and abroad

LUKOIL's corporate museums make an important contribution to corporate culture and provide a universal center for communication. They keep the best traditions of the oil industry alive and provide continuity between successive generations of oil workers.

LUKOIL's network of corporate museums includes the main LUKOIL Museum and more than 25 museums at Group organizations in various regions of Russia, as well as in Ukraine, Bulgaria and Romania. As well as hosting exhibitions, our museums are also used for special ceremonies to greet newly-hired professionals, to celebrate anniversaries, to congratulate retiring employees, to award corporate prizes, and for evenings devoted to specific themes. The LUKOIL Museum holds regular sessions with students of the Gubkin Oil & Gas State University to study the history of the Russian oil industry and issues of corporate culture.

The LUKOIL Museum held 15 touring exhibitions during 2012 both inside and outside the Company. The exhibition themes included: 'LUKOIL's Electricity Business', 'The 80th Birthday of Yu. S Korchagin', '20 Years of RITEK', '15 Years of LUKOIL-Overseas', 'The Young Specialists Council', 'LUKOIL for Children', 'Children's Drawing Competition', 'Innovation at LUKOIL' and others.

 [Sustainability Report](#)





COMPANY GOVERNANCE	BOARD OF DIRECTORS AND MANAGEMENT COMMITTEE	COMMITTEES OF THE BOARD OF DIRECTORS	MANAGEMENT COMMITTEE OF LUKOIL	CHANGES IN GROUP STRUCTURE	FINANCIAL MANAGEMENT	INTERNAL CONTROL AND INTERNAL AUDIT	INFORMATION DISCLOSURE	COMPANY SECURITIES	ADRs	DIVIDENDS
81	82	90	91	100	100	101	103	104	105	107

7

# CORPORATE GOVERNANCE AND SECURITIES





## Company Governance

**LUKOIL's system of corporate governance has been consistently acclaimed by representatives of the investment community over a number of years.**

LUKOIL's system of corporate governance is an effective tool for protecting the rights and interests of Company shareholders. Efficient corporate governance lowers the weighted average cost of capital and reduces investment risks, making investments in LUKOIL more attractive and, as a consequence, raising shareholder value of the Company. LUKOIL's corporate governance system attaches special importance to protecting the rights of minority shareholders.

As a company registered in Russia, LUKOIL is guided in its business by the Code of Corporate Conduct ('the Code'), which was recommended in 2002 by the Russian Federal Securities Commission. The Company complies in full with main requirements of the Code. Shares of LUKOIL as well as its ruble bonds are included in the top (A1) listing at the MICEX stock exchange (Russia's main stock exchange).

The Company does all it can to apply the best international practice by exceeding the Code requirements. In recent years more than a half of members of the LUKOIL Board of Directors have been independent directors.

 **LUKOIL Corporate Governance Report 2012**  
Fact Book, p. 100


## Board of Directors and Management Committee



### BOARD OF DIRECTORS OF LUKOIL

The Board of Directors plays a crucial role in LUKOIL's system of corporate governance, exercising overall control of Company activities in the interests of investors and shareholders. In accordance with Russian legislation and the LUKOIL Charter, the Board of Directors defines priorities for Company development and ensures efficient functioning of the Company's executive bodies.

The Board of Directors of LUKOIL includes independent directors, whose presence enables the Board to formulate an objective opinion on matters discussed and therefore to strengthen confidence in the Company on the part of investors and shareholders. At the end of 2012 there were 6 independent members of the Board, out of total 11 Board members.

 [Regulations on the Board of Directors of OAO «LUKOIL» Fact Book, p. 101](#)

#### *Activities of the Board in 2012*

The Board of Directors held 7 meetings in person and carried out 19 votes in absentia during 2012.

In January the Board of Directors reviewed preliminary business results of the Group for the previous year and defined objectives for the immediate future. In April issues associated with preparation for the Annual General Meeting of Shareholders

were resolved. A Board meeting in May gave preliminary approval to the LUKOIL Annual Report for its subsequent presentation and approval by the Annual General Meeting of Shareholders. The Company's Corporate Governance Report was also approved in May. In July the Board of Directors appointed membership of the 16-strong Management Committee of LUKOIL, and also defined the main terms of contracts with members of the Management Committee. The maximum level of payment to the LUKOIL auditor was also established.

The Board of Directors approved a number of important documents in 2012: a Regulation on appraisal of the activity of the Board of Directors of OJSC LUKOIL; a Procedure for internal control; a Regulation on long-term incentives for the employees of LUKOIL and its subsidiaries in the period 2013–2017; a Regulation on assessment of internatl audit at LUKIOL, etc.

The Board of Directors also carried out in-depth consideration of specific business segments and and made a number of proposals, as follows:

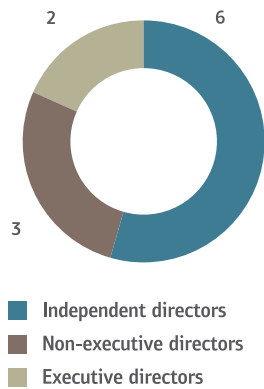
- Concerning the development and prospects of the European market for light petroleum products, and steps to provide logistics for delivery by LUKOIL of such products on European markets.
- Concerning international projects for production of hydrocarbons.

Participation by members of the Board of Directors at in-person meetings of the Board of Directors in 2012 <sup>1</sup>

	BoD meetings	Strategy and Investment Committee	Audit Committee	HR and Remuneration Committee
Valery Grayfer	7/7			
Vagit Alekperov	7/7			
Viktor Blazheev	7/7		4/5	
German Gref (until 27.06.2012)	3/3		2/3	
Igor Ivanov	7/7	4/4		
Ravil Maganov	6/7	2/4		
Richard Matzke	7/7	4/4		
Sergei Mikhailov	7/7		5/5	3/3
Mark Mobius	7/7	4/4		From 27.06.2012 2/2
Guglielmo Moscato	7/7	4/4		Until 27.06.2012 0/1
Ivan Pictet (from 27.06.2012)	4/4		2/2	
Alexander Shokhin	6/7			3/3

<sup>1</sup> In accordance with the resolution of the Board of Directors, for purposes of defining a quorum in conduct of a BoD meeting and voting results, the written opinion of an absent Board member concerning the agenda items, which is received by the Board Secretary before the start of the meeting, is taken into account. So a Board member who submits his written opinion before the start of the meeting is considered to have taken part in the meeting.

BoD membership structure, persons



## Members of the Board of Directors of LUKOIL



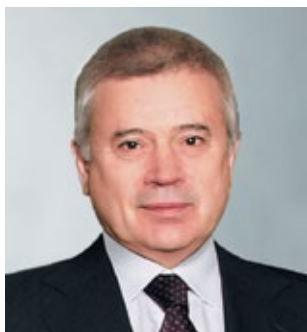
### VALERY GRAYFER

**Chairman of the LUKOIL Board of Directors**  
**Chairman of the RITEK Board of Directors**

**Born 1929**

Graduated in 1952 from the Gubkin Moscow Oil Institute. Doctoral Candidate in Technical Sciences. Awarded six orders, four medals, and a Diploma of the Supreme Soviet of the Tatar ASSR. Awarded a Diploma of the President of the Russian Federation in 2009. Deputy to the USSR Oil Industry Minister, Head of the Tyumen Main Office for the Oil & Gas Industry (from 1985). CEO of RITEK (1992–January 12, 2010); Chairman of the Board of Directors of RITEK (from 2010). Chairman of the Board of Directors of LUKOIL (from 2000). Professor of the Gubkin Russian State Oil & Gas University, Lenin Prize Winner and Russian Government Prize Winner.

Elected to the LUKOIL Board of Directors since 1996.



### VAGIT ALEKPEROV

**President of LUKOIL**  
**Member of the LUKOIL Board of Directors**  
**Chairman of the LUKOIL Management Committee**

**Born 1950**

Graduated in 1974 from the Azizbekov Institute of Oil and Chemistry in Azerbaijan. Doctor of Economics, current Member of the Russian Academy of Natural Sciences. Awarded four orders, eight medals, a Diploma and two Letters of Acknowledgement from the President of the Russian Federation. Winner of two Russian Government Prizes in science and technology. Worked in the oil industry in Azerbaijan and Western Siberia (from 1968). CEO of the Production Association Kogalymneftegaz of Glavtyumenneftegaz of the USSR Ministry of Oil and GasKogalymneftegaz (oil production company), a division of Glavtyumenneftegaz within the Ministry of the Oil & Gas Industry of the USSR (1987–1990). Deputy, then First Deputy to the USSR Oil & Gas Industry Minister (1990–1991). President of Langepasuraykogalymneft (oil production group) (1992–1993). Chairman of the Board of Directors of LUKOIL (1993–2000). President of LUKOIL (from 1993).

Elected to the LUKOIL Board of Directors since 1993.



### VIKTOR BLAZHEEV

Independent Member of the LUKOIL Board of Directors <sup>1</sup>  
 Rector of the Kutafin Moscow State Academy of Law  
 Member of the LUKOIL BoD Audit Committee (until 27.06.2012)  
 Chairman of the LUKOIL BoD Audit Committee (from 27.06.2012)

Born 1961

Graduated from the All-Union Correspondence-Study Law Institute (ACLI) in 1987; completed a post-graduate program at ACLI/Moscow Law Institute in the Civil Litigation Faculty in 1990. Since 1999 he has combined work as a lecturer with various administrative posts at the Moscow State Academy of Law. Dean of the Full-time Department of the Moscow State Academy of Law (1999–2001). Vice-Rector of Moscow State Academy of Law in charge of academic agenda (2001–2002). First Vice-Rector of Moscow State Academy of Law in charge of academic agenda (2002–2007). Rector of Kutafin Moscow State Academy of Law (from 2007).

Elected to the LUKOIL Board of Directors since 2009.



### GERMAN GREF

Independent Member of the LUKOIL Board of Directors (until 27.06.2012) <sup>1</sup>  
 Chairman of the LUKOIL BoD Audit Committee (until 27.06.2012)  
 President, Chairman of the Executive Board of SBERBANK  
 (Savings Bank of the Russian Federation)

Born 1964

Graduated from Omsk State University in 1990, completed a post-graduate program at St. Petersburg State University in 1993. First Deputy Minister of Property Relations of the Russian Federation (1998–2000). Minister of Economic Development and Trade of the Russian Federation (2000–2007). President, Chairman of the Executive Board of Sberbank (Savings Bank of the Russian Federation) (from 2007). Doctoral Candidate in Economic Science.

Elected to the LUKOIL Board of Directors since 2009.

<sup>1</sup> In accordance with the provisions of the Code of Corporate Conduct, which was recommended for application by the Decree of the Russian Federal Commission for the Securities Market, dated April 4, 2002. The same applies to all other independent BoD members listed in this section.



### IGOR IVANOV

**Independent Member of the LUKOIL Board of Directors <sup>1</sup>**  
**President of the Russian Council for International Relations**  
**Chairman of the LUKOIL BoD Strategy and Investment Committee**

**Born 1945**

Graduated from the Maurice Thorez Moscow State Institute of Foreign Languages in 1969. First Deputy Minister of Foreign Affairs of the Russian Federation (1993–1998). Minister of Foreign Affairs of the Russian Federation (1998–2004). Secretary of the Security Council of the Russian Federation (2004–2007). Professor of the Moscow State Institute of International Affairs (University), attached to the Russian Ministry of Foreign Affairs (from 2005). President of the non-profit partnership, the Russian Council for International Affairs (from 2011).

Extraordinary and Plenipotentiary Ambassador of the Russian Federation. Corresponding member of the Russian Academy of Sciences. Awarded Russian and foreign orders and medals.

Elected to the LUKOIL Board of Directors since 2009.



### RAVIL MAGANOV

**Member of the LUKOIL Board of Directors**  
**Member of the LUKOIL Management Committee**  
**First Executive Vice-President of LUKOIL (Exploration & Production)**  
**Member of the LUKOIL BoD Strategy and Investment Committee**

**Born 1954**

Graduated in 1977 from Moscow Gubkin Petrochemical & Gas Institute. Honored Employee of the Oil & Gas Industry of the Russian Federation. Awarded three orders and three medals. Winner of three Russian Government Prizes in science and technology. Chief Engineer, Deputy CEO, CEO of Langepasneftegaz (oil production company) (1988–1993). Vice-President of LUKOIL (1993–1994). First Vice-President of LUKOIL (1994–2006). First Executive Vice-President of LUKOIL (from 2006).

Elected to the LUKOIL Board of Directors since 1993.

<sup>1</sup> In accordance with the provisions of the Code of Corporate Conduct, which was recommended for application by the Decree of the Russian Federal Commission for the Securities Market, dated April 4, 2002. The same applies to all other independent BoD members listed in this section.



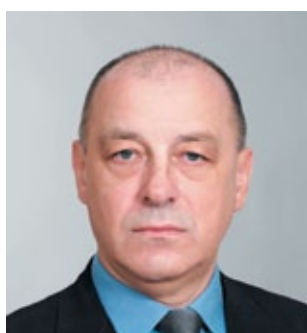
### RICHARD MATZKE

**Independent Member of the LUKOIL Board of Directors <sup>1</sup>**  
**Member of the LUKOIL BoD Strategy and Investment Committee**

**Born 1937**

Graduated from Iowa State University (1959), Pennsylvania State University (1961), and St. Mary's College in California (1977). Masters in Geology, MBA. President of Chevron Overseas Petroleum and Member of the Board of Directors of Chevron Corporation (1989–1999). Vice-Chairman of Chevron and Chevron-Texaco Corporation (2000–2002). Awarded a non-Government (civil) medal 'For Development of the Russian Oil & Gas Industry' in 2006; winner of the national prize 'Director of the Year, 2006' (Russia) in the 'Independent Directors' nomination, organized by the Association of Independent Directors and PricewaterhouseCoopers. Member of the Board of Directors of EurasiaDrillingCompany (from 2010)

Elected to the LUKOIL Board of Directors in 2002–2010 and from June 2011.



### SERGEI MIKHAILOV

**Member of the LUKOIL Board of Directors**  
**CEO of CJSC Consulting Group**  
**Member of the LUKOIL BoD Audit Committee**  
**Member of the LUKOIL BoD HR and Remuneration Committee**

**Born 1957**

Graduated in 1979 from Dzerzhinsky Military Academy, in 1981 from Moscow Aviation Institute (Further Qualification Faculty), and in 1998 from the Plekhanov Russian Economics Academy. Doctoral Candidate in Technical Sciences, Doctor of Economics, Professor. Awarded four medals. Service in the armed forces (1974–1992). Head of Section, Deputy Chairman of the Russian Federal Property Fund (1992–1996). Head of the Restructuring and Investment Department of the Ministry of Industry (1996–1997). CEO of Management-Center (management company) (1997–2003). CEO of Management-Consulting (from 2001 until 28.02.2011). CEO of CJSC Consulting Group (from 2002). Chairman of the Board of Directors of Capital Unit Investment Funds (Management Company), Member of the Board of Russian Mediagroup, Spartak-Moscow Football Club, and Petrocommerce Commercial Bank (from 2004). Member of the Board of Directors of IFD Capital (from 2005). Chairman of the Board of Directors of Capital Investment Group (2008–2009). Member of the Board of Directors of Capital Management Company, Chairman of the Board of Directors of Capital Asset Management (from 2008). Chairman of the Board of Directors of Capital Group Asset Management (from 2010). Deputy CEO of Capital Management Company (from 2011).

Elected to the LUKOIL Board of Directors since 2003.

<sup>1</sup> In accordance with the provisions of the Code of Corporate Conduct, which was recommended for application by the Decree of the Russian Federal Commission for the Securities Market, dated April 4, 2002. The same applies to all other independent BoD members listed in this section.





### **GUGLIELMO ANTONIO CLAUDIO MOSCATO**

**Independent Member of the Board of Directors of LUKOIL <sup>1</sup>**  
**Chairman of the Board and CEO of GasMediterraneo & Petrolio Srl**  
**Member of the LUKOIL BoD HR and Remuneration Committee (until 27.06.2012)**  
**Member of the LUKOIL BoD Strategy and Investment Committee**

**Born 1936**

Graduated in 1961 from Milan Polytechnical University. Previously held positions as BoD Chairman of ENI SpA, BoD Chairman and CEO of AGIP SpA (also BoD Chairman of the Enrico Mattei Foundation (Eni) and Chairman of the Eni Corporate University). Currently holds the position of Member of the Board of Directors of TREVI SpA, Canadian Oil Co (Canoel), BoD Chairman and CEO of Gas Mediterraneo & Petrolio Srl.

Elected to the LUKOIL Board of Directors since 2011.



### **IVAN PICTET**

**Independent Member of the Board of Directors of LUKOIL <sup>1</sup> (from 27.06.2012)**  
**Member of UN Pension Fund Investment Committee**  
**Member of the Audit Committee of the BoD of LUKOIL**

**Born 1944**

Masters in Economics at the University of St. Gallen (1970). Mr Pictet took up a position at the Bank Pictet & Cie in 1972. 1981–2005: Managing Partner of Pictet & Cie. 2005–2010: Senior Managing Partner of Pictet & Cie. 1991 – 1995: President of the Geneva Chamber of Trade & Industry. 2000 – 2010: President of Genève Place Financière

Mr Pictet has been member of the Investment Committee of the Management Board of the United Pension Fund for UN Personnel since 2005; a member of the International Consultative Council of Blackstone Group International Limited since 1995; a member of the AEA European Advisory Board since 2010; a member of the AEA Investors LP Global Advisory Board (New York) since 2011; and a member of the Board of Directors of Symbiotics since 2011. Mr Pictet has also been the President of the Fondation pour Genève and Chairman of the Fondation Pictet pour le développement since 2009. In 2012 Mr Pictet was appointed Chairman of the Board of Directors of PSA International SA.

Elected to the LUKOIL Board of Directors since 2012.

<sup>1</sup> In accordance with the provisions of the Code of Corporate Conduct, which was recommended for application by the Decree of the Russian Federal Commission for the Securities Market, dated April 4, 2002. The same applies to all other independent BoD members listed in this section.



### MARK MOBIUS

**Independent Member of the Board of Directors of LUKOIL <sup>1</sup>**  
**Executive President of Templeton Emerging Markets Group**  
**Chairman of the HR and Remuneration Committee of the BoD of LUKOIL**  
**(from 27.09.2012)**  
**Member of the Strategy and Investment Committee of the BoD of LUKOIL**

**Born 1936**

Graduated from the Massachusetts Institute of Technology (USA) in 1964. Doctor of Economic and Political Science. BA and Masters Degree from Boston University (USA). Executive President of Templeton Asset Management Ltd (until August 2010). Executive President of Templeton Emerging Markets Group (since August 2010). Has worked at Franklin Templeton Investments since 1987.

Elected to the LUKOIL Board of Directors in 2002–2004 and since June 2010.



### ALEXANDER SHOKHIN

**Member of the LUKOIL Board of Directors**  
**President of the Russian Union of Industrialists and Entrepreneurs**  
**President of the National Research University – Higher School of Economics. Head of Department for Theory and Practice of Interaction between Business and Government**  
**Chairman of the LUKOIL BoD HR and Remuneration Committee (until 27.06.2012)**  
**Member of the LUKOIL BoD HR and Remuneration Committee (from 27.06.2012)**

**Born 1951**

Graduated from the Economics Faculty of Lomonosov Moscow State University in 1974, Doctor of Economics, Professor. Awarded an order for 'Services to Russia' (3rd and 4th grade) and a medal of the Russian Security Council for 'Services to National Security'. Began working career in 1969. Deputy Chairman of the Government of the Russian Federation, Minister of the Economy, Minister for Labour and Employment (1991–1994). Deputy in three elected State Dumas of the Russian Federation (1994–2002). First Deputy Chairman of the State Duma of the Russian Federation (1996–1997). Chairman of Duma Fraction 'Our Home is Russia' (1997–1998). Deputy Chairman of the Russian Government in 1998. Chairman of the Supervisory Council of Renaissance Capital Investment Group (2002–2006). Member of the Public Chamber of the Russian Federation (2005–2009). President of the Russian Union of Industrialists and Entrepreneurs (from 2005).

Member of the Russian Presidential Commission for Formation and Preparation of the Executive Managers' Reserve, of the Competitiveness and Enterprise Council of the Prime Minister of Russia, and of Government Commissions for Administrative Reform, for Drafting of Legislation, for High-Technology and Innovation, for Transport and Communications, and for Development of Small and Medium-sized Business.

Elected to the LUKOIL Board of Directors since 2005.

<sup>1</sup> In accordance with the provisions of the Code of Corporate Conduct, which was recommended for application by the Decree of the Russian Federal Commission for the Securities Market, dated April 4, 2002. The same applies to all other independent BoD members listed in this section.

## Committees of the Board of Directors

Committees of the Board of Directors have been created to ensure efficient functioning of the Board of Directors, as follows: for Strategy and Investments; for Audit; and for HR and Remuneration.

The committees carry out preliminary examination of matters of importance and prepare recommendations on these matters to the Board of Directors.

Committee	Functions	Rules of election	Current membership
Committee for Strategy and Investment	Preparing recommendations to the Board of Directors on the following issues: <ul style="list-style-type: none"> <li>analysis of strategic development concepts, programs and plans of the Company</li> <li>the amount of dividends to be paid on shares and the procedure for dividend payment</li> <li>distribution of Company income and loss for the financial year</li> <li>assessment of Company policy for relations with investors and shareholders</li> <li>conduct of Company policy with respect to its own securities</li> <li>participation in financial-industrial groups, associations and other unions of commercial organizations</li> <li>matters regarding large transactions (with property worth between 25 and 50% of the balance sheet value of Company assets)</li> <li>creation of affiliates and opening of representative offices</li> <li>use of Company reserves and non-core assets.</li> </ul>	Elected from among <b>BoD members</b> , at least three in number.	I. Ivanov (Chairman), R. Maganov, M. Mobius, R. Matzke and G. Moscato.
Audit Committee	<ul style="list-style-type: none"> <li>selection of the candidate for external auditor of the Company</li> <li>supervision of the competition for selection of the Company auditor</li> <li>assessment of the auditor's opinion</li> <li>assessment of the efficiency of internal control procedures at the Company</li> <li>assessment of the level of objectivity and independence of the Company auditor</li> <li>assessment of the risk management system</li> <li>setting the maximum amount of remuneration to the Company auditor</li> </ul>	Elected from <b>non-executive members of the BoD<sup>1</sup></b> , not less than three in number.	S. Blazheev (Chairman), S. Mikhailov and I. Pictet
HR and Remuneration Committee	Preparing recommendations to the BoD on the following matters: <ul style="list-style-type: none"> <li>defining criteria for choice of candidates to the Board of Directors, Management Committee and the post of Company President</li> <li>preliminary assessment of candidates to the Management Committee and post of Company President</li> <li>preparing recommendations to the Board of Directors for decisions on HR issues and issues of remuneration to members of Company management bodies and of the Audit Commission</li> <li>substantial terms of contracts with members of the Management Committee and the Company President</li> </ul>	Elected from <b>non-executive members of the Board of Directors<sup>1</sup></b> , not less than three in number.	M. Mobius (Chairman), S. Mikhailov, A. Shokhin

<sup>1</sup> Members of the Board of Directors, but not part of the Board.



Regulations on the Strategy and Investment Committee

Regulations on the Audit Committee

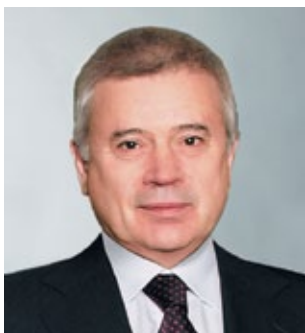
Regulations on the HR and Compensation Committee

## Management Committee of LUKOIL

The Management Committee is the Company's collegial executive body. It is headed by the Committee Chairman and is appointed each year by the Board of Directors.



LUKOIL Corporate Governance Report 2012, p. 9  
Fact Book, p. 104



**VAGIT  
ALEKPEROV**

President of LUKOIL  
Member of the LUKOIL Board of Directors  
Chairman of the LUKOIL Management Committee

Born 1950

Graduated in 1974 from the Azizbekov Institute of Oil and Chemistry in Azerbaijan. Doctor of Economics, current Member of the Russian Academy of Natural Sciences. Awarded four orders, eight medals, a Diploma and two Letters of Acknowledgement from the President of the Russian Federation. Winner of two Russian Government Prizes in science and technology. Worked in the oil industry in Azerbaijan and Western Siberia (from 1968). CEO of the Production Association Kogalymneftegaz of Glavtyumenneftegaz of the USSR Ministry of Oil and GasKogalymneftegaz (oil production company), a division of Glavtyumenneftegaz within the Ministry of the Oil & Gas Industry of the USSR (1987–1990). Deputy, then First Deputy to the USSR Oil & Gas Industry Minister (1990–1991). President of Langepasuraykogalymneft (oil production group) (1992–1993). Chairman of the Board of Directors of LUKOIL (1993–2000). President of LUKOIL (from 1993).

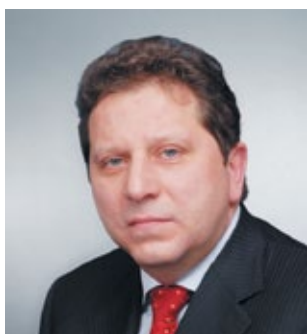


**ANATOLY  
BARKOV**

Member of the LUKOIL Management Committee  
Vice-President, Head of the Main Division of General Affairs, Corporate Security and Communications of LUKOIL

Born 1948

Graduated in 1992 from Ufa Oil Institute. Doctoral Candidate in Economic Science. Honored Employee of the Oil & Gas Industry of the Russian Federation. Awarded an order and 10 medals. Head of Operations, Head of Oil & Gas Production, Senior Engineer at Kogalymneftegaz (1987–1992). Executive Director, then Director of the Department of Foreign Projects at Langepasuraykogalymneft (1992–1993). Vice-President, Head of the Main Division of General Affairs, Corporate Security and Communications of LUKOIL (1993–2012). Vice-President for General Affairs, Corporate Security and Communications of LUKOIL (from 2012).



**VADIM  
VOROBYOV**

**Member of the Management Committee of LUKOIL**  
**Vice-President for Coordination of Petroleum Products Sales of LUKOIL**

**Born 1961**

Graduated in 1983 from Lobachevsky State University of Gorky, in 1998 from N. I. Lobachevsky State University of Nizhny Novgorod. Doctoral Candidate in Economics. Awarded two medals. Komsomol and Communist Party work (1981–1992). Management positions in insurance and bank structures in Nizhny Novgorod (1992–1998). Vice-President, President of NORSI-OIL (1998–2002). CEO of LUKOIL-Volganefteprodukt (2002–2005). Vice-President of LUKOIL and Head of the Main Department for Coordination of Petroleum Product Sales in Russia (2005–2009). Vice-President of LUKOIL and Head of the Main Department for Coordination of Petroleum Product Sales (2009–2012). Vice-President for Coordination of Petroleum Product Sales of LUKOIL (from 2012).



**SERGEI  
KUKURA**

**Member of the LUKOIL Management Committee**  
**First Vice-President of LUKOIL (Economics and Finance)**

**Born 1953**

Graduated in 1979 from the Ivano-Frankovsk Institute of Oil & Gas. Doctor of Economics. Honored Economist of the Russian Federation. Awarded an order and five medals, and Letter of Acknowledgement from the President of the Russian Federation. Winner of a Russian Government Prize for Science and Technology. Vice-President of Langepasuraykogalymneft (1992–1993). First Vice-President of LUKOIL (from 1993).



**RAVIL  
MAGANOV**

**Member of the LUKOIL Board of Directors**  
**Member of the LUKOIL Management Committee**  
**First Executive Vice-President of LUKOIL (Exploration & Production)**  
**Member of the LUKOIL BoD Strategy and Investment Committee**

**Born 1954**

Graduated in 1977 from Moscow Gubkin Petrochemical & Gas Institute. Honored Employee of the Oil & Gas Industry of the Russian Federation. Awarded three orders and three medals. Winner of three Russian Government Prizes in science and technology. Chief Engineer, Deputy CEO, CEO of Langepasneftegaz (oil production company) (1988–1993). Vice-President of LUKOIL (1993–1994). First Vice-President of LUKOIL (1994–2006). First Executive Vice-President of LUKOIL (from 2006).



**SERGEI  
MALYUKOV**

**Member of the LUKOIL Management Committee**  
**Vice-president for Control and Internal Audit of LUKOIL**

**Born 1954**

Graduated in 1977 from Dzerzhinsky Military Academy and in 1997 from the Higher School of Economics. Doctoral Candidate in Philosophy. Awarded five medals. Service in the armed forces (1972–1995). Head of Section, Head of Division, Head of Department of the Main Division for Strategic Development and Securities Investment Analysis of LUKOIL (1995–2010). Head of the Main Division for Control, Internal Audit and Risk Management (2010–January 2012). Vice-President for Control and Internal Audit of LUKOIL (from 2012).

**IVAN  
MASLIAEV**

**Member of the LUKOIL Management Committee**  
**Vice-President, General Counsel of LUKOIL**

**Born 1958**

Graduated in 1980 from Lomonosov Moscow State University. Doctoral Candidate in Law. Honored Lawyer of the Russian Federation. Awarded three medals. Head of the Legal Department of Langepasuraykogalymneft (1992–1993). Head of the Legal Department at LUKOIL (1994–1999). Head of the Main Division for Legal Support at LUKOIL (2000–January 2012). Vice-President, General Counsel of LUKOIL (from 2012).

**ALEXANDER  
MATYTSYN**

**Member of the LUKOIL Management Committee**  
**Vice-President for Finance of LUKOIL**

**Born 1961**

Graduated in 1984 from Lomonosov Moscow State University. Doctoral Candidate in Economics. MBA from Bristol University (1997). Honored Economist of the Russian Federation. Awarded a medal, 'For services to Russia' (2nd grade). Director and CEO of international auditing firm KPMG (1994–1997). Vice-President, Head of the Main Division of Treasury and Corporate Finance of LUKOIL (1997–2012). Vice-President for Finance of LUKOIL (from 2012).



**ANATOLY  
MOSKALENKO**

**Member of the LUKOIL Management Committee  
Vice-President of LUKOIL for Human Resource Management and Development  
of Corporate Structure**

**Born 1959**

Graduated in 1980 from Moscow Higher School of the Armed Forces, from the Military-Diplomatic Academy in 1987, and from the Russian Presidential Civil Service Academy in 2005. Doctoral Candidate in Economics. Awarded five orders and 20 medals. Served in the Armed Forces (1976–2001). Head of the Human Resources Department of LUKOIL (2001–2003). Head of the Main Division of Human Resources at LUKOIL (2003–January 2012). Vice-President of LUKOIL for Human Resource Management and Development of Corporate Structure (from 2012).



**VLADIMIR  
MULYAK**

**Member of the LUKOIL Management Committee  
Vice-President for Technologies and Development of Oil & Gas Fields of LUKOIL**

**Born 1955**

Graduated from Moscow Gubkin Petrochemical & Gas Institute in 1977. Doctoral Candidate in Geological and Mineral Sciences. Doctor of Technical Science. Awarded a medal of the order 'For services to Russia' (2nd grade). Winner of a Russian Government Prize for Science and Technology. Chief Engineer, Head of Lasyeganneft oil & gas production unit of LUKoil-Langepasneftegaz (1990–1996). First Deputy CEO for Production, CEO of Belorusneft (1996–2001). First Vice-President for Production of KomiTEK in 2001. Chief Engineer, First Deputy CEO, CEO of LUKOIL-Komi (2002–2007). Vice-President, Head of the Main Division of Oil & Gas Production of LUKOIL (2007–2012). Vice-President for Technologies and Development of Oil & Gas Fields of LUKOIL (from 2012).





**VLADIMIR  
NEKRASOV**

**Member of the LUKOIL Management Committee  
First Vice-President of LUKOIL (Refining & Marketing)**

**Born 1957**

Graduated in 1978 from Tyumen Industrial Institute. Doctoral Candidate in Technical Science, Member of the Academy of Mining Sciences. Awarded two orders and six medals. Winner of a Russian Government Prize. Chief Engineer, CEO of Kogalymneftegaz (part of LUKOIL-Western Siberia) (1992–1999). Vice-President of LUKOIL and CEO of LUKOIL-Western Siberia (1999–2005). First Vice-President of LUKOIL since 2005.



**VALERY  
SUBBOTIN**

**Member of the LUKOIL Management Committee  
Vice-President for Supplies and Sales of LUKOIL**

**Born 1974**

Graduated from Tyumen State University in 1996. Awarded a medal of the order 'For Services to Russia' (2nd grade). Worked at LUKOIL-Prague, LUKOIL-Bulgaria, and the Moscow Representative Office of the company LITASCO (1998–2003). First Deputy Head of the Office of the Board of Directors of LUKOIL (2003–2005). Vice-President, Head of the Main Division of Supplies and Sales of LUKOIL (2007–2012). Vice-President for Supplies and Sales of LUKOIL (from 2012).

**GENNADY  
FEDOTOV**

**Member of the LUKOIL Management Committee  
Vice-President for Economics and Planning of LUKOIL**

**Born 1970**

Graduated from the Moscow Physics and Technology Institute in 1993. Awarded a medal of the order 'For Services to Russia' (2nd grade). Worked at the companies Halliburton and Shell (1994–2002). Head of Section, Deputy Head, Head of the Main Division for Corporate Budget and Economic Planning of LUKOIL (2002–2007). Vice-President, Head of the Main Division for Economics and Planning of LUKOIL (2007–2012). Vice-President for Economics and Planning of LUKOIL (from 2012).

**LEONID  
FEDUN**

**Member of the LUKOIL Management Committee  
Vice-President for Strategic Development of LUKOIL**

**Born 1956**

Graduated in 1977 from Rostov Nedelin Higher Military School. Doctoral Candidate in Philosophy. Awarded two orders and seven medals. CEO of LUKoil Consulting (1993–1994). Vice-President and Head of the Main Division of Strategic Development and Investment Analysis of LUKOIL (1994–2012). Vice-President for Strategic Development of LUKOIL (from 2012).



**EVGENY  
KHAVKIN**

**Member of the LUKOIL Management Committee  
Vice-President, Head of the BoD Office of LUKOIL**

**Born 1964**

Graduated in 2003 from the Moscow Institute of Economy, Management and Law. Awarded two medals. Worked in oil companies in Western Siberia (from 1988). Deputy Head, then First Deputy Head of the BoD Office of LUKOIL (1997–2003). BoD Secretary, Head of the BoD Office of LUKOIL (2003– January 2012). Vice-President, Head of the BoD Office of LUKOIL (from February 2012).



**LYUBOV  
KHOBA**

**Member of the LUKOIL Management Committee  
Vice-President, Chief Accountant of LUKOIL**

**Born 1957**

Graduated in 1992 from Sverdlovsk Institute of National Economy. Doctoral Candidate in Economic Science. Honored Economist of the Russian Federation. Awarded two medals and an order. Chief Accountant at Kogalymneftegaz (1991–1993). Chief Accountant at LUKOIL (1993–2000). Vice-President of LUKOIL, Head of Financial Accounting (2000–2003). Chief Accountant and Vice-President of LUKOIL (2003–2004). Chief Accountant of LUKOIL (2004–2012). Vice-President, Chief Accountant of LUKOIL (from 2012).

### Share of members of the Board of Directors Management Committee in charter capital of LUKOIL as of December 31, 2012 <sup>1</sup>

BoD and Management Committee members	Share, %
Vagit Alekperov	20,87 <sup>2</sup>
Viktor Blazheev	–
Valery Grayfer	0.007
Igor Ivanov	–
Richard H. Matzke	–
Ravil Maganov	0.37
Sergei Mikhailov	0.06
Mark Mobius	–
Guglielmo Moscato	–
Ivan Pictet	–
Alexander Shokhin	–
Anatoly Barkov	0.07
Vadim Vorobyov	0.006
Sergei Kukura	0.39
Sergei Malyukov	0.001
Ivan Masliaev	0.02
Alexander Matytsyn	0.30
Anatoly Moskalenko	0.01
Vladimir Mulyak	0.01
Vladimir Nekrasov	0.04
Valery Subbotin	0.007
Gennady Fedotov	0.002
Leonid Fedun	9,27 <sup>2</sup>
Evgeny Khavkin	0.01
Lyubov Khoba	0.34

<sup>1</sup> Unless otherwise indicated, share stakes of BoD and Management Committee members are shown in accordance with requirements of Russian law for disclosure of such information, and include shares held directly by Board/Management Committee members as well as shares held by nominee investors in their names.

<sup>2</sup> Including beneficiary ownership.

### The following members of the Board of Directors also submitted information to the Company regarding ownership of ADRs on the Company's ordinary shares (including beneficiary ownership):

Name of BoD member	Stake in charter capital, corresponding to the number of ADRs, %
Richard H. Matzke	0.0003
Guglielmo Moscato	0.00006
Ivan Pictet	0.006

### REMUNERATION TO MEMBERS OF THE BOARD OF DIRECTORS AND MANAGEMENT COMMITTEE

As decided by the LUKOIL AGM, each member of the Board of Directors was paid a remuneration of 4.7 million rubles in 2012 for carrying out their duties. There were additional payments for the roles of Board Chairman (1.1 million rubles), Chairman of a BoD Committee (550 thousand rubles), as well as some other types of payment associated with duties of Board members and members of BoD Committees. Members of the Board of Directors also received compensation for costs associated with fulfilment of their duties as Board members, the nature of which was defined by the LUKOIL AGM on 24 June 2004, in the amount of factually incurred costs, which are confirmed by documents. Mark Mobius, a BoD member, filled for rejection of the remuneration that was offered to him by the decision of the LUKOIL AGM, and the rejection was taken into account in the making of payments to BoD members.

In the reporting year members of the Management Committee were paid remuneration equal to their monthly salary in their principle job. This payment was made in accordance with the main terms of contracts, drawn up with members of the Management Committee, subject to the achievement of key performance indicators during the reporting period. Members of the Management Committee also received an annual base salary, annual bonus payments based on results of their work during the year, additional compensations of a social nature, and annual long-term premium payments in the framework of the long-term incentive program for employees of LUKOIL and its subsidiaries. Size of long-term premium payments was calculated by multiplying the number of shares conditionally owned by a Company official by the dividend per share, which was approved by the Annual General Meeting of Shareholders.

### Remuneration to members of the of BoD and Management Committee of LUKOIL

Board of Directors	Paid in 2012, thousand rubles				Total
	Salary	Bonuses	Remuneration	Other payments	
Board of Directors <sup>1</sup>	–	–	61,380	11,580	72,960
Management Committee	538,030	552,712	38,881	28,655	1,158,278

<sup>1</sup> For members of the Board of Directors, who are also members of the Management Committee, remuneration received for their work on the Board of Directors is reflected only in the 'Board of Directors' line, and their salary, premiums, and remuneration as Management Committee members is reflected only in the 'Management Committee' line.

## Changes in Group Structure

**LUKOIL is implementing a plan of asset restructuring aimed at raising the level of transparency and efficiency of management processes, consolidating core subsidiaries and withdrawing non-core and inefficient assets from the Group.**

About 4,3 thousand non-core, unused and inefficient assets with total value of \$128 million were disposed of outside LUKOIL Group in 2012 as part of the implementation of the Group's programme for disposal of non-core and inefficient assets during 2010–2013. They included shares and interest in the capital of other companies, items of real estate, land plots, vehicles, social infrastructure facilities and other facilities and items.

The number of organizations within LUKOIL Group, as defined by GAAP principles, rose by four units in 2012 to stand at 340 units as of January 1, 2013, including 60 belonging to subsidiaries and affiliates.

A total of 28 organizations became a part of the Group during the reporting year, of which 8 were acquired, 11 entered the Group together with acquired companies, and 9 were newly created, including 2 through spin-offs. A total of 28 companies left the Group, of which 8 due to sale of share stakes, 1 was disposed of together with a company that was sold, 4 were liquidated, and 15 were reorganized through mergers.

## Financial Management

**By observing strict financial discipline LUKOIL achieves high levels of financial stability and a low debt burden, ensuring easy access to capital markets.**

Further work by LUKOIL to improve its cash flow management system caused rating agencies to confirm LUKOIL's investment rating, and Standard & Poor's raised its rating outlook for the Company from stable to positive in May 2012.

Uninterrupted, full and timely financing by the Group of its costs, including capital investments, acquisitions, and increase of payments to shareholders (including interim dividends) amounted to more than \$16 billion in 2012.

LUKOIL carried out work in 2012 to optimize its credit portfolio by reduction of debt financing costs and extension of existing debt

instruments on the best market terms. Total debt was reduced by 27.2% to \$6.621 billion. Secured debt amounted to \$421 million (6.4% of the total) and \$5.632 billion of borrowings (85.1% of the total) were at fixed interest rates.

Work continued in 2012 to reduce the amount of trade credit provided by Group organizations to counterparties (third parties) including advances, payment deferrals, and payment by instalments, and to extend the use of documentary instruments. These efforts are intended to reduce needs for working capital and to ensure greater efficiency in its use.

The Company has installed a system of financial risk monitoring as part of its project to build a system that prevents cash flow interruptions; adequacy and availability of relevant information was tested and a mathematical business model for LUKOIL Group was designed as well as an interactive Group report taking account of risk factors.

## Internal Control and Internal Audit

The system of internal control and internal audit is an integral part of the Company's corporate governance structure, ensuring that the Company operates efficiently and that the interests of its shareholders and investors are protected. The Group's specialized sub-divisions for control and internal audit, led by the Internal Control and Audit Service, ensure that management receives objective and accurate information on the business of organizations in LUKOIL Group.

**About 1,100 control audit and control checks were carried out at LUKOIL Group organizations in all business segments during 2012.**

The main purposes of the checks were:

- analysis of the appropriateness, reliability and efficiency of internal control and risk management;
- ensuring that LUKOIL Group assets are properly kept and efficiently used;
- checking that activities by LUKOIL organizations correspond to current legislation, resolutions by LUKOIL governing bodies and regional bylaws;

- monitoring the observance of established corporate standards and of rules that govern operating, investment and financial activities;
- assessing the accuracy of management and financial accounting;
- identifying shortcomings and assessing the reliability and efficiency of systems for internal control, corporate governance and risk management;
- identifying significant risks related to the business of Group organizations and designing recommendations on ways to minimize such risks.

Company subsidiaries and structural sub-divisions of the Company used the recommendations made on the basis of internal audit to design action plans to address any shortcomings and violations that had been identified. In order to ensure efficiency of its internal audit process, LUKOIL constantly monitors execution of decisions taken by the Company's governing bodies as a result of audits and execution of approved measures that have been designed on the basis of internal audit recommendations.



[LUKOIL Corporate Governance Report 2012, p. 14](#)

### *Compliance with international standards*

The Company has designed a Program for improving the quality of internal audit for the period 2012–2016 in order to develop

internal audit practice and ensure its compliance with international audit standards. A range of actions were carried out in 2012 for the development of internal audit:

Actions	Results in 2012
Creation and improvement of an integrated system of quality assessment	<ul style="list-style-type: none"> <li>• BoD approval of a Resolution on Internal Audit at OJSC LUKOIL;</li> <li>• BoD approval of Internal Audit Rules for OJSC LUKOIL;</li> <li>• Internal assessment of quality and usefulness of internal audit at LUKOIL organizations.</li> </ul>
Improvement of productive cooperation and consulting support between structural sub-divisions	<ul style="list-style-type: none"> <li>• Ensuring participation by internal auditors in the design of measures to address shortcomings and violations, which have been identified;</li> <li>• Discussion of the results of audit checks with the heads of organizations and responsible structural sub-divisions of the Company;</li> <li>• Periodic reporting to the Company President and governance bodies concerning the results of audit checks;</li> <li>• Creation of a report on the state of internal control, audit and risk management.</li> </ul>
Creation of a general corporate system for continued professional development of internal auditors	<ul style="list-style-type: none"> <li>• Holding of an annual professional conference at the Company, steps to raise the level of qualification of employees at control and audit sub-divisions of LUKOIL Group organizations;</li> <li>• Encouraging internal auditors to obtain professional certification and update certification which has already been obtained.</li> </ul>
Use of a risk-oriented approach to internal audit planning	Design of plans for the conduct of control and audit checks based on information concerning substantial risks, provided by Group organizations and structural sub-divisions, taking account of the general corporate register of risks, which was compiled in 2012.

### *Audit*

The Company works continuously to ensure that audit activities are carried out at Group organizations. Audit inspections were carried out at 64 group organizations during 2012.

## Information Disclosure

**High levels of liquidity of Company securities, broad access to capital markets and excellent share price dynamics are the result of well-planned cooperation with the investment community.**

The system of corporate information disclosure for the investment community, which has been in place at the Company for the last decade, is viewed as exemplary on the Russian stock market. LUKOIL has repeatedly been the outright prize winner or has been among prize winners at annual report competitions.

A visit for investors was organized in 2012 to the Company's production sites in Astrakhan and Volgograd. More than 50 buy-side and sell-side analysts and fund managers took part in the visit.

The Company took part in 19 investment conferences during 2012, and about 300 individual and group meetings were held (2.5 more than in 2011), at which 670 investors had the opportunity of meeting with senior managers and representatives of LUKOIL's investor relations service.

### *Public information products for investment community*

In addition to publications, which meet the standard regulatory requirements for information disclosure, the Company publishes on an annual basis an Analysts Databook and Fact Book, which provide detailed industrial and financial statistics for the Company. Once every two years LUKOIL publishes a Sustainability Report for its Russian business. Since 2011 the Company has published a Corporate Governance Report in compliance with the rules of the UK Financial Services Authority.

 [LUKOIL Corporate Governance Report 2012, p. 17](#)



## Company Securities

**Company shares are among the most liquid instruments on the Russian stock market.**

### LUKOIL share price in 2012

The price for company shares showed substantial growth of 17.5% in 2012 to end the year at 2,000.2 rubles (MICEX trading).

**17.5%** share price growth on the MICEX in 2012

Company shares were among the best performers in the Russian oil & gas sector, but they remain undervalued in comparison with Russian and international peers. We are setting ourselves the target of realizing this growth potential in the near future.

**More than \$76 billion** annual turnover of shares and ADRs

Trends in the world economy and perceptions of risk made investors cautious about the Russian stock market throughout 2012. However, adoption of a new business strategy for 2012–2021, a share buy-back and corporate transparency gave strong support to Company shares. International stock markets began 2012 in a mood of optimism on expectations of political measures to tackle the world's economic problems: slowdown of economic


growth in the USA and China, and the crisis in the Eurozone. The largest setback for stocks markets occurred in May, when an asset sell-off was provoked by fears of deepening of the crisis in the Eurozone and loss of economic growth momentum in the USA. Share trends in the summer were mainly on low volumes. Coordinated action by European politicians to overcome the crisis and expectations of a further round of quantitative easing in the USA enabled a resumption of growth on share and commodity markets. But investor confidence flagged in the fall and did not recover again until December. Once again LUKOIL shares outperformed the overall Russian share market and the oil & gas sector in particular.

The biggest investment houses raised their recommendations for LUKOIL shares, increasing the average target price to \$82 per share.

**More than \$56 billion** capitalization

At the end of 2012 more than 87% of analysts were recommending to buy the Company's shares.

LUKOIL shares continue to be used as a basis for derivative securities on forward markets. Future and option contracts for delivery of LUKOIL shares are one of the main instruments in the futures section of the RTS market.

 [Fact Book, p. 106](#)  
[Analyst Databook, p. 66](#)

LUKOIL share price on the MICEX exchange in 2012, rubles



# ADRs

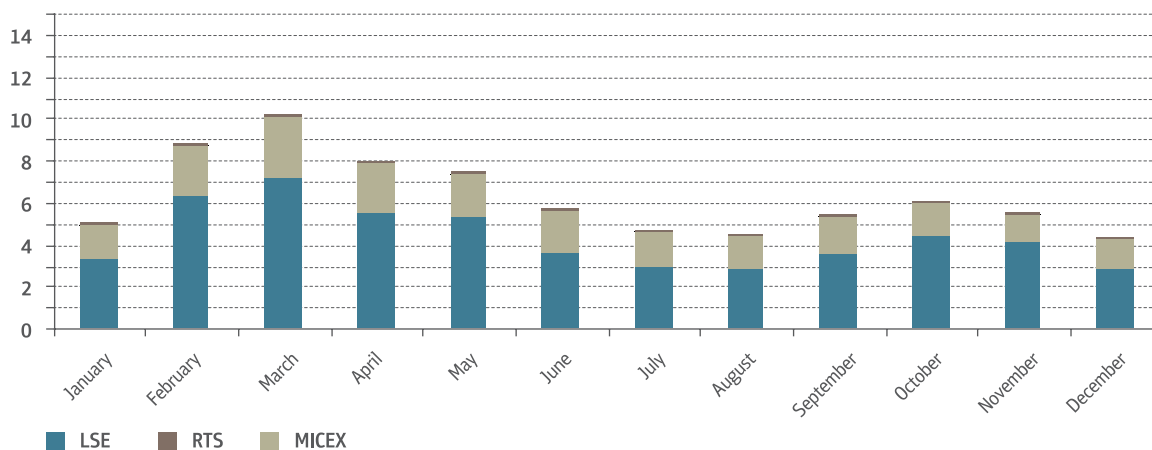
**10** years  
since listing on the  
London Stock  
Exchange

In 2012 the Company marked the 10th anniversary of its listing on the London Stock Exchange. Since 2002 LUKOIL depository receipts have won a position among the most liquid instruments

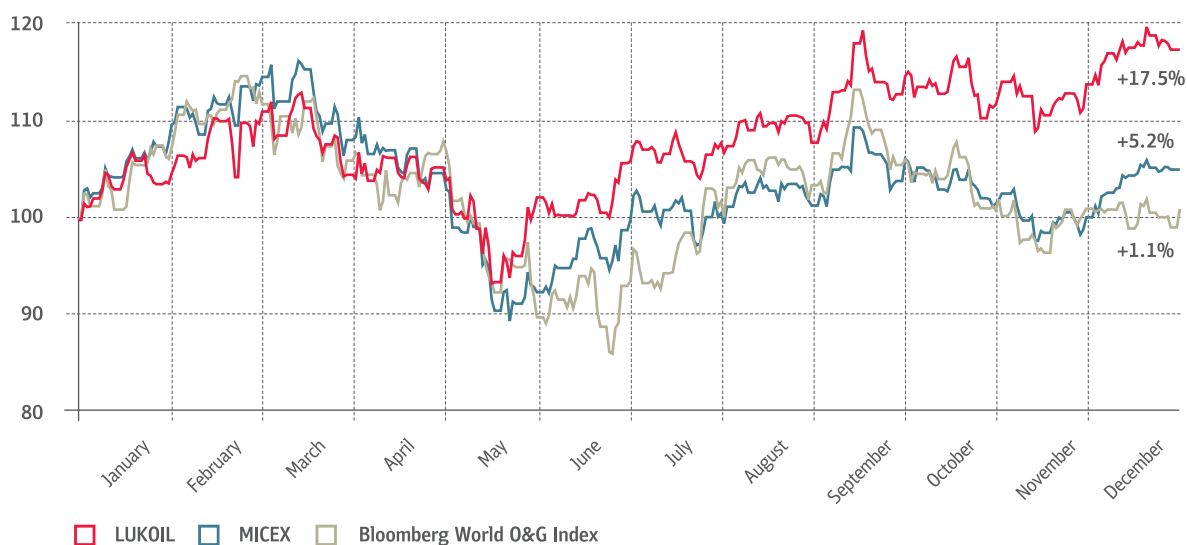
of Eastern European issuers available on the LSE (15.3% of average monthly trading volumes on the IOB system). Total value of LUKOIL ADR trading in 2012 was in excess of \$53 billion

The Company's depository receipts are also traded over the counter in the USA, and on exchanges in Frankfurt, Munich and Stuttgart. By the end of 2012 total issued depository receipts were equivalent to 538.9 million shares of LUKOIL (63.4% of Company charter capital).

Monthly trading in shares and ADRs of LUKOIL in 2012, \$ billion



## LUKOIL share price compared with Bloomberg Oils Index and MICEX Index in 2012



## Recommendations of analysts at major investment banks for LUKOIL shares

	Q1	Q2	Q3	Q4
Buy	67%	87%	80%	87%
Hold	33%	13%	20%	13%
Sell	0%	0%	0%	0%

Charter capital of OJSC LUKOIL as of January 1, 2013 amounted to 21,264,081 rubles and 37.5 kopeks, divided into 850,563,255

shares. More than 50,000 individuals and legal entities around the world are shareholders of the Company.

## Changes in ownership structure of LUKOIL share capital in 2012

 Main LUKOIL shareholders <sup>1</sup> (> 1% of ordinary shares)

	% of total shares on January 1, 2013	% of total shares on January 1, 2012
ING Bank (Eurasia)	77.69	75.94
National Clearing Depository	11.80	
Depository-Clearing Company		8.47
National Depository Center		5.52
SDK Garant	3.95	3.93
OJSC URALSIB	1.44	1.42
J.P. Morgan Bank International LLC	1.42	

<sup>1</sup> Nominee.

## Dividends

**22.9** %  
dividend payout

LUKOIL bases its dividend policy on a balance of interests between the Company and its shareholders, aiming to increase the Company's investment attractiveness and shareholder value, and to respect and strictly observe the rights of shareholders, as set out in acting legislation of the Russian Federation, the Company Charter and internal documents.

Dividend payments for 2012 may be increased by comparison with 2011. On April 22, 2013 the Board of Directors recommended the Annual General Meeting of Shareholders to approve dividends for 2012 at a level of 50 rubles per share (not including interim dividends, paid on the results of the respective reporting period of 2012 in the amount of 40 rubles per ordinary share).

So the total dividend amount for the 2012 financial year may be 90 rubles per share and dividend yield – 4.88%. Base income per ordinary share in 2012 will be \$14.47 compared with \$13.30 in 2011.

### Dividends per ordinary share and dividend yield

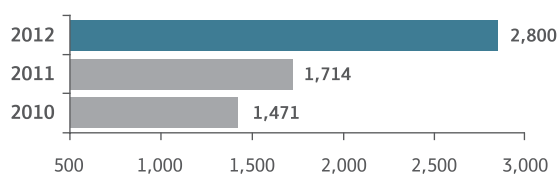
Year	Dividend, rubles	Dividend, \$	Dividend yield, % <sup>1</sup>
2007	42	1.71	2.02
2008	50	1.70	2.86
2009	52	1.72	3.48
2010	59	1.94	3.52
2011	75	2.33	4.17
2012 <sup>2</sup>	90	2.96	4.88

<sup>1</sup> Dividend yield is calculated using average market price per ordinary share on the MICEX Exchange and the ruble/USD exchange rate at the end of the year, for which dividends are paid.

<sup>2</sup> The total dividend amount for the 2012 financial year (including 50 rubles per ordinary share recommended by the Board of Directors to the Annual General Meeting of Shareholders and interim dividends paid earlier for the respective reporting period of 2012 in the amount of 40 rubles per ordinary share).

 **LUKOIL Dividend Policy**  
Analyst Databook, p. 67

### Dividends paid on ordinary shares of the Company, \$ million



## Reference Information

The most complete and up-to-date information about LUKOIL can always be found on the Company's website: [www.lukoil.ru](http://www.lukoil.ru) (Russian) or [www.lukoil.com](http://www.lukoil.com) (English).

The site also provides information about main aspects and results of LUKOIL's business, as well as accurate and up-to-date information about events concerning the Company and the whole spectrum of LUKOIL activities, including details of the Company's social and environmental policies.

The Investor and Shareholder Center on the site presents the company's financial and industrial results, dividend history, share prices, an investor calculator, individual shareholder page, presentations for investors, and Company reports.

### LEGAL ADDRESS AND CENTRAL OFFICE

11, Sretensky Boulevard, Moscow, 101 000, Russia

### CENTRAL INFORMATION SERVICE

Tel: +7 (495) 627-44-44, 628-98-41

Fax: +7 (495) 625-70-16

### SHAREHOLDER RELATIONS

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Fax: +7 (495) 627-41-91

E-mail: [shareholder@lukoil.com](mailto:shareholder@lukoil.com)

### INVESTOR RELATIONS

Tel: + 7 (495) 627-16-96

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11, Sretensky Boulevard, Moscow, 101 000, Russia

Tel: + 7 (495) 981-79-18

Fax: + 7 (495) 627-41-91

### NIKOIL REGISTRAR COMPANY

8 Ivana Franko street, Moscow, 121108, Russia

Tel/fax for individuals: + 7 (495) 926-81-73

Tel/fax for corporates: + 7 (495) 926-81-61

### PUBLISHED REPORTS

Electronic versions of the following reports are available on the Company web site:

1. Report on Company Business.
2. Consolidated Financial Accounts.
3. Quarterly Consolidated Financial Accounts.
4. Management Discussion and Analysis of Financial Situation and Results of Operations
5. Analyst Databook.
6. Fact Book.

### CONCEPTS AND ABBREVIATIONS USED IN THE REPORT

Mentions of 'OJSC LUKOIL', 'LUKOIL Group', 'the Group', 'LUKOIL', 'the Company', 'we' and 'our' are equivalent for the purposes of this Report and refer to LUKOIL Group of companies, to LUKOIL and/or its subsidiary enterprises, depending upon the context in which the terms are used.

The average ruble/dollar exchange rate for 2012 (31.1 rubles/dollar) is used in conversion of ruble figures for expression in dollars, unless otherwise indicated.

Figures for reserves and production of oil include oil, gas condensate and natural gas liquids.

'Regions' with a capital 'R' refers to administrative divisions of the Russian Federation, 'regions' with a small 'r' refers to general geographical divisions.

'Reference fuel' is a rough measure to enable comparisons between different types of fuel, based on their energy content.

1 tonne of reference fuel = one tonne of crude oil = 1,000 m<sup>3</sup> of natural gas.

### ABBREVIATIONS

*boe* – barrels of oil equivalent (1 boe = 6,000 cubic feet of gas)

*km* – kilometer

*ppm* – parts per million

*PSA* – production sharing agreement

*RTS* – Russian Trading System

*MICEX* – Moscow Interbank Currency Exchange

OAO LUKOIL  
CONSOLIDATED FINANCIAL  
STATEMENTS

(prepared in accordance  
with US GAAP)

As of December 31, 2012 and 2011  
and for each of the years in the  
three-year period ended  
December 31, 2012



ZAO «KPMG»  
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Moscow, Russia 123317

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Fax +7 (495) 937 4400/99  
Internet www.kpmg.ru

## Auditors' Report

To the Board of Directors  
OAO LUKOIL

We have audited the accompanying consolidated financial statements of OAO LUKOIL and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the consolidated statements of comprehensive income, stockholders' equity and cash flows for 2012, 2011 and 2010, and the related notes to the consolidated financial statements.

### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on the fair presentation of these consolidated financial statements based on our audits. We conducted our audits in accordance with Russian Federal Auditing Standards and auditing standards generally accepted in the United States of America. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to express an opinion on the fair presentation of these consolidated financial statements.

Audited entity: Open Joint Stock Company "Oil company "LUKOIL"

Registered by Moscow Registration Chamber on 22 of April 1993, Registration No. 024020.

Entered in the Unified State Register of Legal Entities on 17 July 2002 by Department of Ministry of Taxes and Duties, Registration No. 1027700035769, Certificate series 77 No 007892347

11, Sretensky Boulevard, Moscow, Russia, 101000

Independent auditor: ZAO KPMG, a company incorporated under the Laws of the Russian Federation, a part of the KPMG Europe LLP group, and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Registered by the Moscow Registration Chamber on 25 May 1992, Registration No. 011.585.

Included in the Unified State Register of Legal Entities on 13 August 2002 by the Moscow Inter-Regional Tax Inspectorate No.39 of the Ministry for Taxes and Duties of the Russian Federation, Registration No. 1027700125628, Certificate series 77 No. 005721432.

Member of the Non-commercial Partnership "Chamber of Auditors of Russia".  
The Principal Registration Number of the Entry in the State Register of Auditors and Audit Organisations: No.10301000804.

### **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO LUKOIL and its subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for 2012, 2011 and 2010 in accordance with U.S. generally accepted accounting principles.

### **Other Matter**

U.S. generally accepted accounting principles require that the Supplementary Information on Oil and Gas Exploration and Production Activities on pages 41 through 47 be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context.

We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Sloutsky E.A.  
Director, power of attorney No. 49/10 dated October 1, 2010  
ZAO KPMG

February 22, 2013  
Moscow, Russian Federation



OAQ LUKOIL Consolidated Balance Sheets  
As of December 31, 2012 and 2011  
(Millions of US dollars, unless otherwise noted)

	Note	2012	2011
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	3	2,914	2,753
Short-term investments		286	157
Accounts receivable, net	5	8,667	8,921
Inventories	6	8,098	7,533
Prepaid taxes and other expenses		3,541	3,219
Other current assets		767	946
<b>Total current assets</b>		<b>24,273</b>	<b>23,529</b>
Investments	7	4,124	5,952
Property, plant and equipment	8, 9	66,883	56,803
Deferred income tax assets	13	569	591
Goodwill and other intangible assets	10	1,964	1,344
Other non-current assets		1,148	2,973
<b>Total assets</b>		<b>98,961</b>	<b>91,192</b>
<b>Liabilities and Equity</b>			
<b>Current liabilities</b>			
Accounts payable		7,263	5,995
Short-term borrowings and current portion of long-term debt	11	658	1,792
Taxes payable		2,802	2,271
Other current liabilities		1,730	1,050
<b>Total current liabilities</b>		<b>12,453</b>	<b>11,108</b>
Long-term debt	12, 16	5,963	7,300
Deferred income tax liabilities	13	3,651	2,790
Asset retirement obligations	8	2,195	2,120
Other long-term liabilities		511	408
<b>Total liabilities</b>		<b>24,773</b>	<b>23,726</b>
<b>Equity</b>	<b>15</b>		
<b>OAQ LUKOIL stockholders' equity</b>			
Common stock		15	15
Treasury stock, at cost		(5,189)	(4,081)
Equity-linked notes		(2,500)	(980)
Additional paid-in capital		4,734	4,798
Retained earnings		76,216	67,940
Accumulated other comprehensive loss		(69)	(54)
<b>Total OAQ LUKOIL stockholders' equity</b>		<b>73,207</b>	<b>67,638</b>
Non-controlling interests		981	(172)
<b>Total equity</b>		<b>74,188</b>	<b>67,466</b>
<b>Total liabilities and equity</b>		<b>98,961</b>	<b>91,192</b>

President of OAQ LUKOIL

Alekperov V.Y.

Vice-president – Chief accountant of OAQ LUKOIL

Khoba L.N.

The accompanying notes are an integral part of these consolidated financial statements.

	Note	2012	2011	2010
<b>Revenues</b>				
Sales (including excise and export tariffs)	22	139,171	133,650	104,956
<b>Costs and other deductions</b>				
Operating expenses		(9,359)	(9,055)	(8,298)
Cost of purchased crude oil, gas and products		(64,148)	(59,694)	(43,250)
Transportation expenses		(6,171)	(6,121)	(5,608)
Selling, general and administrative expenses		(3,755)	(3,822)	(3,558)
Depreciation, depletion and amortization		(4,832)	(4,473)	(4,154)
Taxes other than income taxes	13	(13,666)	(12,918)	(8,978)
Excise and export tariffs		(22,836)	(22,217)	(18,878)
Exploration expenses		(364)	(532)	(336)
Gain (loss) on disposals and impairments of assets		30	(1,663)	(363)
<b>Income from operating activities</b>		<b>14,070</b>	<b>13,155</b>	<b>11,533</b>
Interest expense		(538)	(694)	(712)
Interest and dividend income		257	211	174
Equity share in income of affiliates	7	518	690	472
Currency translation loss		(512)	(301)	(122)
Other non-operating (expense) income		(72)	58	125
<b>Income before income taxes</b>		<b>13,723</b>	<b>13,119</b>	<b>11,470</b>
Current income taxes		(2,738)	(2,678)	(2,104)
Deferred income taxes		(60)	(615)	(247)
<b>Total income tax expense</b>	<b>13</b>	<b>(2,798)</b>	<b>(3,293)</b>	<b>(2,351)</b>
<b>Net income</b>		<b>10,925</b>	<b>9,826</b>	<b>9,119</b>
Net loss (income) attributable to non-controlling interests		79	531	(113)
<b>Net income attributable to OAO LUKOIL</b>		<b>11,004</b>	<b>10,357</b>	<b>9,006</b>
Earnings per share of common stock attributable to OAO LUKOIL (US dollars):				
	15			
Basic		14.47	13.30	10.95
Diluted		14.17	13.04	10.94
<b>Other comprehensive income, net of tax:</b>				
Defined benefit pension plan:				
Prior service cost arising during the period		-	22	12
Actuarial loss		(15)	(9)	(4)
<b>Other comprehensive (loss) income</b>		<b>(15)</b>	<b>13</b>	<b>8</b>
<b>Comprehensive income</b>		<b>10,910</b>	<b>9,839</b>	<b>9,127</b>
Comprehensive loss (income) attributable to non-controlling interests		79	531	(113)
<b>Comprehensive income attributable to OAO LUKOIL</b>		<b>10,989</b>	<b>10,370</b>	<b>9,014</b>

OAo LUKOIL Consolidated Statements of Stockholders' Equity  
For the years ended December 31, 2012, 2011 and 2010  
(Millions of US dollars, unless otherwise noted)

	2012		2011		2010	
	Stockhold- ers' equity	Comprehen- sive income	Stockhold- ers' equity	Comprehen- sive income	Stockhold- ers' equity	Comprehen- sive income
Common stock						
Balance as of January 1	15		15		15	
<b>Balance as of December 31</b>	<b>15</b>		<b>15</b>		<b>15</b>	
Treasury stock						
Balance as of January 1	(4,081)		(3,683)		(282)	
Stock purchased	(128)		(398)		(3,664)	
Stock disposed	-		-		263	
Equity-linked notes conversion	(980)		-		-	
<b>Balance as of December 31</b>	<b>(5,189)</b>		<b>(4,081)</b>		<b>(3,683)</b>	
Equity-linked notes						
Balance as of January 1	(980)		(980)		-	
Equity-linked notes purchased	(2,500)		-		(980)	
Equity-linked notes conversion	980		-		-	
<b>Balance as of December 31</b>	<b>(2,500)</b>		<b>(980)</b>		<b>(980)</b>	
Additional paid-in capital						
Balance as of January 1	4,798		4,700		4,699	
Premium on non-outstanding shares issued	-		-		1	
Effect of stock compensation plan	(197)		98		98	
Convertible bonds issue	-		-		113	
Changes in non-controlling interests	133		-		(141)	
Treasury stock disposed	-		-		(70)	
<b>Balance as of December 31</b>	<b>4,734</b>		<b>4,798</b>		<b>4,700</b>	
Retained earnings						
Balance as of January 1	67,940		59,212		51,634	
Net income	11,004	11,004	10,357	10,357	9,006	9,006
Dividends on common stock	(2,728)		(1,629)		(1,428)	
<b>Balance as of December 31</b>	<b>76,216</b>		<b>67,940</b>		<b>59,212</b>	
Accumulated other comprehensive loss, net of tax						
Balance as of January 1	(54)		(67)		(75)	
Pension benefits:						
Prior service cost	-	-	22	22	12	12
Actuarial loss	(15)	(15)	(9)	(9)	(4)	(4)
<b>Balance as of December 31</b>	<b>(69)</b>		<b>(54)</b>		<b>(67)</b>	
Total comprehensive income		10,989		10,370		9,014
<b>Total OAo LUKOIL stockholders' equity as of December 31</b>	<b>73,207</b>		<b>67,638</b>		<b>59,197</b>	
Non-controlling interests						
Balance as of January 1	(172)		411		388	
Net (loss) income attributable to non-controlling interests	(79)		(531)		113	
Changes in non-controlling interests	1,232		(52)		(90)	
<b>Balance as of December 31</b>	<b>981</b>		<b>(172)</b>		<b>411</b>	
<b>Total equity as of December 31</b>	<b>74,188</b>		<b>67,466</b>		<b>59,608</b>	

The accompanying notes are an integral part of these consolidated financial statements.

	Share activity		
	2012	2011	2010
	(thousands of shares)	(thousands of shares)	(thousands of shares)
<hr/>			
Common stock, issued			
Balance as of January 1	850,563	850,563	850,563
<b>Balance as of December 31</b>	<b>850,563</b>	<b>850,563</b>	<b>850,563</b>
<hr/>			
Treasury stock			
Balance as of January 1	(76,101)	(69,208)	(3,836)
Purchase of treasury stock	(2,096)	(6,893)	(68,912)
Disposal of treasury stock	-	-	3,540
Equity-linked notes conversion	(17,500)	-	-
<b>Balance as of December 31</b>	<b>(95,697)</b>	<b>(76,101)</b>	<b>(69,208)</b>

OAo LUKOIL Consolidated Statements of Cash Flows  
For the years ended December 31, 2012, 2011 and 2010  
(Millions of US dollars)

	Note	2012	2011	2010
<b>Cash flows from operating activities</b>				
<b>Net income attributable to OAo LUKOIL</b>		<b>11,004</b>	<b>10,357</b>	<b>9,006</b>
Adjustments for non-cash items:				
Depreciation, depletion and amortization		4,832	4,473	4,154
Equity share in income of affiliates, net of dividends received		102	185	316
Dry hole write-offs		127	417	225
(Gain) loss on disposals and impairments of assets		(30)	1,663	363
Deferred income taxes		60	615	247
Non-cash currency translation loss (gain)		293	(214)	(44)
Non-cash investing activities		(18)	(6)	(67)
All other items – net		153	(447)	167
Changes in operating assets and liabilities:				
Trade accounts receivable		641	(758)	(2,285)
Inventories		(126)	(1,420)	(813)
Accounts payable		1,001	885	1,508
Taxes payable		468	177	274
Other current assets and liabilities		490	(413)	490
<b>Net cash provided by operating activities</b>		<b>18,997</b>	<b>15,514</b>	<b>13,541</b>
<b>Cash flows from investing activities</b>				
Acquisition of licenses		(921)	(25)	(15)
Capital expenditures		(11,647)	(8,249)	(6,596)
Proceeds from sale of property, plant and equipment		412	156	128
Purchases of investments		(453)	(101)	(137)
Proceeds from sale of investments		252	79	126
Sale of subsidiaries and equity method affiliates, net of cash disposed		27	227	130
Acquisitions of subsidiaries and equity method affiliates, net of cash acquired		(886)	(1,100)	(932)
<b>Net cash used in investing activities</b>		<b>(13,216)</b>	<b>(9,013)</b>	<b>(7,296)</b>
<b>Cash flows from financing activities</b>				
Net movements of short-term borrowings		(32)	(633)	(213)
Proceeds from issuance of long-term debt		597	1	2,515
Principal repayments of long-term debt		(1,831)	(1,372)	(2,267)
Dividends paid on Company common stock		(2,800)	(1,714)	(1,471)
Dividends paid to non-controlling interest stockholders		(113)	(116)	(85)
Financing received from non-controlling interest stockholders		2	3	18
Purchase of Company's stock		(128)	(398)	(3,664)
Sale of Company's stock		–	–	193
Purchase of equity-linked notes		(740)	(1,760)	(980)
Purchases of non-controlling interest		(635)	(34)	(192)
<b>Net cash used in financing activities</b>		<b>(5,680)</b>	<b>(6,023)</b>	<b>(6,146)</b>
Effect of exchange rate changes on cash and cash equivalents		60	(93)	(5)
<b>Net increase in cash and cash equivalents</b>		<b>161</b>	<b>385</b>	<b>94</b>
Cash and cash equivalents at beginning of year		2,753	2,368	2,274
<b>Cash and cash equivalents at end of year</b>	<b>3</b>	<b>2,914</b>	<b>2,753</b>	<b>2,368</b>
Supplemental disclosures of cash flow information				
Interest paid		497	683	718
Income taxes paid		1,585	2,508	2,126

The accompanying notes are an integral part of these consolidated financial statements.

## NOTE 1.

### ORGANIZATION AND ENVIRONMENT

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

The Group was established in accordance with Presidential Decree 1403, issued on November 17, 1992. Under this decree, on April 5, 1993, the Government of the Russian Federation transferred to the Company 51% of the voting shares of fifteen enterprises. Under Government Resolution 861 issued on September 1, 1995, a further nine enterprises were transferred to the Group during 1995. Since 1995, the Group has carried out a share exchange program to increase its shareholding in each of the twenty-four founding subsidiaries to 100%.

From formation, the Group has expanded substantially through consolidation of its interests, acquisition of new companies and establishment of new businesses.

#### *Business and economic environment*

The accompanying financial statements reflect management's assessment of the impact of the business environment in the countries in which the Group operates on the operations and the financial position of the Group. The future business environments may differ from management's assessment.

#### *Basis of preparation*

These consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

## NOTE 2.

### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### *Principles of consolidation*

These consolidated financial statements include the financial position and results of the Company, controlled subsidiaries of which the Company directly or indirectly owns more than 50% of the voting interest, unless non-controlling stockholders have substantive participating rights, and variable interest entities where the Group is determined to be the primary beneficiary. Other significant investments in companies of which the Company directly or indirectly owns between 20% and 50% of the voting interest and over which it exercises significant influence but not control, are accounted for using the equity method of accounting. Investments in companies of which the Company directly or indirectly owns more than 50% of the voting interest but

where non-controlling stockholders have substantive participating rights are accounted for using the equity method of accounting. Undivided interests in oil and gas joint ventures are accounted for using the proportionate consolidation method. Investments in other companies are recorded at cost. Equity investments and investments in other companies are included in "Investments" in the consolidated balance sheet.

#### *Use of estimates*

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying value of oil and gas properties and other property, plant and equipment, goodwill impairment assessment, asset retirement obligations, deferred income taxes, valuation of financial instruments, and obligations related to employee benefits. Eventual actual amounts could differ from those estimates.

#### *Revenue*

Revenues are recognized when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed or determinable. Revenues include excise on petroleum products' sales and duties on export sales of crude oil and petroleum products.

Revenues from non-cash sales are recognized at the fair market value of the crude oil and petroleum products sold.

#### *Foreign currency translation*

The Company maintains its accounting records in Russian rubles. The Company's functional currency is the US dollar and the Group's reporting currency is the US dollar.

For the majority of operations in the Russian Federation and outside the Russian Federation, the US dollar is the functional currency. Where the US dollar is the functional currency, monetary assets and liabilities have been translated into US dollars at the rate prevailing at each balance sheet date. Non-monetary assets and liabilities have been translated into US dollars at historical rates. Revenues, expenses and cash flows have been translated into US dollars at rates which approximate actual rates at the date of the transaction. Translation differences resulting from the use of these rates are included in profit or loss.

For certain other operations, where the US dollar is not the functional currency and the economy is not highly inflationary, assets and liabilities are translated into US dollars at year-end exchange rates and revenues and expenses are translated

at average exchange rates for the year. Resulting translation adjustments are reflected as a separate component of other comprehensive income.

In all cases, foreign currency transaction gains and losses are included in profit or loss.

As of December 31, 2012, 2011 and 2010, exchange rates of 30.37, 32.20 and 30.48 Russian rubles to the US dollar, respectively, have been used for translation purposes.

#### **Cash and cash equivalents**

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less.

#### **Cash with restrictions on immediate use**

Cash funds for which restrictions on immediate use exist are accounted for within other non-current assets.

#### **Accounts receivable**

Accounts receivable are recorded at their transaction amounts less provisions for doubtful debts. Provisions for doubtful debts are recorded to the extent that there is a likelihood that any of the amounts due will not be collected. Non-current receivables are discounted to the present value of expected cash flows in future periods using the original discount rate.

#### **Inventories**

The cost of finished goods and purchased products is determined using the first-in, first-out cost method (FIFO). The cost of all other inventory categories is determined using the "average cost" method.

#### **Investments**

Debt and equity securities are classified into one of three categories: trading, available-for-sale, or held-to-maturity.

Trading securities are bought and held principally for the purpose of selling in the near term. Held-to-maturity securities are those securities in which a Group company has the ability and intent to hold until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are included in profit or loss. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are reported as a separate component of other comprehensive income until realized. Realized

gains and losses from the sale of available-for-sale securities are determined on a specific identification basis. Dividends and interest income are recognized in profit or loss when earned.

A permanent decline in the market value of any available-for-sale or held-to-maturity security below cost is accounted for as a reduction in the carrying amount to fair value. The impairment is charged to profit or loss and a new cost base for the security is established. Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective interest method and such amortization and accretion is recorded in profit or loss.

#### **Property, plant and equipment.**

Oil and gas properties are accounted for using the successful efforts method of accounting whereby property acquisitions, successful exploratory wells, all development costs (including development dry holes and the Group's share of operators' expenses during the development stage of production sharing and risk service contracts), and support equipment and facilities are capitalized. Unsuccessful exploratory wells are expensed when a well is determined to be non-productive. Other exploratory expenditures, including geological and geophysical costs are expensed as incurred.

The Group continues to capitalize costs of exploratory wells and exploratory-type stratigraphic wells for more than one year after the completion of drilling if the well has found a sufficient quantity of reserves to justify its completion as a producing well and the Company is making sufficient progress towards assessing the reserves and the economic and operating viability of the project. If these conditions are not met or if information that raises substantial doubt about the economic or operational viability of the project is obtained, the well would be assumed impaired, and its costs, net of any salvage value, would be charged to expense.

Depreciation, depletion and amortization of capitalized costs of oil and gas properties is calculated using the unit-of-production method based upon proved reserves for the cost of property acquisitions and proved developed reserves for exploration and development costs.

Production and related overhead costs are expensed as incurred.

Depreciation of assets not directly associated with oil production is calculated on a straight-line basis over the economic lives of such assets, estimated to be in the following ranges:

Buildings and constructions	5 – 40	Years
Machinery and equipment	5 – 20	Years

In addition to production assets, certain Group companies also maintain and construct social assets for the use of local communities. Such assets are capitalized only to the extent that they are expected to result in future economic benefits to the Group. If capitalized, they are depreciated over their estimated economic lives.

Significant unproved properties are assessed for impairment individually on a regular basis and any estimated impairment is charged to expense.

#### ***Asset retirement obligations***

The Group records the fair value of liabilities related to its legal obligations to abandon, dismantle or otherwise retire tangible long-lived assets in the period in which the liability is incurred. A corresponding increase in the carrying amount of the related long-lived asset is also recorded. Subsequently, the liability is accreted for the passage of time and the related asset is depreciated using the unit-of-production method.

#### ***Goodwill and other intangible assets***

Goodwill represents the excess of the cost of an acquired entity over the net of the fair value amounts assigned to assets acquired and liabilities assumed. It is assigned to reporting units as of the acquisition date. Goodwill is not amortized, but is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The impairment test requires assessing qualitative factors and then, if it is necessary, estimating the fair value of a reporting unit and comparing it with its carrying amount, including goodwill assigned to the reporting unit. If the estimated fair value of the reporting unit is less than its net carrying amount, including goodwill, then the goodwill is written down to its implied fair value.

Intangible assets with indefinite useful lives are tested for impairment at least annually. Intangible assets that have limited useful lives are amortized on a straight-line basis over the shorter of their useful or legal lives.

#### ***Impairment of long-lived assets***

Long-lived assets, such as oil and gas properties (other than unproved properties), other property, plant, and equipment, and purchased intangibles subject to amortization, are assessed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future cash flows expected to be generated by that group. If the carrying amount of an asset group exceeds its estimated undiscounted future cash flows, an impair-

ment charge is recognized by writing down the carrying amount to the estimated fair value of the asset group, generally determined as discounted future net cash flows. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale are presented separately in the appropriate asset and liability sections of the balance sheet.

#### ***Income taxes***

Deferred income tax assets and liabilities are recognized in respect of the future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purposes of the consolidated financial statements and their respective tax bases and in respect of operating loss and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse and the assets be recovered and liabilities settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in profit or loss in the reporting period which includes the enactment date.

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income in the reporting periods in which the originating expenditure becomes deductible. In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that the deferred income tax assets will be realized. In making this assessment, management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies.

An income tax position is recognized only if the uncertain position is more likely than not of being sustained upon examination, based on its technical merits. A recognized income tax position is measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties relating to income tax in income tax expense in profit or loss.

#### ***Interest-bearing borrowings***

Interest-bearing borrowings from third parties (except convertible notes) are initially recorded at the value of net proceeds received. Any difference between the net proceeds and the redemption value is amortized at a constant rate over the term of the borrowing. Amortization is included in profit or loss and the carrying amounts are adjusted as amortization accumulates.

For borrowings from related parties (except convertible notes) issued with an interest rate lower than the market interest rate, the Group determines book value using market interest rate.



The resulting difference is allocated to additional paid-in capital and is amortized at a constant rate over the term of the borrowings. Amortization is included in profit or loss each period and the carrying amounts are adjusted as amortization accumulates.

For convertible notes issued with a cash conversion option, the Group allocates the proceeds from issuance between a liability component and an equity component. The Group records the equity component at an amount equal to the difference between the proceeds received and the fair value of the liability component, measured as the fair value of a similar liability that does not have an associated equity component. The Group recognizes the interest cost in subsequent periods at its borrowing rate for non-convertible debt.

If borrowings are repurchased or settled before maturity, any difference between the amount paid and the carrying amount is recognized in profit or loss in the period in which the repurchase or settlement occurs.

#### ***Pension benefits***

The expected costs in respect of pension obligations of Group companies are determined by an independent actuary. Obligations in respect of each employee are accrued over the periods during which the employee renders service to the Group.

The Group recognizes the funded status of the postretirement defined benefit plan in the consolidated balance sheet with corresponding adjustments to accumulated other comprehensive income. The adjustment to accumulated other comprehensive income represents the net unrecognized actuarial gains and unrecognized prior service costs. These amounts are subsequently recognized as net periodic benefit cost. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods are recognized as a component of other comprehensive income. These amounts are subsequently recognized as a component of net periodic benefit cost on the same basis as the amounts recognized in accumulated other comprehensive income.

#### ***Treasury stock***

Purchases by Group companies of the Company's outstanding stock are recorded at cost and classified as treasury stock within Stockholders' equity. Shares shown as Authorized and Issued include treasury stock. Shares shown as Outstanding do not include treasury stock.

#### ***Earnings per share***

Basic earnings per share is computed by dividing net income available to common stockholders of the Company by the weighted-average number of shares of common stock outstanding during

the reporting period. A calculation is carried out to establish if there is potential dilution in earnings per share if convertible securities were to be converted into shares of common stock or contracts to issue shares of common stock were to be exercised. If there is such dilution, diluted earnings per share is presented.

#### ***Contingencies***

Certain conditions may exist as of the balance sheet date, which may result in losses to the Group but the impact of which will only be resolved when one or more future events occur or fail to occur.

If a Group company's assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability is accrued and charged to profit or loss. If the assessment indicates that a potentially material loss is not probable, but is reasonably possible, or is probable, but cannot be reasonably estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, is disclosed in the notes to the consolidated financial statements. Loss contingencies considered remote or related to unasserted claims are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

#### ***Environmental expenditures***

Estimated losses from environmental remediation obligations are generally recognized no later than completion of remedial feasibility studies. Group companies accrue for losses associated with environmental remediation obligations when such losses are probable and reasonably estimable. Such accruals are adjusted as further information becomes available or circumstances change. Costs of expected future expenditures for environmental remediation obligations are not discounted to their present value.

#### ***Use of derivative instruments***

The Group's derivative activity is limited to certain petroleum products' marketing and trading operations and hedging of commodity price risks. Currently this activity involves the use of futures and swaps contracts together with purchase and sale contracts that qualify as derivative instruments. The Group accounts for these activities under the mark-to-market methodology in which the derivatives are revalued each accounting period. Resulting realized and unrealized gains or losses are presented in profit or loss on a net basis. Unrealized gains and losses are carried as assets or liabilities on the consolidated balance sheet.

#### ***Share-based payments***

The Group accounts for liability classified share-based payment awards to employees at fair value on the date of grant and as of

each reporting date. Expenses are recognized over the vesting period. Equity classified share-based payment awards to employees are valued at fair value on the date of grant and expensed over the vesting period.

#### **Comparative amounts**

Certain prior period amounts have been reclassified to conform with the current period's presentation.

#### **Changes in accounting policy**

In September 2011, the FASB issued Accounting Standards Update ("ASU") No. 2011-08, *"Testing Goodwill for Impairment,"* which allows an entity to use a qualitative approach to test goodwill for impairment. This ASU permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount and hence whether it is necessary to perform the two-step goodwill impairment test as required by the provisions of Topic 350 of the Codification. ASU No. 2011-08 is effective for annual and interim goodwill impairment tests performed for the fiscal years beginning after December 15, 2011. The Group adopted the requirements of ASU No. 2011-08 starting from the first quarter of 2012. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

In June 2011, the FASB issued ASU No. 2011-05, *"Presentation of comprehensive income,"* which amends Topic 220 of the Codification. This ASU increases the prominence of other comprehensive income in financial statements. Under this ASU, an entity has the option to present the components of net income and comprehensive income in either one or two statements. The ASU eliminates the option in US GAAP to present other comprehensive income in the statement of changes in equity. ASU No. 2011-05 is effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011 (except those reclassification adjustments deferred by ASU No. 2011-12) and should be applied retrospectively. The Group adopted the requirements of ASU No. 2011-05 starting from the first quarter of 2012. This adoption changed the presentation of net and comprehensive incomes and stockholders' equity, but did not have any impact on the Group's results of operations, financial position or cash flows.

In May 2011, the FASB issued ASU No. 2011-04, *"Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs,"* which amends Topic 820 of the Codification. This ASU provides guidance for fair value measurements and disclosure requirements and clarifies the Board's intent about the application of existing fair value measurement requirements. The new standard does not extend the use of fair value but, rather, provides guidance about how fair value should be applied where it already is required or permitted under US GAAP.

ASU No. 2011-04 is effective for public entities during interim and annual periods beginning after December 15, 2011 and should be applied prospectively. The Group adopted the requirements of ASU No. 2011-04 starting from the first quarter of 2012. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In April 2011, the FASB issued ASU No. 2011-02, *"A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring,"* which amends Topic 310 of the Codification. This ASU provides additional guidance in considering whether a restructuring constitutes a troubled debt restructuring and helps creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties. ASU No. 2011-02 is effective starting from the first interim or annual period beginning on or after June 15, 2011. The Group adopted the requirements of ASU No. 2011-02 starting from the third quarter of 2011. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

#### **Recent accounting pronouncements**

In December 2011, the FASB issued ASU No. 2011-11, *"Disclosures about Offsetting Assets and Liabilities."* This ASU requires entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. ASU No. 2011-11 is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods, and should be applied retrospectively.

In January 2013, the FASB issued ASU No. 2013-01 *"Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities,"* which clarifies that ordinary trade receivables and receivables are not in the scope of ASU No. 2011-11. The Group is evaluating the effect of the adoption of ASU No. 2011-11 and does not expect any material impact on its results of operations, financial position or cash flows.

**NOTE 3.**  
**CASH AND CASH EQUIVALENTS**

	As of December 31, 2012	As of December 31, 2011
Cash held in Russian rubles	571	926
Cash held in US dollars	1,816	1,224
Cash held in other currencies	403	271
Cash held in related party banks in Russian rubles	117	309
Cash held in related party banks in other currencies	7	23
<b>Total cash and cash equivalents</b>	<b>2,914</b>	<b>2,753</b>

**NOTE 4.**  
**NON-CASH TRANSACTIONS**

The consolidated statement of cash flows excludes the effect of non-cash transactions, which are described in the following table:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Non-cash investing activity	18	6	67
<b>Total non-cash transactions</b>	<b>18</b>	<b>6</b>	<b>67</b>

The following table shows the effect of non-cash transactions on investing activity:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Net cash used in investing activity	13,216	10,773	7,296
Non-cash investing activity	18	6	67
<b>Total investing activity</b>	<b>13,234</b>	<b>10,779</b>	<b>7,363</b>

**NOTE 5.**  
**ACCOUNTS RECEIVABLE, NET**

	As of December 31, 2012	As of December 31, 2011
Trade accounts receivable (net of provisions of \$247 million and \$179 million as of December 31, 2012 and 2011, respectively)	6,431	7,209
Current VAT and excise recoverable	1,862	1,333
Other current accounts receivable (net of provisions of \$57 million and \$54 million as of December 31, 2012 and 2011, respectively)	374	379
<b>Total accounts receivable, net</b>	<b>8,667</b>	<b>8,921</b>

**NOTE 6.  
INVENTORIES**

	As of December 31, 2012	As of December 31, 2011
Crude oil and petroleum products	6,765	6,265
Materials for extraction and drilling	387	321
Materials and supplies for refining	93	57
Other goods, materials and supplies	853	890
<b>Total inventories</b>	<b>8,098</b>	<b>7,533</b>

**NOTE 7.  
INVESTMENTS**

	As of December 31, 2012	As of December 31, 2011
Investments in equity method affiliates and joint ventures	2,794	4,887
Long-term loans to equity method affiliates and joint ventures	1,312	1,001
Other long-term investments	18	64
<b>Total long-term investments</b>	<b>4,124</b>	<b>5,952</b>

*Investments in "equity method" affiliates and joint ventures*

The summarized financial information below is in respect of equity method affiliates and corporate joint ventures. The 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.

	Year ended December 31, 2012		Year ended December 31, 2011		Year ended December 31, 2010	
	Total	Group's share	Total	Group's share	Total	Group's share
Revenues	29,618	4,160	32,770	4,777	24,348	3,672
Income before income taxes	13,617	945	13,832	1,005	9,187	675
Less income taxes	(5,387)	(427)	(4,241)	(315)	(2,682)	(203)
<b>Net income</b>	<b>8,230</b>	<b>518</b>	<b>9,591</b>	<b>690</b>	<b>6,505</b>	<b>472</b>

	As of December 31, 2012		As of December 31, 2011	
	Total	Group's share	Total	Group's share
Current assets	6,399	983	7,379	1,406
Property, plant and equipment	18,738	4,015	19,064	5,587
Other non-current assets	523	167	1,454	462
<b>Total assets</b>	<b>25,660</b>	<b>5,165</b>	<b>27,897</b>	<b>7,455</b>
Short-term debt	1,182	277	1,100	223
Other current liabilities	3,409	496	3,703	668
Long-term debt	7,717	1,256	7,461	1,069
Other non-current liabilities	1,406	342	1,581	608
<b>Net assets</b>	<b>11,946</b>	<b>2,794</b>	<b>14,052</b>	<b>4,887</b>

In April 2011, the Company and OA0 ANK Bashneft signed an agreement to establish a joint venture and to develop two oil fields named after R.Trebs and A.Titov, located in the Nenets Autonomous District of Russia. According to the agreement, the mineral rights for the development of the fields were re-issued by OA0 ANK Bashneft in favor of its 100% subsidiary 000 Bashneft-Polus. In December 2011, the Company acquired 25.1% of 000 Bashneft-Polus for \$153 million, and 000 Bashneft-Polus acquired 29 exploration wells located on these fields from a Group company for \$60 million. The parties agreed to transport oil extracted from the fields

via the Group's transportation infrastructure and to consider the exploitation of certain other nearby infrastructure owned by the Group. In May 2012, state authorities cancelled the order to transfer the mineral rights for the development of the fields named after R.Trebs and A.Titov to the joint venture and the license was returned to OA0 ANK Bashneft. Management does not believe that this matter will have a material adverse effect on the Group's financial condition. The Company and OA0 ANK Bashneft are continuing their cooperation within the project and are carrying out actions for re-issuance of the mineral rights by the state authorities in favor of 000 Bashneft-Polus.

**NOTE 8.**  
**PROPERTY, PLANT AND EQUIPMENT AND ASSET RETIREMENT OBLIGATIONS**

	At cost		Net	
	As of December 31, 2012	As of December 31, 2011	As of December 31, 2012	As of December 31, 2011
Exploration and Production:				
Russia	61,123	54,269	39,092	34,415
International	9,700	8,138	7,487	6,376
<b>Total</b>	<b>70,823</b>	<b>62,407</b>	<b>46,579</b>	<b>40,791</b>
Refining, Marketing, Distribution and Chemicals:				
Russia	13,600	12,133	8,140	7,395
International	10,297	6,903	7,375	4,282
<b>Total</b>	<b>23,897</b>	<b>19,036</b>	<b>15,515</b>	<b>11,677</b>
Power generation and other:				
Russia	5,621	4,890	4,501	4,026
International	429	406	288	309
<b>Total</b>	<b>6,050</b>	<b>5,296</b>	<b>4,789</b>	<b>4,335</b>
<b>Total property, plant and equipment</b>	<b>100,770</b>	<b>86,739</b>	<b>66,883</b>	<b>56,803</b>

The Company performs a regular annual impairment test of its assets. The test is based on geological models and development programs, which are revised on a regular basis, at least annually. The fair value of tested assets is determined using the present value of the expected cash flows. Fair value measurements models used in the impairment tests were Level 3 (unobservable inputs) fair value measurements.

During the year ended December 31, 2011, the Company recognized an impairment loss on exploration and production assets of OOO Narianmarneftegaz ("NMNG") in the amount of \$1,175 million, as well as an impairment loss of \$175 million for assets related to the international refining, marketing and distribution segment.

The following tables set out values of property, plant and equipment measured at fair value on a nonrecurring basis in periods subsequent to their initial recognition:

	Fair value	Level 3 fair value measurements	Before-tax loss
<b>Year ended December 31, 2011</b>			
Property, plant and equipment	1,195	1,195	1,350

As of December 31, 2012 and 2011, the asset retirement obligations amounted to \$2,200 million and \$2,126 million, respectively, of which \$5 million and \$6 million was included

in "Other current liabilities" in the consolidated balance sheets as of each balance sheet date.

During 2012 and 2011, asset retirement obligations changed as follows:

	2012	2011
Asset retirement obligations as of January 1	2,126	1,798
Accretion expense	172	158
New obligations	147	172
Changes in estimates of existing obligations	(263)	173
Spending on existing obligations	(5)	(5)
Property dispositions	(10)	(5)
Foreign currency translation and other adjustments	33	(165)
<b>Asset retirement obligations as of December 31</b>	<b>2,200</b>	<b>2,126</b>

The asset retirement obligations incurred during 2012 and 2011 were Level 3 (unobservable inputs) fair value measurements.

#### NOTE 9. SUSPENDED WELLS

Net changes in capitalized exploratory suspended well costs during 2012, 2011 and 2010 were as follows:

	2012	2011	2010
Balance as of January 1	542	478	479
Additions pending the determination of proved reserves	25	97	156
Charged to expenses	-	-	(94)
Reclassification to proved properties	(43)	(33)	(63)
<b>Balance as of December 31</b>	<b>524</b>	<b>542</b>	<b>478</b>

Aging of capitalized suspended exploratory well costs were as follows:

	As of December 31, 2012	As of December 31, 2011	As of December 31, 2010
<b>Exploratory well costs capitalized</b>			
for a period of one year or less	21	78	148
for two years	66	144	72
for three years	133	72	89
for four years	67	82	155
for five years or more	237	166	14
for a period of greater than one year	503	464	330
<b>Total exploratory well costs capitalized</b>	<b>524</b>	<b>542</b>	<b>478</b>
Number of projects that have exploratory well costs capitalized for a period greater than one year	8	14	11

Aging of the exploratory wells that have been capitalized for more than one year since completion of drilling as of December 31, 2012:

Project name (field name)	Location	As of December 31, 2012	Years wells drilled
Block A	Saudi Arabia	255	2007-2010
Cape Three Points Deep Water	Ghana	92	2010
Centralno-Astrakhanskoe	European Russia	80	2007-2009
Independence	Cote d'Ivoire	66	2011
Aral	Uzbekistan	5	2010
3 projects of less than \$4 million each	European Russia	5	2002-2009
<b>Total of 8 projects</b>		<b>503</b>	

Capitalized exploratory well costs of \$255 million that are related to two fields in the "Block A" area in Saudi Arabia are represented by four wells drilled in 2007-2010. The wells were suspended pending final assessment of the operational and economic viability of the project. During 2011, to assess the required technology for the development and extraction of the tight gas reservoirs, the Group engaged an international engineering survey company to evaluate recompletion options for the wells, to prove the commercialization potential of the appraisal area and to optimize the stimulation technology for its development. These evaluations were completed in December 2011. During 2012, the Group held several meetings with the project partner, Saudi Arabian Oil Company, to confirm a common position for negotiations of amendments to the current Upstream Agreement with the government of Saudi Arabia. As a result of these meetings, the partners agreed the approach to reserves estimation, products yield as well as pricing and marketing matters and possible ways of project cost efficiency

improvement. During 2013, the partners will submit the proposals on field evaluation and project implementation measures for consideration and approval by the Saudi Arabian Government with the view of taking a decision on further project development.

Capitalized exploratory well costs of \$92 million that are related to block "Cape Three Points Deep Water" in Ghana are represented by one exploratory well which discovered an oil and gas condensate field and confirmed the presence of reserves within the block. One appraisal well was drilled in 2011, which was unsuccessful and written off. The Group extended the exploratory period until 2013. Additionally, according to signed contract for rig rental one exploratory well will be drilled during 2013.

Capitalized exploratory well costs of \$80 million that are related to Centralno-Astrakhanskoe gas field in European part of Russia are represented by two exploratory wells drilled in 2007-2009.

Seismic and geophysical works, as well as drilling of structural wells are planned on the field during 2013-2015 in order to determine the position of future exploratory wells.

Capitalized exploratory well costs of \$66 million that are related to block "CI-401" in Cote d'Ivoire are represented by one explora-

tory well. During 2012, the Group and other participants entered into the appraisal period till June 30, 2014. According to signed contract for rig rental one appraisal well will be drilled during 2013.

The Company is evaluating the development plans for the other projects.

**NOTE 10.**  
**GOODWILL AND OTHER INTANGIBLE ASSETS**

The carrying value of goodwill and other intangible assets as of December 31, 2012 and 2011 was as follows:

	As of December 31, 2012	As of December 31, 2011
Amortized intangible assets		
Software	419	389
Licenses and other assets	276	343
Goodwill	1,269	612
<b>Total goodwill and other intangible assets</b>	<b>1,964</b>	<b>1,344</b>

All goodwill amounts relate to the refining, marketing and distribution segment. In the third quarter of 2012, the Group obtained control over the joint venture which operates the ISAB refinery (Priolo, Italy) and recognized goodwill in

the amount of \$646 million (*refer to Note 17. Business combinations*). Additional goodwill in the amount of \$11 million relates to other acquisitions.

**NOTE 11.**  
**SHORT-TERM BORROWINGS AND CURRENT PORTION OF LONG-TERM DEBT**

	As of December 31, 2012	As of December 31, 2011
Short-term borrowings from third parties	113	118
Short-term borrowings from related parties	13	30
Current portion of long-term debt	532	1,644
<b>Total short-term borrowings and current portion of long-term debt</b>	<b>658</b>	<b>1,792</b>

Short-term borrowings from third parties are unsecured and include amounts repayable in US dollars of \$54 million and \$56 million, amounts repayable in Euros of \$11 million and \$17 million and amounts repayable in other currencies of \$48 million and

\$45 million as of December 31, 2012 and 2011, respectively. The weighted-average interest rate on short-term borrowings from third parties was 5.75% and 4.93% per annum as of December 31, 2012 and 2011, respectively.



**NOTE 12.****LONG-TERM DEBT**

	As of December 31, 2012	As of December 31, 2011
Long-term loans and borrowings from third parties (including loans from banks in the amount of \$885 million and \$1,120 million as of December 31, 2012 and 2011, respectively)	1,287	2,652
6.375% non-convertible US dollar bonds, maturing 2014	898	897
2.625% convertible US dollar bonds, maturing 2015	1,436	1,412
6.356% non-convertible US dollar bonds, maturing 2017	500	500
7.250% non-convertible US dollar bonds, maturing 2019	596	596
6.125% non-convertible US dollar bonds, maturing 2020	998	998
6.656% non-convertible US dollar bonds, maturing 2022	500	500
13.35% Russian ruble bonds, maturing 2012	–	776
9.20% Russian ruble bonds, maturing 2012	–	311
7.40% Russian ruble bonds, maturing 2013	198	186
Capital lease obligations	82	116
<b>Total long-term debt</b>	<b>6,495</b>	<b>8,944</b>
Current portion of long-term debt	(532)	(1,644)
<b>Total non-current portion of long-term debt</b>	<b>5,963</b>	<b>7,300</b>

**Long-term loans and borrowings**

Long-term loans and borrowings from third parties include amounts repayable in US dollars of \$1,037 million and \$834 million, amounts repayable in Euros of \$230 million and \$284 million, amounts repayable in Russian rubles of \$1 million and \$1,514 million, and amounts repayable in other currencies of \$19 million and \$20 million as of December 31, 2012 and 2011, respectively. This debt has maturity dates from 2013 through 2023. The weighted-average interest rate on long-term loans and borrowings from third parties was 2.28% and 5.39% per annum as of December 31, 2012 and 2011, respectively. A number of long-term loan agreements contain certain financial covenants which are being met by the Group. Approximately 33% of total long-term loans and borrowings from third parties are secured by export sales and property, plant and equipment.

A Group company has a secured loan agreement with Asian Development bank, BNP Paribas (Suisse), Credit Agricole Corporate and Investment bank, the Korea Development bank and Islamic Development bank with an outstanding amount of \$197 million as of December 31, 2012. Borrowings under this agreement bear interest at three month LIBOR plus 3.00% per annum and have maturity dates up to 2020.

The Company has an unsecured syndicated loan agreement with the European Bank for Reconstruction and Development with

an outstanding amount of \$126 million as of December 31, 2012, maturing up to 2017. Borrowings under this agreement bear interest from six month LIBOR plus 0.45% to six month LIBOR plus 0.65% per annum.

A Group company has a secured loan agreement with Credit Suisse, supported by an Overseas Private Investment Corporation guarantee, with an outstanding amount of \$111 million as of December 31, 2012. Borrowings under this agreement bear interest at six month LIBOR plus 4.8% per annum and have maturity dates up to 2015.

A Group company has an unsecured syndicated loan agreement with an outstanding amount of \$105 million as of December 31, 2012, with maturity dates up to 2013. The loan was arranged by ABN AMRO Bank, Banco Bilbao Vizcaya Argentaria, BNP Paribas, The Bank of Tokyo-Mitsubishi UFJ, ING Bank, Mizuho Corporate Bank and WestLB. Borrowings under this agreement bear interest from three month LIBOR plus 0.85% to three month LIBOR plus 0.95% per annum.

As of December 31, 2012, the Group has a number of other loan agreements with fixed rates with a number of banks and other organizations totaling \$407 million, maturing from 2013 to 2023. The weighted average interest rate under these loans was 2.76% per annum.

As of December 31, 2012, the Group has a number of other floating rate loan agreements with a number of banks and other organizations totaling \$341 million, maturing from 2013 to 2020. The weighted average interest rate under these loans was 0.88% per annum.

#### ***US dollar convertible bonds***

In December 2010, a Group company issued unsecured convertible bonds totaling \$1.5 billion with a coupon yield of 2.625% and maturity in June 2015. The bonds were placed at face value. The bonds are convertible into LUKOIL ADRs (each representing one ordinary share of the Company) and currently have a conversion price of \$71.08 per ADR. Bondholders have the right to convert the bonds into LUKOIL ADRs during the period starting from 40 days after the issue date and ending 6 dealing days before the maturity date. The issuer has the right to redeem the bonds after December 31, 2013.

#### ***US dollar non-convertible bonds***

In November 2010, a Group company issued two tranches of non-convertible bonds totaling \$1.0 billion with a coupon yield of 6.125% and maturity in 2020. The first tranche totaling \$800 million was placed at a price of 99.081% of the bond's face value with a resulting yield to maturity of 6.250%. The second tranche totaling \$200 million was placed at a price of 102.44% of the bond's face value with a resulting yield to maturity of 5.80%. These tranches have a half year coupon period.

In November 2009, a Group company issued two tranches of non-convertible bonds totaling \$1.5 billion. The first tranche totaling \$900 million with a coupon yield of 6.375% per annum was placed with a maturity of 5 years at a price of 99.474% of the bond's face value with a resulting yield to maturity of 6.500%. The second tranche totaling \$600 million with a coupon yield of 7.250% per annum was placed with a maturity of 10 years at a price of 99.127% of the bond's face value with a resulting yield to maturity of 7.375%. These tranches have a half year coupon period.

In June 2007, a Group company issued non-convertible bonds totaling \$1.0 billion. \$500 million were placed with a maturity of 10 years and a coupon yield of 6.356% per annum. Another \$500 million were placed with a maturity of 15 years and a coupon yield of 6.656% per annum. All bonds were placed at their face value and have a half year coupon period.

#### ***Russian ruble bonds***

In December 2009, the Company issued 10 million stock exchange bonds with a face value of 1,000 Russian rubles each. The bonds were placed at face value with a maturity of 1,092 days. The bonds had a 182 days' coupon period and bore interest at

9.20% per annum. In December 2012, the Company redeemed all issued bonds in accordance with the conditions of the bond issue.

In August 2009, the Company issued 25 million stock exchange bonds with a face value of 1,000 Russian rubles each. The bonds were placed at face value with a maturity of 1,092 days. The bonds had a 182 days' coupon period and bore interest at 13.35% per annum. In August 2012, the Company redeemed all issued bonds in accordance with the conditions of the bond issue.

In December 2006, the Company issued 14 million non-convertible bonds with a face value of 1,000 Russian rubles each. Eight million bonds were placed with a maturity of 5 years and a coupon yield of 7.10% per annum and six million bonds were placed with a maturity of 7 years and a coupon yield of 7.40% per annum. All bonds were placed at their face value and have a half year coupon period. In December 2011, the Company redeemed all issued bonds with a maturity of five years in accordance with the conditions of bond issue.

#### ***Maturities of long-term debt***

Annual maturities of total long-term debt during the next five years, including the portion classified as current, are \$532 million in 2013, \$1,521 million in 2014, \$1,602 million in 2015, \$117 million in 2016, \$589 million in 2017 and \$2,134 million thereafter.

#### **NOTE 13. TAXES**

The Group is taxable in a number of jurisdictions within and outside of the Russian Federation and, as a result, is subject to a variety of taxes as established under the statutory provisions of each jurisdiction.

The total cost of taxation to the Group is reported in the consolidated statements of comprehensive income as "Total income tax expense" for income taxes, as "Excise and export tariffs" for excise taxes, export tariffs and petroleum products sales taxes and as "Taxes other than income taxes" for other types of taxation. In each category taxation is made up of taxes levied at various rates in different jurisdictions.

Operations in the Russian Federation are subject to a Federal income tax rate of 2.0% and a regional income tax rate that varies from 13.5% to 18.0% at the discretion of the individual regional administration. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

As of January 1, 2012 and 2011, and during 2012, 2011 and 2010, the Group did not have any unrecognized tax benefits and thus, no interest and penalties related to unrecognized tax benefits were accrued.

The Company and its Russian subsidiaries file income tax returns in Russia. With a few exceptions, income tax returns in Russia are open to examination by the Russian tax authorities for tax years beginning in 2010. Tax losses may be fully or partially used to offset taxable profits in the same company in any of the ten years following the year of loss. Until January 1, 2012, there were no provisions in the tax 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.

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 paid 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.

Domestic and foreign components of income before income taxes were:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Domestic	12,458	12,561	10,569
Foreign	1,265	558	901
<b>Income before income taxes</b>	<b>13,723</b>	<b>13,119</b>	<b>11,470</b>

Domestic and foreign components of income taxes were:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Current			
Domestic	2,178	2,159	1,693
Foreign	560	519	411
Current income tax expense	2,738	2,678	2,104
Deferred			
Domestic	131	581	299
Foreign	(71)	34	(52)
Deferred income tax expense	60	615	247
<b>Total income tax expense</b>	<b>2,798</b>	<b>3,293</b>	<b>2,351</b>

The following table is a reconciliation of the amount of income tax expense that would result from applying the Russian combined statutory income tax rate of 20% applicable to the Company to income before income taxes to total income taxes:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Income before income taxes	13,723	13,119	11,470
Notional income tax at the Russian statutory rate	2,745	2,624	2,294
Increase (reduction) in income tax due to:			
Non-deductible items, net	227	693	266
Foreign rate differences	(60)	169	(4)
Domestic regional rate differences	(311)	(328)	(226)
Change in valuation allowance	197	135	21
<b>Total income tax expense</b>	<b>2,798</b>	<b>3,293</b>	<b>2,351</b>

Taxes other than income taxes were:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Mineral extraction tax	12,354	11,594	7,864
Social taxes and contributions	604	587	429
Property tax	535	573	518
Other taxes and contributions	173	164	167
<b>Taxes other than income taxes</b>	<b>13,666</b>	<b>12,918</b>	<b>8,978</b>

Deferred income taxes are included in the consolidated balance sheets as follows:

	As of December 31, 2012	As of December 31, 2011
Other current assets	153	127
Deferred income tax assets – non-current	569	591
Other current liabilities	(284)	(216)
Deferred income tax liabilities – non-current	(3,651)	(2,790)
<b>Net deferred income tax liability</b>	<b>(3,213)</b>	<b>(2,288)</b>

The following table sets out the tax effects of each type of temporary differences which give rise to deferred income tax assets and liabilities:

	As of December 31, 2012	As of December 31, 2011
Accounts receivable	4	5
Long-term liabilities	399	398
Inventories	6	13
Property, plant and equipment	344	207
Accounts payable	5	5
Operating loss carry forwards	758	646
Other	195	229
<b>Total gross deferred income tax assets</b>	<b>1,711</b>	<b>1,503</b>
Less valuation allowance	(750)	(553)
<b>Deferred income tax assets</b>	<b>961</b>	<b>950</b>
Property, plant and equipment	(3,751)	(2,870)
Accounts payable	(50)	(39)
Accounts receivable	(143)	(91)
Long-term liabilities	(39)	(38)
Inventories	(103)	(63)
Investments	(38)	(33)
Other	(50)	(104)
<b>Deferred income tax liabilities</b>	<b>(4,174)</b>	<b>(3,238)</b>
<b>Net deferred income tax liability</b>	<b>(3,213)</b>	<b>(2,288)</b>

As a result of acquisitions during 2012 the Group recognized a net deferred tax liability of \$240 million.

As of December 31, 2012, retained earnings of foreign subsidiaries included \$18,753 million for which deferred taxation has not been provided because remittance of the earnings has been indefinitely postponed through reinvestment and, as a result, such amounts are considered to be indefinitely invested. It is not practicable to estimate the amount of additional taxes that might be payable on such undistributed earnings.

In accordance with Topic 830, "Foreign currency matters" of the Codification and Topic 740, "Income Taxes" of the Codification deferred tax assets and liabilities are not recognized for the changes in exchange rate effects resulting from the translation of transactions and balances from the Russian ruble to the US dollar using historical exchange rates. Also, in accordance with Topic 740 of the Codification, no deferred tax assets or liabilities are recognized for the effects of the related statutory indexation of property, plant and equipment.

Based upon the levels of historical taxable income and projections for future taxable income over the periods in which the deferred income tax assets are deductible, management believes it is more likely than not that Group companies will realize the benefits of the deductible temporary differences and loss carry forwards, net of existing valuation allowances as of December 31, 2012 and 2011.

As of December 31, 2012, the Group had operating loss carry forwards of \$2,490 million of which \$566 million expire during 2013, \$119 million expire during 2014, \$1 million expire during 2015, \$1 million expire during 2016, \$1 million expire during 2018, \$2 million expire during 2019, \$2 million expire during 2020, \$712 million expire during 2021, \$10 million expire during 2022, \$11 million expire during 2035 and \$1,065 million have an indefinite carry forward.

**NOTE 14.**  
**PENSION BENEFITS**

The Group sponsors a postretirement defined benefit pension program that covers the majority of the Group's employees. One type of pension plan is based on years of service, final remuneration levels as of the end of 2003 and employee gratitude, received during the period of work. The other type of pension plan is based on the salary. These plans are solely financed by Group companies. Simultaneously employees have the right to receive pension benefits with a share-based payment by the Group (up to 4% of the annual salary of the employee). Plan assets and pensions payoffs are managed by a non-state pension fund, LUKOIL-GARANT.

The Group also provides several long-term social benefits, including lump-sum death-in-service benefit, in case of disability and upon retirement payments. Also certain payments are received by retired employees upon reaching a certain old age and invalidity.

The Company uses December 31 as the measurement date for its post employment and post retirement benefits program. An independent actuary has assessed the benefit obligations as of December 31, 2012 and 2011.

The following table provides information about the benefit obligations and plan assets as of December 31, 2012 and 2011. The benefit obligations below represent the projected benefit obligation of the pension plan.

	2012	2011
<b>Benefit obligations</b>		
Benefit obligations as of January 1	260	296
Effect of exchange rate changes	17	(14)
Service cost	14	15
Interest cost	19	22
Plan amendments	12	(4)
Actuarial loss	18	-
Benefits paid	(45)	(52)
Curtailment gain	(1)	(3)
<b>Benefit obligations as of December 31</b>	<b>294</b>	<b>260</b>
<b>Plan assets</b>		
Fair value of plan assets as of January 1	105	112
Effect of exchange rate changes	7	(6)
Return on plan assets	8	2
Employer contributions	45	49
Benefits paid	(45)	(52)
<b>Fair value of plan assets as of December 31</b>	<b>120</b>	<b>105</b>
Funded status	(174)	(155)
<b>Amounts recognized in the consolidated balance sheet as of December 31, 2012 and 2011</b>		
Accrued benefit liabilities included in "Other long-term liabilities"	(158)	(128)
Accrued benefit liabilities included in "Other current liabilities"	(16)	(27)

Weighted average assumptions used to determine benefit obligations as of December 31, 2012 and 2011:

	2012	2011
Discount rate	7.10%	7.80%
Rate of compensation increase	7.10%	7.30%

Weighted average assumptions used to determine net periodic benefit costs for the year ended December 31, 2012 and 2011:

	2012	2011
Discount rate	7.80%	7.80%
Rate of compensation increase	7.30%	7.70%
Expected rate of return on plan assets	8.63%	8.95%

Included in accumulated other comprehensive loss as of December 31, 2012 and 2011, are the following before-tax amounts that have not yet been recognized in net periodic benefit cost:

	2012	2011
Unamortized prior service cost	59	61
Unrecognized actuarial loss	21	4
<b>Total costs</b>	<b>80</b>	<b>65</b>

Amounts recognized in other comprehensive loss during the year ended December 31, 2012 and 2011:

	2012	2011
Additional loss arising during the period	15	9
Additional prior service cost from plan amendment	10	(4)
Re-classified prior service cost amortization	(10)	(18)
<b>Net amount recognized for the period</b>	<b>15</b>	<b>(13)</b>

The real returns on bonds and equities are based on what is observed in the international markets over extended periods of time. In the calculation of the expected return on assets no use is made of the historical returns LUKOIL-GARANT has achieved.

In addition to the plan assets, LUKOIL-GARANT holds assets in the form of an insurance reserve. The purpose of this insurance reserve is to satisfy pension obligations should the plan assets not be sufficient to meet pension obligations. The Group's contributions

to the pension plan are determined without considering the assets in the insurance reserve.

The plans are funded on a discretionary basis through a solidarity account, which is held in trust with LUKOIL-GARANT. LUKOIL-GARANT does not allocate separately identifiable assets to the Group or its other third party clients. All funds of plan assets and other individual pension accounts are managed as a pool of investments.

The asset allocation of the investment portfolio maintained by LUKOIL-GARANT for the Group and its clients was as follows:

Type of assets	As of December 31, 2012	As of December 31, 2011
Eurobonds	8%	4%
Russian corporate bonds	4%	28%
Bank deposits	74%	44%
Equity securities of Russian issuers	–	6%
Shares of OAO LUKOIL	–	2%
Shares in investment funds	11%	13%
Cash	1%	–
Other assets	2%	3%
	100%	100%

The investment strategy employed by LUKOIL-GARANT includes an overall goal to attain a maximum investment return, while guaranteeing the principal amount invested. The strategy is to invest with a medium-term perspective while maintaining a level of liquidity through proper allocation of investment assets. Investment policies include rules and limitations to avoid concentrations of investments.

The investment portfolio is primarily comprised of investments: bank deposits and securities with fixed yield. The securities with fixed yield include mainly high yield corporate bonds with low and medium risk ratings. Maturities range from one to three years.

Components of net periodic benefit cost were as follows:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Service cost	14	15	16
Interest cost	19	22	23
Less expected return on plan assets	(9)	(10)	(11)
Amortization of prior service cost	13	17	18
Curtailement gain	–	(2)	(3)
<b>Total net periodic benefit cost</b>	<b>37</b>	<b>42</b>	<b>43</b>

Total employer contributions for 2013 are expected to be \$49 million. An amount of \$16 million before-tax is included in other comprehensive income and expected to be recognized in the net periodic benefit cost in 2013.



The following benefit payments, which reflect expected future services, as appropriate, are expected to be paid:

	2013	2014	2015	2016	2017	5-year period 2013-2017	5-year period 2018-2022
Pension benefits	17	15	15	15	15	77	61
Other long-term employee benefits	32	17	17	16	17	99	75
<b>Total expected benefits to be paid</b>	<b>49</b>	<b>32</b>	<b>32</b>	<b>31</b>	<b>32</b>	<b>176</b>	<b>136</b>

#### NOTE 15. STOCKHOLDERS' EQUITY

##### *Common stock*

	As of December 31, 2012 (thousands of shares)	As of December 31, 2011 (thousands of shares)
Authorized and issued common stock, par value of 0.025 Russian rubles each	850,563	850,563
Treasury stock	(95,697)	(76,101)
<b>Outstanding common stock</b>	<b>754,866</b>	<b>774,462</b>

##### *Dividends and dividend limitations*

Profits available for distribution to common stockholders in respect of any reporting period are determined by reference to the statutory financial statements of the Company prepared in accordance with the laws of the Russian Federation and denominated in Russian rubles. Under Russian Law, dividends are limited to the net profits of the reporting year as set out in the statutory financial statements of the Company. These laws and other legislative acts governing the rights of shareholders to receive dividends are subject to various interpretations.

The Company's net profits were 217,807 million Russian rubles, 271,934 million Russian rubles and 139,853 million Russian rubles respectively for 2012, 2011 and 2010, pursuant to the statutory financial statements, which at the US dollar exchange rates as of December 31, 2012, 2011 and 2010, amounted to \$7,171 million, \$8,446 million and \$4,589 million, respectively.

At the extraordinary stockholders' meeting on December 18, 2012, interim dividends were declared for 2012 in the amount of 40.00 Russian rubles per common share, which at the date of the meeting was equivalent to \$1.30. Dividends payable of \$12 million and \$10 million are included in "Other current liabilities" in the consolidated balance sheets as of December 31, 2012 and 2011, respectively.

At the annual stockholders' meeting on June 27, 2012, dividends were declared for 2011 in the amount of 75.00 Russian rubles per common share, which at the date of the meeting was equivalent to \$2.26.

At the annual stockholders' meeting on June 23, 2011, dividends were declared for 2010 in the amount of 59.00 Russian rubles per common share, which at the date of the meeting was equivalent to \$2.11.

### Earnings per share

The calculation of diluted earnings per share for these years was as follows:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Net income	11,004	10,357	9,006
Add back interest and accretion on 2.625% convertible US dollar bonds, maturing 2015 (net of tax at effective rate)	64	63	3
Total diluted net income	11,068	10,420	9,009
Weighted average number of outstanding common shares (thousands of shares)	760,588	778,964	822,359
Add back treasury shares held in respect of convertible debt (thousands of shares)	20,509	20,383	892
Weighted average number of outstanding common shares, assuming dilution (thousands of shares)	781,097	799,347	823,251
Earnings per share of common stock attributable to OAO LUKOIL (US dollars):			
Basic	14.47	13.30	10.95
Diluted	14.17	13.04	10.94

### NOTE 16. FINANCIAL AND DERIVATIVE INSTRUMENTS

#### Fair value

The fair values of cash and cash equivalents (Level 1), current and long-term accounts receivable (Level 3) are approximately equal to their value as disclosed in the consolidated financial statements. The fair value of long-term receivables was determined by discounting with estimated market interest rates for similar financing arrangements.

The fair value of long-term debt (Level 3) differs from the amount disclosed in the consolidated financial statements. The estimated fair value of long-term debt as of December 31, 2012 and 2011 was \$7,035 million and \$8,666 million, respectively, as a result of discounting using estimated market interest rates for similar financing arrangements. These amounts include all future cash outflows associated with the long-term debt repayments, including the current portion and interest. Market interest rates mean the rates of raising long-term debt by companies with a similar credit rating for similar tenors, repayment schedules and similar other main terms. During the year ended December 31, 2012, the Group did not have significant transactions or events that would result in nonfinancial assets and liabilities measured at fair value on a nonrecurring basis.

#### Derivative instruments

The Group uses financial and commodity-based derivative contracts to manage exposures to fluctuations in foreign currency exchange rates, commodity prices, or to exploit market opportunities. Since the Group is not currently using hedge accounting, defined by Topic 815, "Derivative and hedging," of the Codification, all gains and losses, realized or unrealized, from derivative contracts have been recognized in profit or loss.

Topic 815 of the Codification requires purchase and sales contracts for commodities that are readily convertible to cash (e.g., crude oil, natural gas and gasoline) to be recorded on the balance sheet as derivatives unless the contracts are for quantities the Group expects to use or sell over a reasonable period in the normal course of business (i.e., contracts eligible for the normal purchases and normal sales exception). The Group does apply the normal purchases and normal sales exception to certain long-term contracts to sell oil products. This normal purchases and normal sales exception is applied to eligible crude oil and refined product commodity purchase and sales contracts. However, the Group may elect not to apply this exception (e.g., when another derivative instrument will be used to mitigate the risk of a purchase or sale contract but hedge accounting will not be applied; in which case both the purchase or sales contract and the derivative contract mitigating the resulting risk will be recorded on the balance sheet at fair value).

The fair value hierarchy for the Group's derivative assets and liabilities accounted for at fair value on a recurring basis was:

	As of December 31, 2012				As of December 31, 2011			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets</b>								
Commodity derivatives	-	417	-	417	-	575	-	575
<b>Total assets</b>	-	<b>417</b>	-	<b>417</b>	-	<b>575</b>	-	<b>575</b>
<b>Liabilities</b>								
Commodity derivatives	-	(459)	-	(459)	-	(599)	-	(599)
<b>Total liabilities</b>	-	<b>(459)</b>	-	<b>(459)</b>	-	<b>(599)</b>	-	<b>(599)</b>
<b>Net liabilities</b>	-	<b>(42)</b>	-	<b>(42)</b>	-	<b>(24)</b>	-	<b>(24)</b>

The derivative values above are based on an analysis of each contract as the fundamental unit of account as required by Topic 820, "Fair Value Measurements and Disclosures," of the Codification. Therefore, derivative assets and liabilities with the same counterparty are not reflected net where the legal right of offset exists. Gains or losses from contracts in one level may be offset by gains or losses on contracts in another level or by changes in values of physical contracts or positions that are not reflected in the table above.

Commodity derivatives are valued using quotations provided by brokers and price index developers. These quotes are corroborated with market data and are classified as Level 2. Commodity derivatives are valued using industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and contractual prices for the underlying instruments, as well as other relevant economic measures.

#### **Commodity derivative contracts**

The Group operates in the worldwide crude oil, refined product, natural gas and natural gas liquids markets and is exposed to fluctuations in the prices for these commodities. These fluctuations can affect the Group's revenues as well as the cost of operating, investing and financing activities. Generally, the Group's policy is to remain exposed to the market prices of commodities. However, the Group uses futures, forwards, swaps and options in various markets to balance physical systems, meet customer needs, manage price exposures on specific transactions, and do an immaterial amount of trading not directly related to the Group's physical business. These activities may move the Group's profile away from market average prices.

The fair value of commodity derivative assets and liabilities as of December 31, 2012 was:

	As of December 31, 2012
<b>Assets</b>	
Accounts receivable	417
<b>Liabilities</b>	
Accounts payable	(459)

Hedge accounting has not been used for items in the table.

As required under Topic 815 of the Codification the amounts shown in the preceding table are presented gross (i.e., without netting assets and liabilities with the same counterparty where the right of offset and intent to net exist). Derivative assets and liabilities resulting from eligible commodity contracts have been netted in the consolidated balance sheet and are recorded as accounts receivable in the amount of \$55 million and accounts payable in the amount of \$97 million.

Financial results from commodity derivatives were included in the consolidated statements of comprehensive income in "Cost of purchased crude oil, gas and products". Realized losses were \$300 million and unrealized losses were \$21 million for the year ended December 31, 2012 and realized losses were \$667 million and unrealized gains were \$10 million for the year ended December 31, 2011.

As of December 31, 2012, the net position of outstanding commodity derivative contracts, primarily to manage price exposure on underlying operations, was not significant.

#### ***Currency exchange rate derivative contracts***

The Group has foreign currency exchange rate risk resulting from its international operations. The Group does not comprehensively hedge the exposure to currency rate changes, although the Group selectively hedges certain foreign currency exchange rate exposures, such as firm commitments for capital projects or local currency tax payments and dividends.

The fair value of foreign currency derivatives assets and liabilities open as of December 31, 2012 was not significant.

The impact from foreign currency derivatives during the year ended December 31, 2012 on the consolidated statements of comprehensive income was not significant. The net position of outstanding foreign currency swap contracts as of December 31, 2012 also was not significant.

#### ***Credit risk***

The Group's financial instruments that are potentially exposed to concentrations of credit risk consist primarily of cash equivalents, over-the-counter derivative contracts and trade receivables. Cash equivalents are placed in high-quality commercial paper, money market funds and time deposits with major international banks and financial institutions.

The credit risk from the Group's over-the-counter derivative contracts, such as forwards and swaps, derives from the counterparty to the transaction, typically a major bank or financial institution. Individual counterparty exposure is managed within predetermined credit limits and includes the use of cash-call margins when appropriate, thereby reducing the risk of significant

non-performance. The Group also uses futures contracts, but futures have a negligible credit risk because they are traded on the New York Mercantile Exchange or the ICE Futures.

Certain of the Group's derivative instruments contain provisions that require the Group to post collateral if the derivative exposure exceeds a threshold amount. The Group has contracts with fixed threshold amounts and other contracts with variable threshold amounts that are contingent on the Group's credit rating. The variable threshold amounts typically decline for lower credit ratings, while both the variable and fixed threshold amounts typically revert to zero if the Group's credit rating falls below investment grade. Cash is the primary collateral in all contracts; however, many contracts also permit the Group to post letters of credit as collateral.

There were no derivative instruments with such credit-risk-related contingent features that were in a liability position on December 31, 2012. The Group posted \$12 million in collateral in the normal course of business for the over-the-counter derivatives. If the Group's credit rating were lowered one level from its "BBB-" rating (per Standard and Poors) on December 31, 2012, and it would be below investment grade, the Group would be required to post additional collateral of \$5 million to the Group's counterparties for the over-the-counter derivatives, either with cash or letters of credit. The maximum additional collateral based on the lowest downgrade would be \$14 million in total.

#### **NOTE 17. BUSINESS COMBINATIONS**

In January 2012, the Group received a notice that the Board of Directors of ERG S.p.A. ("ERG") decided to exercise its option to sell to the Group a further 20% interest in the joint venture which operates the ISAB refining complex (Priolo, Italy). The notice was received in accordance with the initial agreement on the establishment of the joint venture signed in 2008. This agreement gave the second investor – ERG a step-by-step put option to sell its share in the joint venture to the Group. The transaction was approved by European regulatory authorities and was completed in September 2012. After final adjustments, its amount totaled €494 million (approximately \$621 million). Accordingly, the Group's stake in the joint venture increased from 60% to 80% and in accordance with the initial agreement on the establishment of the joint venture the Group obtained control and consolidated this joint venture. The Group allocated \$646 million to goodwill, \$2,914 million to property, plant and equipment, \$747 million to deferred tax liability, \$1,024 million to current assets and \$444 million to current liabilities. The value of property, plant and equipment was determined by an independent appraiser.

The acquisition-date fair value of the equity interest in ISAB held by the Group immediately before the acquisition date was \$2,074 million. As a result of remeasuring the equity interest

in ISAB held immediately before the business combination to fair value the Group recognized a gain of \$3 million as other non-operating income. To measure the acquisition-date fair value a present value technique (level 3) was employed.

This business combination did not have a material impact on the Group's consolidated operations for the year ended December 31, 2012. Therefore, no pro-forma income statement information has been provided.

#### NOTE 18.

##### CONSOLIDATION OF VARIABLE INTEREST ENTITY

The Group and ConocoPhillips had a joint venture NMNG which develops oil reserves in the Timan-Pechora region of the Russian Federation. The Group and ConocoPhillips had equal voting rights over the joint venture's activity and effective ownership interests of 70% and 30%, respectively. In August 2012, the Group acquired ConocoPhillips' investment in NMNG and certain assets related to NMNG for \$604 million. The acquisition brought the Group's total ownership interest in NMNG to 100%.

Up until the date of acquisition of the 30% interest, the Group consolidated NMNG due to the fact that NMNG was a variable interest entity and the Group was considered to be the primary beneficiary.

#### NOTE 19.

##### COMMITMENTS AND CONTINGENCIES

###### *Capital expenditure, exploration and investment programs*

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 2012, a construction agreement for a heavy-residue hydrocracking complex at Group refinery LUKOIL Neftochim Bourgas AD in Bulgaria was signed. Commissioning of the complex is expected in 2015. The amount of capital commitment under this agreement is approximately \$1.1 billion.

Group companies have commitments for capital expenditure contributions in the amount of \$363 million related to various production sharing agreements over the next 25 years.

The Company 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. The Group estimates the amount of capital commitment under this agreement for 2013 to be approximately \$232 million.

The Group signed a number of agreements for 2012-2015 for construction of offshore platforms in the Caspian region. As of December 31, 2012, the Group estimates the amount of this commitment to be approximately \$1,346 million (net of advances).

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. Currently the Group is approving certain amendments to the capital construction program, including its extension to the end of 2014. As of December 31, 2012, the Group estimates the amount of this commitment to be approximately \$303 million.

###### *Operating lease obligations*

Group companies have commitments of \$475 million primarily for the lease of vessels and petroleum distribution outlets. Operating lease expenses were \$218 million, \$175 million and \$155 million during the years ended December 31, 2012, 2011 and 2010, respectively. Commitments for minimum rentals under these leases as of December 31, 2012 are as follows:

	As of December 31, 2012
2013	119
2014	106
2015	73
2016	48
2017	34
beyond	95

###### *Insurance*

The insurance industry in the Russian Federation and certain other areas where the Group has operations is in the course of development. Management believes that the Group has adequate property damage coverage for its main production assets. In respect of third party liability for property and environmental damage arising from accidents on Group property or relating to Group operations, the Group has insurance coverage that is generally higher than insurance limits set by the local legal requirements. Management believes that the Group has adequate insurance coverage of the risks, which could have a material effect on the Group's operations and financial position.

### ***Environmental liabilities***

Group companies and their predecessor entities have operated in the Russian Federation and other countries for many years and, within certain parts of the operations, environmental related problems have developed. Environmental regulations are currently under consideration in the Russian Federation and other areas where the Group has operations. Group companies routinely assess and evaluate their obligations in response to new and changing legislation.

As liabilities in respect of the Group's environmental obligations are able to be determined, they are charged against income. The likelihood and amount of liabilities relating to environmental obligations under proposed or any future legislation cannot be reasonably estimated at present and could become material. Under existing legislation, however, management believes that there are no significant unrecorded liabilities or contingencies, which could have a materially adverse effect on the operating results or financial position of the Group.

### ***Social assets***

Certain Group companies contribute to Government sponsored programs, the maintenance of local infrastructure and the welfare of their employees within the Russian Federation and elsewhere. Such contributions include assistance with the construction, development and maintenance of housing, hospitals and transport services, recreation and other social needs. The funding of such assistance is periodically determined by management and is appropriately capitalized (only to the extent that they are expected to result in future economic benefits to the Group) or expensed as incurred.

### ***Taxation environment***

The taxation systems in the Russian Federation and other emerging markets where Group companies operate are relatively new and are characterized by numerous taxes and frequently changing legislation, which is often unclear, contradictory, and subject to interpretation. Often, differing interpretations exist among different tax authorities within the same jurisdictions and among taxing authorities in different jurisdictions. Taxes are subject to review and investigation by a number of authorities, who are enabled by law to impose severe fines, penalties and interest charges. In the Russian Federation a tax year remains open for review by the tax authorities during the three subsequent calendar years. However, under certain circumstances a tax year may remain open longer. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation. Such factors may create substantially more significant taxation risks in the Russian Federation and other emerging markets where Group companies operate, than those in other countries where taxation regimes have been subject to development and clarification over long periods.

The tax authorities in each region may have a different interpretation of similar taxation issues which may result in taxation issues successfully defended by the Group in one region being unsuccessful in another region. There is some direction provided from the central authority based in Moscow on particular taxation issues. The Group has implemented tax planning and management strategies based on existing legislation at the time of implementation. The Group is subject to tax authority audits on an ongoing basis, as is normal in the Russian environment and other republics of the former Soviet Union, and, at times, the authorities have attempted to impose additional significant taxes on the Group. Management believes that it has adequately met and provided for tax liabilities based on its interpretation of existing tax legislation. However, the relevant tax authorities may have differing interpretations and the effects on the financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

### ***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. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts' ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was dismissed from the lawsuit. The Colorado Supreme Court found, however, that the trial court made a procedural error by failing to hold an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company and remanded the case to the Colorado Court of Appeals to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., *forum non conveniens*). The Colorado Court of Appeals declined to dismiss the case based on *forum non conveniens* and the case was remanded to the District Court. In June 2009, three creditors of ADC filed an Involuntary Bankruptcy Petition putting ADC into bankruptcy. In November 2009, after adding a claim, ADC removed the case from the District Court to the US Bankruptcy Court. On October 28, 2010, the Bankruptcy Court granted the Company's Motion for Remand and Abstention and remanded the case to the Denver District Court. On October 20, 2011, the Denver District Court dismissed all claims against the Company for lack of jurisdiction. ADC filed notice of appeal on April 17, 2012. On August 23, 2012, the Court of Appeals affirmed the Denver District Court's dismissal for lack of jurisdiction. ADC filed a Petition for Rehearing which was denied on September 20, 2012.

ADC then filed a petition for Writ of Certiorari in the Colorado Supreme Court on October 18, 2012. The Company filed its Response to the Writ on November 1, 2012. The Colorado Supreme Court has not indicated yet if it will consider this case. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

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 Federal Court case, the Company has filed a Motion to Dismiss and discovery has been stayed pending further action. 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.

#### **NOTE 20.** **RELATED PARTY TRANSACTIONS**

In the rapidly developing business environment in the Russian Federation, companies and individuals have frequently used nominees and other forms of intermediary companies in transactions. The senior management of the Company believes that the Group has appropriate procedures in place to identify and properly disclose transactions with related parties in this environment and has disclosed all of the relationships identified which it deemed to be significant. Related party sales and purchases of oil and oil products were primarily to and from affiliated companies. Related party processing services were provided by affiliated refineries.

Below are related party transactions not disclosed elsewhere in the financial statements. Refer also to Notes 3, 7, 11, 14 and 21 for other transactions with related parties.

Sales of oil and oil products to related parties were \$1,038 million, \$1,298 million and \$2,383 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Other sales to related parties were \$50 million, \$54 million and \$134 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Purchases of oil and oil products from related parties were \$409 million, \$374 million and \$521 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Purchases of processing services from related parties were \$702 million, \$901 million and \$719 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Other purchases from related parties were \$92 million, \$73 million and \$39 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Amounts receivable from related parties, including advances, were \$496 million and \$339 million as of December 31, 2012 and 2011, respectively. Amounts payable to related parties were \$85 million and \$115 million as of December 31, 2012 and 2011, respectively.

#### **NOTE 21.** **COMPENSATION PLAN**

During the period from 2010 to 2012, the Company had a compensation plan available to certain members of management, which was based on assigned shares and provides compensation consisting of two parts.

The first part represented annual bonuses that were based on the number of assigned shares and amount of dividend per share. The payment of these bonuses were contingent on the Group meeting certain financial KPIs in each financial year. The second was based upon the Company's common stock appreciation from 2010 to 2012, with rights vested in December 2012. The number of assigned shares for this compensation plan was approximately 17.3 million shares.

For the first part of the share plan the Group recognized a liability based on expected dividends and number of assigned shares.

The second part of the share plan originally was classified as equity settled. The grant date fair value of the plan was estimated at \$295 million using the Black-Scholes-Merton option-pricing model, assuming a risk-free interest rate of 8.0% per annum, an expected dividend yield of 3.09% per annum, an expected term of three years and a volatility factor of 34.86%. The expected volatility factor was estimated based on the historical volatility of the Company's shares for the previous five year period up to January 2010. In December 2012, this compensation plan was amended in relation to all participants, which resulted in reclassification of the second part of the plan as a liability. As a result of this amendment the Group recorded an additional expense in the fourth quarter of 2012 in the amount of \$33 million.

Related to this plan the Group recorded \$182 million, \$137 million and \$129 million of compensation expense during the years ended December 31, 2012, 2011 and 2010 respectively, of which \$98 million was initially recognized as an increase in additional paid-in capital in each year correspondingly. As a result of the plan amendments that took place in the fourth quarter of 2012 \$295 million was reclassified from additional paid-in capital to liabilities. As of December 31, 2012 and 2011, \$380 million and \$28 million related to this plan are included in "Other current liabilities" of the consolidated balance sheets, respectively. The total recognized tax benefits related to these accruals were \$37 million, \$20 million and \$21 million during the years ended December 31, 2012, 2011 and 2010.

In late December 2012, the Company introduced a new compensation plan to certain members of management for the period from 2013 to 2017. Its conditions are similar to the conditions of the previous compensation plan after modification. The number of assigned shares is approximately 19 million. The Group is currently finalizing the calculation of the grant date fair value of the new plan.

**NOTE 22.**  
**SEGMENT INFORMATION**

Presented below is information about the Group's operating and geographical segments for the years ended December 31, 2012, 2011 and 2010, in accordance with Topic 280, "Segment reporting," of the Codification.

The Group has the following operating segments – exploration and production; refining, marketing and distribution; chemicals; power generation and other business segments. These segments have been determined based on the nature of their operations. Management on a regular basis assesses the performance of these operating segments. The exploration and production segment explores for, develops and produces primarily crude oil. The refining, marketing and distribution segment processes crude oil into refined products and purchases, sells and transports crude oil and refined petroleum products. The chemicals segment refines and sells chemical products. The power generation segment produces steam and electricity, distributes them and provides related services. The activities of the other business operating segment include businesses beyond the Group's traditional operations.

Geographical segments are based on the area of operations and include two segments: Russia and International.

**Operating segments**

2012	Exploration and production	Refining, marketing and distribution	Chemicals	Power generation	Other	Elimination	Consolidated
<b>Sales</b>							
Third parties	3,130	133,139	1,362	1,411	129	–	139,171
Inter-segment	43,959	1,738	307	1,557	2,926	(50,487)	–
<b>Total sales</b>	<b>47,089</b>	<b>134,877</b>	<b>1,669</b>	<b>2,968</b>	<b>3,055</b>	<b>(50,487)</b>	<b>139,171</b>
Operating expenses	5,210	3,565	568	1,867	2,299	(4,150)	9,359
Depreciation, depletion and amortization	3,061	1,371	65	248	124	(37)	4,832
Interest expense	850	691	47	73	557	(1,680)	538
Income tax expense	1,920	711	57	34	52	24	2,798
Net income (net loss)	8,326	3,639	(279)	(278)	(363)	(41)	11,004
Total assets	67,523	70,120	1,166	4,530	20,512	(64,890)	98,961
Capital expenditures	8,902	2,078	90	503	277	–	11,850



2011	Exploration and production	Refining, marketing and distribution	Chemicals	Power generation	Other	Elimination	Consolidated
Sales							
Third parties	3,449	126,665	1,944	1,472	120	-	133,650
Inter-segment	41,409	1,884	500	1,520	2,467	(47,780)	-
Total sales	44,858	128,549	2,444	2,992	2,587	(47,780)	133,650
Operating expenses							
Operating expenses	4,347	3,975	459	2,098	2,029	(3,853)	9,055
Depreciation, depletion and amortization	2,865	1,248	63	224	129	(56)	4,473
Interest expense	732	709	20	47	505	(1,319)	694
Income tax expense	2,106	1,060	43	(5)	10	79	3,293
Net income (net loss)	6,665	3,687	(27)	(127)	(370)	529	10,357
Total assets	60,311	62,173	1,488	4,220	21,201	(58,201)	91,192
Capital expenditures	6,629	1,354	89	196	224	-	8,492

2010	Exploration and production	Refining, marketing and distribution	Chemicals	Power generation	Other	Elimination	Consolidated
Sales							
Third parties	3,012	99,064	1,331	1,416	133	-	104,956
Inter-segment	33,511	1,182	271	1,277	1,937	(38,178)	-
Total sales	36,523	100,246	1,602	2,693	2,070	(38,178)	104,956
Operating expenses							
Operating expenses	3,965	3,771	294	1,901	1,628	(3,261)	8,298
Depreciation, depletion and amortization	2,773	1,033	40	183	126	(1)	4,154
Interest expense	806	859	26	38	405	(1,422)	712
Income tax expense	1,449	874	37	(14)	4	1	2,351
Net income (net loss)	6,139	3,330	101	(167)	(317)	(80)	9,006
Total assets	57,280	56,908	1,249	4,338	15,390	(51,148)	84,017
Capital expenditures	4,908	1,320	76	420	120	-	6,844

*Geographical segments*

	2012	2011	2010
Sales of crude oil within Russia	1,634	1,571	956
Export of crude oil and sales of crude oil by foreign subsidiaries	26,036	32,522	26,342
Sales of refined products within Russia	16,803	15,242	10,928
Export of refined products and sales of refined products by foreign subsidiaries	86,604	76,335	60,018
Sales of chemicals within Russia	418	914	728
Export of chemicals and sales of chemicals by foreign subsidiaries	992	1,095	642
Other sales within Russia	3,281	3,213	2,881
Other export sales and other sales by foreign subsidiaries	3,403	2,758	2,461
<b>Total sales</b>	<b>139,171</b>	<b>133,650</b>	<b>104,956</b>

2012	Russia	International	Elimination	Consolidated
Sales				
Third parties	25,370	113,801	-	139,171
Inter-segment	39,355	200	(39,555)	-
<b>Total sales</b>	<b>64,725</b>	<b>114,001</b>	<b>(39,555)</b>	<b>139,171</b>
Operating expenses	7,333	2,113	(87)	9,359
Depletion, depreciation and amortization	3,834	998	-	4,832
Interest expense	194	504	(160)	538
Income tax expense	2,316	489	(7)	2,798
Net income	10,238	776	(10)	11,004
Total assets	78,515	36,108	(15,662)	98,961
Capital expenditures	9,343	2,507	-	11,850

2011	Russia	International	Elimination	Consolidated
Sales				
Third parties	24,674	108,976	–	133,650
Inter-segment	39,567	143	(39,710)	–
Total sales	64,241	109,119	(39,710)	133,650
Operating expenses	6,999	2,094	(38)	9,055
Depletion, depreciation and amortization	3,692	781	–	4,473
Interest expense	338	477	(121)	694
Income tax expense	2,715	554	24	3,293
Net income	9,769	4	584	10,357
Total assets	73,150	34,384	(16,342)	91,192
Capital expenditures	6,516	1,976	–	8,492

2010	Russia	International	Elimination	Consolidated
Sales				
Third parties	17,615	87,341	–	104,956
Inter-segment	34,599	37	(34,636)	–
Total sales	52,214	87,378	(34,636)	104,956
Operating expenses	6,334	2,005	(41)	8,298
Depletion, depreciation and amortization	3,393	761	–	4,154
Interest expense	415	427	(130)	712
Income tax expense	1,993	359	(1)	2,351
Net income (net loss)	8,542	542	(78)	9,006
Total assets	74,033	30,225	(20,241)	84,017
Capital expenditures	5,333	1,511	–	6,844

The Group's international sales to third parties include sales in Switzerland of \$67,057 million, \$66,884 million and \$53,245 million for the years ended December 31, 2012, 2011 and 2010, respectively. The Group's international sales to third parties include sales in the USA of \$12,649 million, \$9,496 million and \$8,595 million for the years ended December 31, 2012, 2011 and 2010, respectively. These amounts are attributed to individual countries based on the jurisdiction of subsidiaries making the sale.

#### NOTE 23. SUBSEQUENT EVENTS

In accordance with the requirements of Topic 855, "*Subsequent events*," of the Codification, the Group evaluated subsequent events through the date the financial statements were available to be issued. Therefore subsequent events were evaluated by the Group up to February 22, 2013.

This section provides unaudited supplemental information on oil and gas exploration and production activities in accordance with Topic 932, "Disclosures About Oil and Gas Producing Activities," of the Codification in six separate tables:

- I. Capitalized costs relating to oil and gas producing activities.
- II. Costs incurred in oil and gas property acquisition, exploration, and development activities.
- III. Results of operations for oil and gas producing activities.
- IV. Reserve quantity information.
- V. Standardized measure of discounted future net cash flows.
- VI. Principal sources of changes in the standardized measure of discounted future net cash flows.

Amounts shown for equity companies represent the Group's share in its exploration and production affiliates, which are accounted for using the equity method of accounting.

#### I. CAPITALIZED COSTS RELATING TO OIL AND GAS PRODUCING ACTIVITIES

As of December 31, 2012	International	Russia	Total consolidated companies	Group's share in equity companies
Unproved oil and gas properties	1,145	2,393	3,538	551
Proved oil and gas properties	8,555	58,408	66,963	2,436
Accumulated depreciation, depletion, and amortization	(2,213)	(21,803)	(24,016)	(838)
Net capitalized costs	7,487	38,998	46,485	2,149

As of December 31, 2011	International	Russia	Total consolidated companies	Group's share in equity companies
Unproved oil and gas properties	659	1,192	1,851	166
Proved oil and gas properties	7,479	52,330	59,809	2,315
Accumulated depreciation, depletion, and amortization	(1,762)	(19,527)	(21,289)	(718)
Net capitalized costs	6,376	33,995	40,371	1,763

As of December 31, 2010	International	Russia	Total consolidated companies	Group's share in equity companies
Unproved oil and gas properties	536	1,050	1,586	274
Proved oil and gas properties	6,578	49,914	56,492	2,111
Accumulated depreciation, depletion, and amortization	(1,490)	(18,530)	(20,020)	(597)
Net capitalized costs	5,624	32,434	38,058	1,788

## II. COSTS INCURRED IN OIL AND GAS PROPERTY ACQUISITION, EXPLORATION, AND DEVELOPMENT ACTIVITIES

Year ended December 31, 2012	International	Russia	Total consolidated companies	Group's share in equity companies
Acquisition of properties – proved	97	–	97	–
Acquisition of properties – unproved	37	937	974	–
Exploration costs	144	525	669	16
Development costs	1,621	6,489	8,110	490
Total costs incurred	1,899	7,951	9,850	506

Year ended December 31, 2011	International	Russia	Total consolidated companies	Group's share in equity companies
Acquisition of properties – proved	–	41	41	–
Acquisition of properties – unproved	70	164	234	–
Exploration costs	507	358	865	8
Development costs	968	4,726	5,694	123
Total costs incurred	1,545	5,289	6,834	131

Year ended December 31, 2010	International	Russia	Total consolidated companies	Group's share in equity companies
Acquisition of properties – proved	113	–	113	–
Acquisition of properties – unproved	–	15	15	122
Exploration costs	199	220	419	16
Development costs	685	3,686	4,371	115
Total costs incurred	997	3,921	4,918	253

### III. RESULTS OF OPERATIONS FOR OIL AND GAS PRODUCING ACTIVITIES

The Group's results of operations for oil and gas producing activities are presented below. In accordance with Topic 932 of the Codification, sales and transfers to Group companies are based on market prices. Income taxes are based on statutory rates. The results of operations exclude corporate overhead and interest costs.

Year ended December 31, 2012	International	Russia	Total consolidated companies	Group's share in equity companies
Revenue				
Sales	2,910	23,011	25,921	1,728
Transfers	–	17,165	17,165	34
Total revenues	2,910	40,176	43,086	1,762
Production costs (excluding production taxes)	(299)	(3,562)	(3,861)	(126)
Exploration expense	(159)	(205)	(364)	(6)
Depreciation, depletion, and amortization, and valuation provision	(500)	(2,544)	(3,044)	(126)
Taxes other than income taxes	(399)	(24,247)	(24,646)	(564)
Related income taxes	(428)	(1,618)	(2,046)	(423)
Total results of operations for producing activities	1,125	8,000	9,125	517

Year ended December 31, 2011	International	Russia	Total consolidated companies	Group's share in equity companies
Revenue				
Sales	2,656	25,373	28,029	1,924
Transfers	–	14,107	14,107	14
Total revenues	2,656	39,480	42,136	1,938
Production costs (excluding production taxes)	(242)	(3,529)	(3,771)	(93)
Exploration expense	(439)	(93)	(532)	(2)
Depreciation, depletion, and amortization, and valuation provision	(324)	(2,511)	(2,835)	(125)
Taxes other than income taxes	(460)	(23,817)	(24,277)	(640)
Related income taxes	(531)	(1,824)	(2,355)	(407)
Total results of operations for producing activities	660	7,706	8,366	671

Year ended December 31, 2010	International	Russia	Total consolidated companies	Group's share in equity companies
Revenue				
Sales	1,926	20,003	21,929	1,350
Transfers	–	12,395	12,395	13
Total revenues	1,926	32,398	34,324	1,363
Production costs (excluding production taxes)	(218)	(3,212)	(3,430)	(113)
Exploration expense	(240)	(96)	(336)	(2)
Depreciation, depletion, and amortization, and valuation provision	(306)	(2,504)	(2,810)	(127)
Taxes other than income taxes	(257)	(17,872)	(18,129)	(321)
Related income taxes	(314)	(1,807)	(2,121)	(275)
Total results of operations for producing activities	591	6,907	7,498	525

#### IV. RESERVE QUANTITY INFORMATION

Proved reserves are the estimated quantities of oil and gas reserves which geological and engineering data demonstrate will be recoverable with reasonable certainty in future years from known reservoirs under existing economic and operating conditions. In accordance with Topic 932 of the Codification existing economic and operating conditions are based on the 12-months average price and the year-end costs. Proved reserves do not include additional quantities of oil and gas reserves that may result from applying secondary or tertiary recovery techniques not yet tested and determined to be economic.

Proved developed reserves are the quantities of proved reserves expected to be recovered through existing wells with existing equipment and operating methods.

Due to the inherent uncertainties and the necessarily limited nature of reservoir data, estimates of reserves are inherently imprecise, require the application of judgment and are subject to change as additional information becomes available.

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. The Subsoil Law of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. Since the law applies both to newly issued and old licenses and the Group has currently renewed more than 50% of its licenses, management believes that licenses will be renewed upon their expiration for the remainder of the economic life of each respective field.

Estimated net proved oil and gas reserves and changes thereto for the years ended December 31, 2012, 2011 and 2010, are shown in the tables set out below.

Millions of barrels	Consolidated subsidiaries			Group's share in equity companies
	International	Russia	Total	
<b>Crude oil</b>				
January 1, 2010	329	13,054	13,383	313
Revisions of previous estimates	(4)	(279)	(283)	(5)
Purchase of hydrocarbons in place	62	–	62	–
Extensions and discoveries	10	550	560	10
Production	(26)	(671)	(697)	(24)
December 31, 2010	371	12,654	13,025	294
Revisions of previous estimates	(12)	246	234	7
Purchase of hydrocarbons in place	–	7	7	–
Extensions and discoveries	4	515	519	1
Production	(26)	(636)	(662)	(22)
December 31, 2011	337	12,786	13,123	280
Revisions of previous estimates	(1)	67	66	(1)
Purchase of hydrocarbons in place	42	–	42	–
Extensions and discoveries	40	511	551	2
Production	(25)	(631)	(656)	(21)
Sales of reserves	(2)	(3)	(5)	–
<b>December 31, 2012</b>	<b>391</b>	<b>12,730</b>	<b>13,121</b>	<b>260</b>
<b>Proved developed reserves</b>				
December 31, 2010	207	8,401	8,608	182
December 31, 2011	197	8,397	8,594	178
<b>December 31, 2012</b>	<b>136</b>	<b>8,241</b>	<b>8,377</b>	<b>160</b>

The non-controlling interest share included in the above total proved reserves was 71 million barrels, 163 million barrels and 187 million barrels as of December 31, 2012, 2011 and 2010, respectively.

The non-controlling interest share included in the above proved developed reserves was 43 million barrels, 96 million barrels and 132 million barrels as of December 31, 2012, 2011 and 2010, respectively. Substantially all non-controlling interests relate to the reserves in the Russian Federation.



Billions of cubic feet	Consolidated subsidiaries			Group's share in equity companies
	International	Russia	Total	
<b>Natural gas</b>				
January 1, 2010	6,631	15,933	22,564	286
Revisions of previous estimates	(35)	1,198	1,163	11
Extensions and discoveries	98	226	324	4
Production	(187)	(524)	(711)	(26)
December 31, 2010	6,507	16,833	23,340	275
Revisions of previous estimates	(487)	253	(234)	25
Purchase of hydrocarbons in place	–	1	1	–
Extensions and discoveries	240	309	549	1
Production	(189)	(545)	(734)	(27)
December 31, 2011	6,071	16,851	22,922	274
Revisions of previous estimates	(155)	602	447	12
Purchase of hydrocarbons in place	1	–	1	–
Extensions and discoveries	93	595	688	5
Production	(248)	(571)	(819)	(26)
Sales of reserves	(17)	–	(17)	–
<b>December 31, 2012</b>	<b>5,745</b>	<b>17,477</b>	<b>23,222</b>	<b>265</b>
Proved developed reserves:				
December 31, 2010	2,715	6,024	8,739	143
December 31, 2011	3,250	6,065	9,315	163
<b>December 31, 2012</b>	<b>2,505</b>	<b>6,066</b>	<b>8,571</b>	<b>156</b>

The non-controlling interest share included in the above total proved reserves was 23 billion cubic feet, 31 billion cubic feet and 34 billion cubic feet as of December 31, 2012, 2011 and 2010, respectively. The non-controlling interest share included in the

above proved developed reserves was 14 billion cubic feet, 21 billion cubic feet and 24 billion cubic feet as of December 31, 2012, 2011 and 2010, respectively. Substantially all non-controlling interests relate to the reserves in the Russian Federation.

#### V. STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS

The standardized measure of discounted future net cash flows, related to the above oil and gas reserves, is calculated in accordance with the requirements of Topic 932 of the Codification. Estimated future cash inflows from production are computed by applying the 12-months average price for oil and gas to year-end quantities of estimated net proved reserves. Adjustments in this calculation for future price changes are limited to those required by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future pre-tax net cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a ten percent

discount factor. Discounting requires a year-by-year estimate of when future expenditures will be incurred and when reserves will be produced.

The information provided in the tables set out below does not represent management's estimate of the Group's expected future cash flows or of the value of the Group's proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations. The arbitrary valuation, prescribed under Topic 932 of the Codification, requires assumptions as to the timing and amount of future development and production costs. The calculations should not be relied upon as an indication of the Group's future cash flows or of the value of its oil and gas reserves.

As of December 31, 2012	International	Russia	Total consolidated companies	Group's share in equity companies
Future cash inflows	58,747	619,743	678,490	24,279
Future production and development costs	(36,468)	(424,260)	(460,728)	(12,469)
Future income tax expenses	(4,156)	(34,573)	(38,729)	(2,592)
Future net cash flows	18,123	160,910	179,033	9,218
Discount for estimated timing of cash flows (10% p.a.)	(9,964)	(96,015)	(105,979)	(4,723)
Discounted future net cash flows	8,159	64,895	73,054	4,495
Non-controlling share in discounted future net cash flows	–	397	397	–

As of December 31, 2011	International	Russia	Total consolidated companies	Group's share in equity companies
Future cash inflows	51,665	616,290	667,955	25,773
Future production and development costs	(26,242)	(416,403)	(442,645)	(12,897)
Future income tax expenses	(6,056)	(35,768)	(41,824)	(2,896)
Future net cash flows	19,367	164,119	183,486	9,980
Discount for estimated timing of cash flows (10% p.a.)	(10,930)	(97,394)	(108,324)	(5,145)
Discounted future net cash flows	8,437	66,725	75,162	4,835
Non-controlling share in discounted future net cash flows	–	937	937	–

As of December 31, 2010	International	Russia	Total consolidated companies	Group's share in equity companies
Future cash inflows	40,871	432,401	473,272	18,629
Future production and development costs	(23,193)	(313,375)	(336,568)	(9,503)
Future income tax expenses	(3,843)	(19,775)	(23,618)	(2,107)
Future net cash flows	13,835	99,251	113,086	7,019
Discount for estimated timing of cash flows (10% p.a.)	(8,641)	(60,808)	(69,449)	(3,656)
Discounted future net cash flows	5,194	38,443	43,637	3,363
Non-controlling share in discounted future net cash flows	–	963	963	–

**VI. PRINCIPAL SOURCES OF CHANGES IN THE STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS**

<b>Consolidated companies</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Discounted present value as at January 1	75,162	43,637	45,597
Net changes due to purchases and sales of minerals in place	256	39	(193)
Sales and transfers of oil and gas produced, net of production costs	(14,215)	(13,515)	(12,454)
Net changes in prices and production costs estimates	(8,480)	69,089	22,241
Net changes in mineral extraction taxes	627	(32,678)	(23,976)
Extensions and discoveries, less related costs	3,174	3,492	1,886
Previously estimated development cost incurred during the period	7,241	6,182	5,565
Revisions of previous quantity estimates	377	620	(433)
Net change in income taxes	1,337	(7,467)	407
Other changes	(735)	224	(141)
Accretion of discount	8,310	5,539	5,138
<b>Discounted present value at December 31</b>	<b>73,054</b>	<b>75,162</b>	<b>43,637</b>

<b>Group's share in equity companies</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Discounted present value as at January 1	4,835	3,363	2,622
Sales and transfers of oil and gas produced, net of production costs	(1,066)	(1,203)	(927)
Net changes in prices and production costs estimates	(101)	3,820	2,296
Net changes in mineral extraction taxes	(7)	(1,720)	(985)
Extensions and discoveries, less related costs	20	8	53
Previously estimated development cost incurred during the period	88	66	120
Revisions of previous quantity estimates	(3)	179	(56)
Net change in income taxes	139	(365)	(294)
Other changes	17	267	234
Accretion of discount	573	420	300
<b>Discounted present value at December 31</b>	<b>4,495</b>	<b>4,835</b>	<b>3,363</b>



MANAGEMENT'S DISCUSSION  
AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS  
OF OPERATIONS

The following report contains a discussion and analysis of the financial condition of OAO LUKOIL as of December 31, 2012 and the results of its operations for each of the years ended December 31, 2012, 2011 and 2010, and significant factors that may affect its future performance. It should be read in conjunction with our US GAAP consolidated financial statements and notes and supplemental oil and gas disclosure.

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

indicators expressed in barrels were translated into barrels using an average conversion rate of 7.33 barrels per tonne. Translations of cubic meters to cubic feet were made at the rate of 35.31 cubic feet per cubic meter. Translations of barrels of crude oil into barrels of oil equivalent ("BOE") were made at the rate of 1 barrel per BOE and of cubic feet – at the rate of 6 thousand cubic feet per BOE.

*This report includes forward-looking statements – words such as "believes," "anticipates," "expects," "estimates," "intends," "plans," etc. – that reflect management's current estimates and beliefs, but are not guarantees of future results. Please see "Forward-looking statement" on page 86 for a discussion of some factors that could cause actual results to differ materially.*

## KEY FINANCIAL AND OPERATIONAL RESULTS

	2012	Change to 2011, %	2011	Change to 2010, %	2010
Sales (millions of US dollars)	139,171	4.1	133,650	27.3	104,956
Net income attributable to OAO LUKOIL (millions of US dollars)	11,004	6.2	10,357	15.0	9,006
EBITDA (millions of US dollars)	18,915	1.7	18,606	15.9	16,049
Taxes other than income taxes, excise and export tariffs (millions of US dollars)	(36,502)	3.9	(35,135)	26.1	(27,856)
Earning per share of common stock attributable to OAO LUKOIL (US dollars):					
Basic	14.47	8.8	13.30	21.4	10.95
Diluted	14.17	8.7	13.04	19.1	10.94
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	794,332	0.5	790,674	(4.5)	828,098
Daily hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE per day)	2,170	0.2	2,166	(4.5)	2,269
Crude oil and natural gas liquids produced by the Group including our share in equity affiliates (thousands of barrels)	677,023	(1.1)	684,522	(5.1)	721,560
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	19,934	10.5	18,038	(0.4)	18,103
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes)	63,773	1.8	62,667	(1.7)	63,770
Hydrocarbon proved reserves including our share in equity affiliates (millions of BOE)	17,296	0.2	17,269	0.1	17,255

Our net income for 2012 amounted to \$11,004 million, which is \$647 million, or 6.2%, more than in the previous year. In 2011, our net income was \$10,357 million, which is \$1,351 million, or 15.0%, more than in 2010. Moreover, our net income for the fourth quarter of 2012 amounted to \$2,688 million, which is nearly twice as much as in the fourth quarter of 2011. Our net income was influenced mainly by export tariffs and mineral extraction tax rates and by hydrocarbon prices. In 2011, our net income was materially affected by impairment loss in OOO Narianmarneftegaz in amount of \$955 million net of tax and non-controlling interest effect, recognized in the fourth quarter of 2011.

## 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 38 countries on four continents.

LUKOIL is one of the world's largest energy companies in terms of hydrocarbon reserves that amounted to 17.3 billion BOE as of January 1, 2013 and comprised of 13.4 billion barrels of crude oil and 23.5 trillion cubic feet of gas.

Our operations are divided into four main business segments:

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

Each of our four main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the *“Domestic crude oil and refined products prices”* section on page 58, 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 22 “Segment information” to our consolidated financial statements*.



## RECENT DEVELOPMENTS AND OUTLOOK

The following has been achieved in 2012:

### Exploration and production

- 7 new oil and 1 gas fields were brought into production (2011 – 4 oil and gas fields).
- In December, a Group subsidiary won the bidding for the use of a subsoil site that includes Imilorskoye, West Imilorskoye and Istochnoye fields. The site is located in Western Siberia with the oil in place and the recoverable oil reserves totaling, respectively, 855.5 million tonnes and 193.7 million tonnes in the C1 and C2 categories combined.
- The trend of crude oil production decline was broken and production volumes stabilized as a result of significant growth of drilling footage and reservoir stimulation.
- Active stage of development began on V.Filanovsky field on the Caspian seashore.
- Natural gas production volumes increased by 11.2% compared to 2011.

### Refining

- Starting from July 1, all the volume of gasoline produced by Group refineries in Russia complies with Euro-5.
- In September, we increased the Group's ownership stake in the joint venture operating the ISAB refining complex ("ISAB") from 60% to 80% and obtained control over ISAB.
- In the third quarter, a new diesel fuel hydrorefining unit with rated capacity of 3 million tonnes per year was put into operation at our refinery in Volgograd that made all of the refinery's diesel fuel output compliant with Euro-5.

### Marketing and distribution

- In April, a new oil product terminal with a total capacity of 1 million cubic meters was opened in the port Barcelona, Spain by a Group company and Spanish company Meroil on a 50/50 basis.

These and other achievements in 2012 are described in detail further in this report.

## CHANGES IN THE GROUP STRUCTURE

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

In August 2012, the Group acquired ConocoPhillips' investment in OOO "Narianmarneftegas" ("NMNG") and certain related assets for \$604 million. ConocoPhillips group owned 30% interest in NMNG. The acquisition increased the Group's total ownership interest in NMNG to 100%.

In January 2010, the Company signed an agreement to develop the West Qurna-2 field located in the south of Iraq. Originally, the parties to the agreement were the Iraqi state-owned South Oil Company and the contracting consortium formed by the Iraqi state-owned North Oil Company, the Company and Norway's Statoil ASA. The Company's share in the project was 56.25%. In 2012, the Group increased its share in the project up to 75%. The West Qurna-2 field has recoverable crude oil reserves of about 12.9 billion barrels.

As a part of the expansion of its presence in Kazakhstan, in December 2009, the Group acquired the remaining 46.0% interest in its equity affiliate LUKARCO B.V. ("LUKARCO") for \$1.6 billion, thereby increasing the ownership stake to 100%. LUKARCO is a holding company, which owns a 5.0% share in Tengizchevroil, a joint venture which develops the Tengiz and Korolevskoe fields in Kazakhstan, and a 12.5% share in Caspian Pipeline Consortium ("CPC"), which carries Kazakhstani and Russian oil to Novorossiysk marine terminal. Therefore, the Group increased the ownership in Tengizchevroil from 2.7% to 5.0% and the ownership in CPC from 6.75% to 12.5%. The first installment in the amount of \$300 million was paid in December 2009. \$800 million were paid in December 2010 and the remaining amount – in December 2011.

## IMPAIRMENT OF ASSETS IN OOO NARIANMARNEFTEGAZ

In 2005, the Company and ConocoPhillips, within their strategic partnership, established a joint venture based on a Group subsidiary NMNG to develop oilfields located in Northern Timan-Pechora region of Russia. The Group's share in joint venture was 70%, LUKOIL and ConocoPhillips run NMNG on a 50/50 basis. In 2008, NMNG commenced commercial production at the Yuzhnoye Khylychuyu oilfield, joint venture's major oilfield. As of December 31, 2008, proved reserves of the oilfield were estimated to be approximately 505 million barrels. In 2009 and 2010, the crude oil production from the field amounted to 7.0 and 6.9 million tonnes, respectively. In 2010, the production from the oilfield began to decline due to some unexpected geological reasons and it only reached 3.3 million tonnes in 2011. As of December 31, 2011, crude oil reserves decreased significantly and amounted to approximately 142 million barrels.

In 2011, as a result of respective analysis the Company recognized an impairment loss regarding upstream and other assets of NMNG in amount of \$1,261 million. An impact on our net income for 2011 net of ConocoPhillip's share in the impairment loss and deferred tax assets write-off amounted to \$955 million and an impact on our EBITDA amounted to \$883 million.

## RESOURCE BASE

The table below summarizes the net oil-equivalent 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, 2013 and 2012.

### Changes in 2012

(millions of BOE)	January 1, 2013 <sup>(1)</sup>	Production <sup>(2)</sup>	Extensions, discoveries and changes in structure	Revision of previous estimates	January 1, 2012
Western Siberia	9,712	(448)	337	112	9,711
Timan-Pechora	2,468	(120)	94	(56)	2,550
Ural region	2,217	(112)	69	91	2,169
Volga region	1,063	(35)	104	20	974
Other in Russia	216	(15)	7	–	224
Outside Russia	1,620	(88)	92	(25)	1,641
<b>Proved oil and gas reserves</b>	<b>17,296</b>	<b>(818)</b>	<b>703</b>	<b>142</b>	<b>17,269</b>
<b>Probable oil and gas reserves</b>	<b>7,723</b>				<b>8,415</b>
<b>Possible oil and gas reserves</b>	<b>4,272</b>				<b>3,939</b>

<sup>(1)</sup> Excluding reserves related to the Imilorskoye, West Imilorskoye and Istochnoye fields.

<sup>(2)</sup> Gas production shown before own consumption.

The Company's proved reserves as of January 1, 2013 amount to 17,296 million BOE and comprise of 13,381 million barrels of crude oil and 23,487 billion cubic feet of gas. Replacement of production by proved reserves increment in 2012 exceeded 100%.

In 2012, proved reserves growth as a result of geological exploration, production drilling and acquisitions, totaled 703 million BOE, largely as a result of the detailed field appraisal in the Northern Caspian and Komi Republic. Revision of previous estimates contributed 142 million BOE to the increase. In 2012, basic factors that contributed to a positive reinterpretation of proved reserves

were improvement of development techniques at the existing fields, progress in the preparation for the commissioning of a number of new fields and greater gas utilization.

The Company's 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.



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

(thousands of tonnes)	Change to 2011				
	2012	Total, %	Change in structure	Organic change	2011
Western Siberia	49,214	0.2	–	112	49,102
Timan-Pechora	15,634	(10.9)	–	(1,913)	17,547
Ural region	13,498	5.4	–	693	12,805
Volga region	3,603	12.5	–	400	3,203
Other in Russia	1,899	(2.7)	–	(53)	1,952
Crude oil produced in Russia	83,848	(0.9)	–	(761)	84,609
Crude oil produced internationally	3,342	(2.1)	(74)	3	3,413
<b>Total crude oil produced by consolidated subsidiaries</b>	<b>87,190</b>	<b>(0.9)</b>	<b>(74)</b>	<b>(758)</b>	<b>88,022</b>
<b>Our share in crude oil produced by equity affiliates:</b>					
- in Russia	386	8.1	–	29	357
- outside Russia	2,280	(10.2)	–	(258)	2,538
<b>Total crude oil produced</b>	<b>89,856</b>	<b>(1.2)</b>	<b>(74)</b>	<b>(987)</b>	<b>90,917</b>

The main oil producing region for the Company is Western Siberia where we produced 56.4% of our crude oil in 2012 (55.8% in 2011). Since the second half of 2011, the Company managed to stabilize crude oil production in the region that had been declining for several preceding years.

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

The structural decrease of our international production was a result of sale of 1.5% (10.0% of our share) in Karachaganak Petroleum

Operating consortium (“KPO”), an upstream project in Kazakhstan, to a state-owned KazMunayGaz in the end of the second quarter of 2012.

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

	2012		2011		2010	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	1,994	272	4,010	547	2,243	306
Crude oil purchases internationally	119,883	16,355	151,753	20,703	156,759	21,386
<b>Total crude oil purchased</b>	<b>121,877</b>	<b>16,627</b>	<b>155,763</b>	<b>21,250</b>	<b>159,002</b>	<b>21,692</b>

Significant part of our crude oil purchases is for processing. In 2012, we purchased 12,512 thousand tonnes of crude oil to process at our and at third party refineries, compared to 12,969 thousand tonnes in 2011. The decrease was due to higher volumes of own supply. Our purchases for trading also decreased compared to 2011.

**Production of gas and natural gas liquids.** In 2012, we produced 19,934 million cubic meters (117.3 million BOE) of gas available for sale (including our share in equity affiliates), that is 10.5% more than in 2011.

Our major gas production field is the Nakhodkinskoe field, where we produced 8,041 million cubic meters of natural gas in 2012 (8,273 million cubic meters in 2011). Our international gas production increased by 39.7%, mostly due to growth of our production in Uzbekistan. We produced 992 million cubic meters of gas from the Gissar field (commercial production commenced in December 2011), and increased production from the Khauzak field by 635 million cubic meters, or by 24.2%.

In 2012, the output of natural gas liquids at the Group gas processing plants in Western Siberia, Ural and Volgograd regions of Russia was 13.6 million BOE, compared to 13.1 million BOE in 2011.

## REFINING, MARKETING AND TRADING

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

In September 2012, we increased our interest up to 80% and obtained control over ISAB, in which we previously held 60% (49% before April 2011). Therefore, starting from September 2012, ISAB became our consolidated subsidiary.

Compared to 2011, the total volume of refined products produced by the Group (including our share in equity affiliates production) increased by 1.8%. Due to scheduled overhauls, production

volumes of our Russian refineries decreased by 1.8%. Production of our international refineries increased by 9.7% as a result of the increase of our share in ISAB.

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

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

The following table summarizes key figures for our refining activities.

	2012	2011	2010
	(millions of US dollars)		
Refining expenses at the Group refineries	1,669	1,418	1,121
- in Russia	1,141	1,112	806
- outside Russia <sup>(1)</sup>	528	306	315
Refining expenses at ISAB and Zeeland Refinery <sup>(2)</sup>	702	890	719
Refining expenses at third party refineries	96	7	5
Capital expenditures	1,406	783	702
- in Russia	988	586	542
- outside Russia	418	197	160
	(thousand barrels per day)		
Refinery throughput at the Group refineries	1,128	1,073	1,107
- in Russia	890	909	908
- outside Russia <sup>(1) (3)</sup>	238	164	199
Refinery throughput at ISAB and Zeeland Refinery <sup>(2) (3)</sup>	195	230	222
Refinery throughput at third party refineries	53	5	2
<b>Total refinery throughput</b>	<b>1,376</b>	<b>1,308</b>	<b>1,331</b>
	(thousands of tonnes)		
Refined products produced at the Group refineries	54,009	51,055	52,762
- in Russia	42,468	43,248	43,346
- outside Russia <sup>(1)</sup>	11,541	7,807	9,416
Production of ISAB and Zeeland Refinery <sup>(2)</sup>	9,764	11,612	11,008
Refined products produced at third party refineries	2,472	256	107
<b>Total refined products produced</b>	<b>66,245</b>	<b>62,923</b>	<b>63,877</b>

<sup>(1)</sup> Including 80% share of ISAB for September-December 2012.

<sup>(2)</sup> Including 60% share of ISAB from April 2011 to August 2012 (49% share of ISAB before April 2011) and 45% share of Zeeland Refinery.

<sup>(3)</sup> Including refined product processed.

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

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

The table below summarizes figures for our trading activities.

	2012	2011	2010
	(thousands of tonnes)		
Retail sales	15,424	15,249	14,336
Wholesale sales	97,558	87,337	91,020
<b>Total refined products sales</b>	<b>112,982</b>	<b>102,586</b>	<b>105,356</b>
Refined products purchased in Russia	1,772	2,026	1,853
Refined products purchased internationally	52,761	45,655	45,816
<b>Total refined products purchased</b>	<b>54,533</b>	<b>47,681</b>	<b>47,669</b>

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

	2012		2011		2010	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Exports of crude oil using Transneft export routes	223,185	30,448	215,605	29,414	231,525	31,586
Exports of crude oil bypassing Transneft	31,418	4,286	38,739	5,285	65,999	9,004
<b>Total crude oil exports</b>	<b>254,603</b>	<b>34,734</b>	<b>254,344</b>	<b>34,699</b>	<b>297,524</b>	<b>40,590</b>

In 2012, the volume of our export of crude oil from Russia remained on the level of 2011, and we exported 41.4% of our total domestic crude oil production (41.0% – in 2011).

Almost all the volume of crude oil exported bypassing Transneft was routed through our own export infrastructure. The reduction of export through our own export infrastructure was mainly caused by a decrease in production from Yuzhnoye Khylichuyu oilfield (1,275 thousand tonnes in 2012 compared to 3,316 thousand tonnes in 2011).

In 2012, we exported from Russia 22.5 million tonnes of refined products, a decrease of 6.2%, compared to 2011. Primarily, we export from Russia diesel fuel, fuel oil and gasoil. These products account for approximately 89% of our refined products export volumes.

The decrease in refined products export was a result of a decrease in throughput at our Russian refineries together with the increase of domestic demand.

In 2012, our revenue from export of crude oil and refined products from Russia both to Group companies and third parties amounted to \$25,174 million and \$16,779 million, respectively

(\$25,022 million for crude oil and \$17,725 million for refined products in 2011).

#### POWER GENERATION

In 2012, 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 000 LUKOIL-Volgogradenergo, 000 LUKOIL-Kubanenergo, 000 LUKOIL-Astrakhanenergo, 000 LUKOIL-Rostovenergo, 000 LUKOIL-Stavropolenergo, 000 LUKOIL-TTK, 000 LUKOIL-Ecoenergo, our own power generating facilities at our oil and gas fields in Russia and power generators in Bulgaria, Romania and Ukraine. Our total output of electrical energy was 15.4 billion kW-h in 2012 (13.1 billion kW-h in 2011). Our total output of heat energy was approximately 14.7 million Gcal in 2012 (15.5 million Gcal in 2011).

In 2012, we began construction of another two combined cycle gas turbine units in Astrakhan with a combined capacity of 235 MW. The completion is scheduled for the third quarter of 2013.

## 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 2012, the Brent crude oil price fluctuated between \$88 and \$128 per barrel and reached its peak of \$128.18 in the beginning of March.

Substantially all the crude oil the Group exports is Urals blend. The following table shows the average crude oil and refined product prices in 2012, 2011 and 2010.

	2012	Change to 2011, %	2011	Change to 2010, %	2010
(in US dollars per barrel, except for figures in percent)					
Brent crude	111.67	0.4	111.26	39.9	79.50
Urals crude (CIF Mediterranean) <sup>(1)</sup>	110.55	1.3	109.10	39.4	78.29
Urals crude (CIF Rotterdam) <sup>(1)</sup>	110.19	1.0	109.08	39.4	78.26
(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam)	631.08	3.5	609.51	37.8	442.35
Diesel fuel 10 ppm (FOB Rotterdam)	980.00	2.2	958.73	39.3	688.46
High-octane gasoline (FOB Rotterdam)	1,036.14	5.3	984.12	33.9	735.24

Source: Platts.

<sup>(1)</sup> 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 2012, 2011 and 2010.

	2012	Change to 2011, %	2011	Change to 2010, %	2010
(in US dollars per metric tonne, except for figures in percent)					
Fuel oil	320.29	0.4	318.99	30.1	245.27
Diesel fuel	832.71	9.5	760.53	36.5	557.36
High-octane gasoline (Regular)	813.94	(5.1)	857.70	20.1	714.26
High-octane gasoline (Premium)	869.33	(3.2)	897.81	20.8	743.17

Source: InfoTEK (excluding VAT).

### CHANGES IN THE US DOLLAR-RUBLE EXCHANGE RATE AND INFLATION

A substantial part of our revenue is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, ruble inflation and movements of exchange rates can significantly affect the results of our operations. In particular, the appreciation of the ruble against the

US dollar generally causes our costs to increase in US dollar terms, and vice versa. The appreciation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 0.7% in 2012, compared to 2011. At the same time, the nominal appreciation of the US dollar amounted to 5.8% (based on average ruble-dollar exchange rates for 2012 and 2011).

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

	2012	2011	2010
Ruble inflation (CPI), %	6.6	6.1	8.7
Average exchange rate for the period (ruble to US dollar)	31.09	29.39	30.37
Exchange rate at the end of the period (ruble to US dollar)	30.37	32.20	30.48

### 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 2012, 2011 and 2010, the tax charge on the operations in Russia was approximately 88%, 88% and 85% of our total tax charge, respectively.

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 2012, 2011 and 2010, respectively, were 78%, 80% and 77%.

In 2012, tax expenses in Russia were about 53% 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:

		2012 <sup>(1)</sup>	Change to 2011, %	2011 <sup>(1)</sup>	Change to 2010, %	2010 <sup>(1)</sup>
Export tariffs on crude oil	\$/tonne	404.15	(1.2)	409.19	49.6	273.55
Export tariffs on refined products						
Middle distillates (jet fuel), diesel fuel and gasoils	\$/tonne	266.70	(2.8)	274.27	39.5	196.60
Light distillates						
gasoline	\$/tonne	363.72	6.4	341.94	73.9	196.60
straight-run gasoline	\$/tonne	363.72	9.2	333.08	69.4	196.60
Liquid fuels (fuel oil)	\$/tonne	266.70	27.9	208.46	96.8	105.91
Mineral extraction tax						
Crude oil	RUR/tonne	5,065.95	13.7	4,456.54	44.9	3,075.76
Natural gas	RUR/1,000 m <sup>3</sup>	251.00	5.9	237.00	61.2	147.00

<sup>(1)</sup> Average values.

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

		2012 <sup>(1)</sup>	Change to 2011, %	2011 <sup>(1)</sup>	Change to 2010, %	2010 <sup>(1)</sup>
Mineral extraction tax						
Crude oil	\$/tonne	162.93	7.4	151.65	49.7	101.28
Natural gas	\$/1,000 m <sup>3</sup>	8.07	0.1	8.06	66.5	4.84

<sup>(1)</sup> Average values.

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

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

In 2012, the base rate was 446 rubles per metric tonne extracted (419 rubles in 2011 and 2010). The base rate for 2013 is currently set at 470 rubles per metric tonne extracted. However, the rate may be amended by the authorities later on.

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

The Group produces crude oil in the Caspian Sea and benefits from application of zero extraction tax rate. We expect the amount of benefit to increase as the production volumes grow.

**Natural gas extraction tax rate.** The mineral extraction tax on natural gas produced by independent producers in Russia is calculated using a flat rate. In 2011, the rate was 237 rubles per thousand cubic meters and in 2012 the rate was 251 rubles per thousand cubic meters. The rate for 2013 is set at 265 rubles per thousand cubic meters.

**Crude oil export duty rate** is calculated on a progressive scale. The rate is zero when the average Urals blend international market

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

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

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

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

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

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

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

(except for straight-run gasoline). Only domestic sales volumes are subject to excises.

**Excise on refined products.** The responsibility to pay excises on refined products in Russia is imposed on refined product producers

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

Starting from 2011, excise rates on refined products in Russia were increased and tied to the ecological class of fuel. Excise tax rates for 2012, 2011 and 2010 are listed below.

		2012	Change to 2011, %	2011	Change to 2010, %	2010
Gasoline						
Below Euro-3	RUR/tonne	7,976.37	33.1	5,995.00	105.1	2,923.00
Euro-3	RUR/tonne	7,633.37	34.6	5,672.00	42.1	3,992.00
Euro-4	RUR/tonne	6,822.00	32.6	5,143.00	28.8	3,992.00
Euro-5	RUR/tonne	5,977.91	16.2	5,143.00	28.8	3,992.00
Diesel fuel						
Below Euro-3	RUR/tonne	4,199.55	52.5	2,753.00	131.7	1,188.00
Euro-3	RUR/tonne	4,058.33	63.3	2,485.00	109.2	1,188.00
Euro-4	RUR/tonne	3,562.00	58.5	2,247.00	89.1	1,188.00
Euro-5	RUR/tonne	3,260.36	45.1	2,247.00	89.1	1,188.00
Motor oils	RUR/tonne	6,072.00	29.7	4,681.00	44.2	3,246.10
Straight-run gasoline	RUR/tonne	7,824.00	28.5	6,089.00	41.9	4,290.00
		2012	Change to 2011, %	2011	Change to 2010, %	2010
Gasoline						
Below Euro-3	\$/tonne	256.53	25.8	204.00	112.0	96.25
Euro-3	\$/tonne	245.50	27.2	193.01	46.8	131.45
Euro-4	\$/tonne	219.41	25.4	175.01	33.1	131.45
Euro-5	\$/tonne	192.26	9.9	175.01	33.1	131.45
Diesel fuel						
Below Euro-3	\$/tonne	135.06	44.2	93.68	139.5	39.12
Euro-3	\$/tonne	130.52	54.4	84.56	116.2	39.12
Euro-4	\$/tonne	114.56	49.8	76.46	95.5	39.12
Euro-5	\$/tonne	104.86	37.1	76.46	95.5	39.12
Motor oils	\$/tonne	195.29	22.6	159.29	49.0	106.89
Straight-run gasoline	\$/tonne	251.63	21.4	207.20	46.7	141.26

In 2013, the excise rates increase as follows:

	January 1, 2013 till June 30, 2013		July 1, 2013 till December 31, 2013	
	RUR/tonne	\$/tonne <sup>(1)</sup>	RUR/tonne	\$/tonne <sup>(1)</sup>
Gasoline				
Below Euro-3	10,100.00	332.54	10,100.00	332.54
Euro-3	9,750.00	321.01	9,750.00	321.01
Euro-4	8,560.00	281.83	8,960.00	295.00
Euro-5	5,143.00	169.33	5,143.00	169.33
Diesel fuel				
Below Euro-3	5,860.00	192.94	5,860.00	192.94
Euro-3	5,860.00	192.94	5,860.00	192.94
Euro-4	4,934.00	162.45	5,100.00	167.91
Euro-5	4,334.00	142.69	4,500.00	148.16
Motor oils	7,509.00	247.23	7,509.00	247.23
Straight-run gasoline	10,229.00	336.78	10,229.00	336.78

<sup>(1)</sup> Exchange rate as of December 31, 2012 applied.

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

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

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

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

## **TRANSPORTATION OF CRUDE OIL AND REFINED PRODUCTS IN RUSSIA**

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

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

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

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

**YEAR ENDED DECEMBER 31, 2012, COMPARED TO YEARS ENDED DECEMBER 31, 2011 AND DECEMBER 31, 2010**

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

	2012	2011	2010
	(millions of US dollars)		
<b>Revenues</b>			
Sales (including excise and export tariffs)	139,171	133,650	104,956
<b>Costs and other deductions</b>			
Operating expenses	(9,359)	(9,055)	(8,298)
Cost of purchased crude oil, gas and products	(64,148)	(59,694)	(43,250)
Transportation expenses	(6,171)	(6,121)	(5,608)
Selling, general and administrative expenses	(3,755)	(3,822)	(3,558)
Depreciation, depletion and amortization	(4,832)	(4,473)	(4,154)
Taxes other than income taxes	(13,666)	(12,918)	(8,978)
Excise and export tariffs	(22,836)	(22,217)	(18,878)
Exploration expense	(364)	(532)	(336)
Gain (loss) on disposals and impairments of assets	30	(1,663)	(363)
<b>Income from operating activities</b>	<b>14,070</b>	<b>13,155</b>	<b>11,533</b>
Interest expense	(538)	(694)	(712)
Interest and dividend income	257	211	174
Equity share in income of affiliates	518	690	472
Currency translation loss	(512)	(301)	(122)
Other non-operating (expense) income	(72)	58	125
<b>Income before income taxes</b>	<b>13,723</b>	<b>13,119</b>	<b>11,470</b>
Current income taxes	(2,738)	(2,678)	(2,104)
Deferred income taxes	(60)	(615)	(247)
<b>Total income tax expense</b>	<b>(2,798)</b>	<b>(3,293)</b>	<b>(2,351)</b>
<b>Net income</b>	<b>10,925</b>	<b>9,826</b>	<b>9,119</b>
Net loss (income) attributable to non-controlling interests	79	531	(113)
<b>Net income attributable to OAO LUKOIL</b>	<b>11,004</b>	<b>10,357</b>	<b>9,006</b>
Earning per share of common stock attributable to OAO LUKOIL (in US dollars):			
Basic	14.47	13.30	10.95
Diluted	14.17	13.04	10.94

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

## SALES REVENUES

Sales breakdown	2012	2011	2010
	(millions of US dollars)		
Crude oil			
Export and sales on international markets other than CIS	24,414	30,132	25,251
Export and sales to CIS	1,622	2,390	1,091
Domestic sales	1,634	1,571	956
	<b>27,670</b>	<b>34,093</b>	<b>27,298</b>
Refined products			
Export and sales on international markets			
Wholesale	75,880	65,060	50,340
Retail	10,724	11,275	9,678
Domestic sales			
Wholesale	8,113	7,349	5,427
Retail	8,690	7,893	5,501
	<b>103,407</b>	<b>91,577</b>	<b>70,946</b>
Petrochemicals			
Export and sales on international markets	992	1,095	642
Domestic sales	418	914	728
	<b>1,410</b>	<b>2,009</b>	<b>1,370</b>
Gas and gas products			
Export and sales on international markets	2,385	1,878	1,565
Domestic sales	1,092	1,001	786
	<b>3,477</b>	<b>2,879</b>	<b>2,351</b>
Sales of energy and related services	<b>1,394</b>	<b>1,472</b>	<b>1,416</b>
Other			
Sales on international markets	962	880	890
Domestic sales	851	740	685
	<b>1,813</b>	<b>1,620</b>	<b>1,575</b>
<b>Total sales</b>	<b>139,171</b>	<b>133,650</b>	<b>104,956</b>

Sales volumes	2012	2011	2010
		(thousands of barrels)	
Crude oil			
Export and sales on international markets other than CIS	222,466	275,696	326,669
Export and sales to CIS	31,622	45,329	23,280
Domestic sales	33,264	32,699	26,637
	<b>287,352</b>	<b>353,724</b>	<b>376,586</b>
		(thousands of tonnes)	
Crude oil			
Export and sales on international markets other than CIS	30,350	37,612	44,566
Export and sales to CIS	4,314	6,184	3,176
Domestic sales	4,538	4,461	3,634
	<b>39,202</b>	<b>48,257</b>	<b>51,376</b>
		(thousands of tonnes)	
Refined products			
Export and sales on international markets			
Wholesale	85,917	76,313	80,043
Retail	6,568	6,945	7,314
Domestic sales			
Wholesale	11,641	11,024	10,977
Retail	8,856	8,304	7,022
	<b>112,982</b>	<b>102,586</b>	<b>105,356</b>
<b>Total sales volume of crude oil and refined products</b>	<b>152,184</b>	<b>150,843</b>	<b>156,732</b>

Realized average sales prices		2012	2011	2010
Average realized price international				
Oil (excluding CIS)	(\$/barrel)	109.74	109.30	77.30
Oil (CIS)	(\$/barrel)	51.31	52.71	46.84
Refined products				
Wholesale	(\$/tonne)	883.18	852.55	628.91
Retail	(\$/tonne)	1,632.81	1,623.53	1,323.31
Average realized price within Russia				
Oil	(\$/barrel)	49.12	48.06	35.90
Refined products				
Wholesale	(\$/tonne)	696.91	666.62	494.37
Retail	(\$/tonne)	981.21	950.51	783.49

In 2012, our revenues increased by \$5,521 million, or by 4.1%, compared to 2011 (in 2011 increased by \$28,694 million, or by 27.3%, compared to 2010).

Our revenues from crude oil sales decreased by \$6,423 million, or by 18.8% (in 2011 increased by \$6,795 million, or by 24.9%, compared to 2010).

Our revenues from sales of refined products increased by \$11,830 million, or by 12.9% (in 2011 increased by \$20,631 million, or by 29.1%, compared to 2010).

### Sales of crude oil

#### *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.

#### *2011 vs. 2010*

Our total crude oil sales revenues increased by \$6,795 million, or by 24.9%, due to growth of crude oil prices. At the same time, due to a decrease of production our sales volumes decreased by 6.1%, or by 3,119 thousand tonnes.

Compared to 2010, we significantly increased crude oil supplies to Belarus, while sales to outside the CIS decreased correspondingly.

In 2011, revenue from export of crude oil from Russia both to the Group companies and third parties amounted to \$25,022 million.

### Sales of refined products

#### *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.

#### *2011 vs. 2010*

Our revenue from the wholesale of refined products outside of Russia increased by \$14,720 million, or by 29.2%, due to an increase in the average realized price by 35.6% in 2011. At the same time, the wholesale volumes decreased by 3,730 thousand tonnes, or by 4.7%, mainly as a result of decrease in export from Russia and the shutdown of the Odessa refinery.

Our revenue from international retail sales increased by \$1,597 million, or by 16.5%, also due to an increase in average prices by 22.7%. Retail sales volumes decreased by 369 thousand tonnes, or by 5.0%, following restructuring of our retail network in the USA. At the same time, this was partially compensated by increased retail sales volumes in Europe.

Our revenue from the wholesale of refined products on the domestic market increased by \$1,922 million, or by 35.4%, mainly due to an increase in the average realized price by 34.8%. The increase of sales volumes was not significant.

Our revenue from retail sales in Russia increased by \$2,392 million, or by 43.5%, due to an increase in prices and sales volumes. Our retail volumes in Russia increased by 18.3% following significant increase of domestic demand.

In 2011, our revenue from the export of refined products from Russia both to Group companies and third parties amounted to \$17,725 million.

### Sales of petrochemical products

#### *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 on our petrochemical plant in Stavropol, Russia



in December 2011. Domestic sales volumes dropped by 55.0% compared to 2011. International sales volumes also decreased by 8.2%.

#### *2011 vs. 2010*

In 2011, our revenue from sales of petrochemical products increased by \$639 million, or by 46.6%, mainly as a result of an increase in international sales volumes. In the fourth quarter of 2010, we commenced production at our petrochemical plant Karpatnaftochim Ltd. in Ukraine after modernization and construction of a chlorine and caustic production line. Our realized prices increased by 11.8%.

#### **Sales of gas and gas products**

##### *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. At the domestic market, this was mainly a result of the increase of 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.

##### *2011 vs. 2010*

Sales of gas and gas refined products increased by \$528 million, or by 22.5%, in 2011. Wholesale gas refined products sales revenue increased by \$364 million, or by 43.6%, primarily as a result of an increase in sales prices. Retail gas products revenue increased by \$112 million, or by 22.1%, also due to price growth.

Natural gas sales revenue increased by \$30 million, or by 3.6%.

#### **Sales of energy and related services**

##### *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.

##### *2011 vs. 2010*

In 2011, our revenue from sales of electricity, heat and related services increased by \$56 million, or by 4.0%. This growth was a result of an increase in tariff rates and the ruble appreciation. At the same time, in the second half 2011, the revenue of our energy segment decreased significantly due to the reduction of resale operations.

#### **Sales of other products**

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

##### *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.

##### *2011 vs. 2010*

In 2011, other sales increased by \$45 million, or by 2.9%. The sales of goods and other products from our retail stations increased to \$700 million, or by 15.5%. At the same time, transportation services provided to third parties decreased compared to 2010.

## OPERATING EXPENSES

Operating expenses include the following:

	2012	2011	2010
	(millions of US dollars)		
Hydrocarbon extraction expenses	3,861	3,771	3,430
Own refining expenses	1,669	1,418	1,121
Refining expenses at third parties and affiliated refineries	798	897	724
Cost of processing operations at ISAB	64	–	–
Expenses for crude oil transportation to refineries	1,241	1,060	1,048
Power generation and distribution expenses	619	617	654
Petrochemical expenses	303	343	221
Other operating expenses	804	949	1,100
<b>Total operating expenses</b>	<b>9,359</b>	<b>9,055</b>	<b>8,298</b>

The method of allocation of operating expenses above differs from the approach used in preparing the data for [Note 22 “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.

In 2012, our operating expenses increased by \$304 million, or by 3.4%.

### 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.

#### 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.

#### 2011 vs. 2010

In 2011, our extraction expenses increased by \$341 million, or by 9.9%. Our average hydrocarbon extraction cost increased from \$4.30 per BOE to \$4.96 per BOE, or by 15.3%, compared to 2010.

The increase was mainly a result of the real ruble appreciation against the US dollar and increased expenses for power supply, repairs and labor costs.

### Own refining expense

#### 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 on page 56 for details](#)).

#### 2011 vs. 2010

Our own refining expenses increased by \$297 million, or by 26.5%, in 2011.

Refining expenses at our domestic refineries increased by 38.0%, or by \$306 million. This increase was a result of an increase in consumption and cost of additives, increased power supply costs, higher expenses on repairs and the ruble appreciation against the US dollar.

Refining expenses at our international refineries decreased by 2.9%, or by \$9 million. The decrease of production volumes at our Bulgarian and Romanian refineries was partially offset by higher energy costs and overhauls. Moreover, we continued to incur operating expenses at our dormant refinery in Odessa although at a significantly lower level than in 2010 as we had to keep production facilities on line.

#### 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.

##### *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 on page 56 for details*). This was partially offset by commencement of crude oil processing at third party refineries in Belorussia in the beginning of 2012.

##### *2011 vs. 2010*

In 2011, refining expenses at third party and affiliated refineries increased by \$173 million, or by 23.9%. This was due to the increase of our share in ISAB from 49% to 60% since April, 2011, resulting in the increase of our share of costs. Increased energy costs, appreciation of euro to the US dollar and overhauls performed at the ISAB complex in the first quarter of 2011 also contributed to the increase of expenses.

#### 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.

##### *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 Belorussia, where we commenced crude oil processing in the first quarter of 2012.

##### *2011 vs. 2010*

Expenses for crude oil transportation to refineries in 2011 didn't change significantly. The increase in transportation tariffs compared to 2010 and the effect of ruble appreciation was compensated for by a decrease in volumes of own supply to refineries.

#### Petrochemical expenses

##### *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 Stavropol, Russia, operating expenses of the plant didn't decrease significantly due to overhauls at other plant units. The effect of the decreased production at 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.

##### *2011 vs. 2010*

In 2011, operating expenses of our petrochemical plants increased by \$122 million, or by 55.2%, due to an increase in production volumes as a result of the commencement of production at our petrochemical plant Karpatnaftochim Ltd. in Ukraine in the fourth quarter of 2010 after modernization and construction of a chlorine and caustic production line. Additionally, the increased consumption of raw materials due to the changes in product mix and ruble appreciation contributed to the increase of expenses.

#### 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.

##### *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.

##### *2011 vs. 2010*

In 2011, other operating expenses decreased by \$151 million, or by 13.7%. The decrease was a result of a lower volume of transportation services provided outside of Russia and the decrease of rental activities as a result of the restructuring of our retail network in the USA.

#### COST OF PURCHASED CRUDE OIL, GAS AND PRODUCTS

Cost of purchased crude oil, gas and products includes cost of crude oil and refined products purchased for trading or refining,

gas and fuel oil to supply our power generation entities and the result of hedging of international crude oil and refined products sales.

#### *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 loss from hedging, compared to a \$657 million loss in 2011.

#### *2011 vs. 2010*

Cost of purchased crude oil, gas and products increased by \$16,444 million in 2011, or by 38.0%, due to an increase in crude oil and refined products prices.

In 2011, we recognized a \$657 million loss from hedging, compared to a \$232 million loss in 2010.

### TRANSPORTATION EXPENSES

#### *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%.

#### *2011 vs. 2010*

Our transportation expenses increased by \$513 million, or by 9.1%. This increase was primarily related to Russia and resulted from the ruble appreciation, increased tariffs and change in supply directions.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed in 2011, compared to 2010, as follows: crude oil pipeline tariffs increased by 14.1%, railway tariffs for refined products transportation increased by 6.9%, crude oil freight rates decreased by 3.5%, and refined products freight rates decreased by 9.2%.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

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

#### *2012 vs. 2011*

Our selling, general and administrative expenses in 2012 did not change significantly.

#### *2011 vs. 2010*

Our selling, general and administrative expenses increased by \$264 million, or by 7.4%. This increase was driven mainly by higher selling expenses both in Russia and abroad. Expenses in Russia were also affected by the real ruble appreciation. At the same time, the decrease of provisions for bad debts partially offset the adverse effect of the above mentioned factors.

### 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 on page 56 for details*).

#### *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.

#### *2011 vs. 2010*

Our share in income of affiliates increased by \$218 million, or by 46.2%, in 2011, mostly due to increase in income of Tengizchevroil.

## TAXES OTHER THAN INCOME TAXES

	2012	2011	2010
	(millions of US dollars)		
<b>In Russia</b>			
Mineral extraction taxes	12,261	11,502	7,795
Social security taxes and contributions	493	480	327
Property tax	511	538	479
Other taxes	82	77	93
<b>Total in Russia</b>	<b>13,347</b>	<b>12,597</b>	<b>8,694</b>
<b>International</b>			
Mineral extraction taxes	93	92	69
Social security taxes and contributions	111	107	102
Property tax	24	35	39
Other taxes	91	87	74
<b>Total internationally</b>	<b>319</b>	<b>321</b>	<b>284</b>
<b>Total</b>	<b>13,666</b>	<b>12,918</b>	<b>8,978</b>

### 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 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.

### 2011 vs. 2010

In 2011, taxes other than income taxes increased by 43.9%, or by \$3,940 million. This was mainly due to an increase in mineral

extraction taxes in Russia as a result of the rise of the tax rate following the increase of international crude oil prices.

In 2011, application of decreased rate for crude oil produced from depleted oilfields and zero rate for crude oil produced from the fields with extra heavy crude oil and the greenfields led to \$1,161 million tax reduction (\$1,313 million in 2010). The major oilfield where we benefited from zero extraction tax rate was the Yuzhnoye Khylychuyu field. In early December 2010, accumulated volume of production from this field exceeded the incentive level of 15 million tonnes and since that moment we have been paying extraction tax in full.

The increase in social security taxes and contributions in Russia was due to tax legislation amendments.

## EXCISE AND EXPORT TARIFFS

	2012	2011	2010
	(millions of US dollars)		
<b>In Russia</b>			
Excise tax on refined products	1,922	1,710	951
Crude oil export tariffs	11,315	11,714	10,513
Refined products export tariffs	5,561	5,028	3,574
<b>Total in Russia</b>	<b>18,798</b>	<b>18,452</b>	<b>15,038</b>
<b>International</b>			
Excise tax on refined products	3,355	3,445	3,700
Crude oil export tariffs	274	319	136
Refined products export tariffs	409	1	4
<b>Total internationally</b>	<b>4,038</b>	<b>3,765</b>	<b>3,840</b>
<b>Total</b>	<b>22,836</b>	<b>22,217</b>	<b>18,878</b>

### 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 sharp increase of 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 higher share of crude oil export to Belorussia. Moreover, export tariff savings on crude oil produced from 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 Belorussia, 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.

**2011 vs. 2010**

In 2011, export tariffs increased by \$2,835 million, or by 19.9%. The effect of increase of crude oil and refined products tariff rates was partially compensated by a decrease in crude oil export volumes by 14.5% and refined products export volumes by 6.9%, compared to 2010.

Starting from December, 2010 the Group applies reduced export duty rate for the crude oil produced from the Yu. Korchagin field in the Caspian Sea, however due to relatively small amount of crude oil export from that field the effect of this incentive on our 2011 and 2010 financial results was insignificant.

Starting from 2011, excise rates on refined products in Russia were increased and tied to the ecological class of fuel. Despite the fact that the Company produces high quality ecological motor fuel subject to lower excise rates compared to fuel of lower quality, average excise rates roughly doubled for us compared to 2010.

**EXPLORATION EXPENSES****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 amount of \$26 million. In the second quarter, we charged to expense the cost of an exploratory well in Volga region of Russia in amount of \$50 million.

**2011 vs. 2010**

Our exploration expense increased by \$196 million, or by 58.3%. Dry hole costs amounted to \$417 million in 2011, compared to \$225 million in 2010.

In 2011, dry hole costs were mostly related to our overseas projects, namely \$181 million in Ghana, \$149 million in Cote d'Ivoire, \$27 million in Vietnam and \$17 million in Kazakstan. Dry hole costs in Russia included \$28 million and \$10 million related to projects in Komi Republic and in Western Siberia, respectively.

**GAIN (LOSS) ON DISPOSALS AND IMPAIRMENTS OF ASSETS****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.

Losses on disposals and impairments of assets also includes the financial result from disposals of a number of non-core assets and individually insignificant impairments of non-performing business units.

**2011 vs. 2010**

Loss on disposals and impairments of assets for 2011 mainly included an impairment loss related to certain upstream and other assets of NMNG in amount of \$1,261 million. *For details please refer to Impairment of assets in OOO Narianmarneftegaz" section on page 53.*

Additionally, in 2011, the Company recognized an impairment loss of \$175 million for international refining, marketing and distribution assets.

**OTHER NON-OPERATING (EXPENSE) INCOME**

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****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 maximum statutory rate in Russia is 20%. 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. The high level of the effective income tax rate in 2011 was mostly due to the impairment loss in NMNG. *For details please refer to Impairment of assets in OOO Narianmarneftegaz" section on page 53.*

**2011 vs. 2010**

In 2011, our total income tax expense increased by \$942 million, or by 40.1%. At the same time, our income before income tax increased by \$1,649 million, or by 14.4%.

In 2011, our effective income tax rate was 25.1%, compared to 20.5% in 2010, while the maximum statutory rate for the Russian Federation is 20%.

**RECONCILIATION OF NET INCOME TO EBITDA (earnings before interest, income taxes, depreciation and amortization)**

	2012	2011	2010
	(millions of US dollars)		
<b>Net income</b>	<b>11,004</b>	<b>10,357</b>	<b>9,006</b>
Add back:			
Income tax expense	2,798	3,293	2,351
Depreciation and amortization	4,832	4,473	4,154
Interest expense	538	694	712
Interest and dividend income	(257)	(211)	(174)
<b>EBITDA</b>	<b>18,915</b>	<b>18,606</b>	<b>16,049</b>

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

	2012	2011	2010
	(millions of US dollars)		
Net cash provided by operating activities	18,997	15,514	13,541
Net cash used in investing activities	(13,216)	(9,013)	(7,296)
Net cash used in by financing activities	(5,680)	(6,023)	(6,146)

### OPERATING ACTIVITIES

Our primary source of cash flow is funds generated from our operations. During 2012, cash generated from operating activities amounted to \$18,997 million, which is 22.5% more than in 2011. This increase was largely a result of a decrease in working capital by \$2,474 million, compared to January 1, 2012.

The decrease in working capital was mainly caused by:

- \$1,711 million net decrease in trade accounts receivable and payable

- \$194 million net decrease in taxes receivable and payable

- \$686 million net decrease in other assets and liabilities

At the same time, this was partially offset by a \$126 million increase in inventories.

### INVESTING ACTIVITIES

Our capital expenditures, including non-cash transactions, amounted to \$11,850 million, which is 39.5% more than in 2011.

	2012	2011	2010
	(millions of US dollars)		
<b>Capital expenditures <sup>(1)</sup></b>			
Exploration and production			
Russia	7,014	5,084	3,911
International	1,888	1,545	997
Total exploration and production	8,902	6,629	4,908
Refining, marketing and distribution			
Russia	1,510	1,030	945
International	568	324	375
Total refining, marketing and distribution	2,078	1,354	1,320
Chemicals			
Russia	62	55	27
International	28	34	49
Total chemicals	90	89	76
Power generation and distribution	503	196	420
Other	277	224	120
<b>Total capital expenditures</b>	<b>11,850</b>	<b>8,492</b>	<b>6,844</b>

<sup>(1)</sup> Including non-cash transactions and prepayments.

Capital expenditures in exploration and production segment increased by \$2,273 million, or by 34.3%. In Russia, the rise was due to development of the V. Filanovsky oilfield on the Caspian seashore and increased production drilling in Western Siberia. Internationally, we increased investments in developing our projects in Iraq and Uzbekistan.

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

In Russia, it refers to construction of catalytic cracking unit and in extension of reservoir park at our Nizhny Novgorod refinery and construction of hydro cracking unit at our refinery in Volgograd.

Capital expenditures in power generation sector increased as a result of fulfillment of our investment program, namely construction of 235 MW combined cycle gas turbine in Astrakhan with a completion scheduled for the third quarter of 2013.

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

	2012	2011	2010
	(millions of US dollars)		
Yamal	476	372	162
Caspian region <sup>(1)</sup>	1,425	555	369
Ghana	13	216	87
Cote d'Ivoire	44	227	92
Iraq	924	203	172
Uzbekistan	477	480	286
<b>Total</b>	<b>3,359</b>	<b>2,053</b>	<b>1,168</b>

<sup>(1)</sup> Russian and international projects.

In the fourth quarter of 2012, a Group company paid \$836 million as a first 50% installment for the subsoil rights for the site that includes Imilorskoye, West Imilorskoye and Istochnoye fields in

Western Siberia. The second 50% payment was made in January 2013. Also, \$58 million were paid for the subsoil rights for the Verkhneyangoreyski site in the Komi Republic.

	2012	2011	2010
	(millions of US dollars)		
<b>Acquisitions of subsidiaries and associates <sup>(1)</sup></b>			
Exploration and production			
Russia	200	252	–
International	22	500	922
Total exploration and production	222	752	922
Refining, marketing and distribution			
Russia	25	10	7
International	658	342	3
Total refining, marketing and distribution	683	352	10
Power generation and distribution	–	–	–
Other	–	–	–
Less cash acquired	(19)	(4)	–
<b>Total acquisitions</b>	<b>886</b>	<b>1,100</b>	<b>932</b>

<sup>(1)</sup> Including prepayments related to acquisitions and non-cash transactions.

In 2012, the Group acquired additional 20% share in ISAB for approximately \$621 million.

In 2011, we made a final payment of \$500 million within the acquisition of LUKARCO, a payment of \$342 million for 11% share in ISAB and a payment of \$153 million for a 25.1% share in OOO "Bashneft-Polus".

#### FINANCING ACTIVITIES

In 2012, net movements of short-term and long-term debt generated an outflow of \$1,266 million, compared to an outflow of \$2,004 million in 2011.

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

In 2011, we made an advance payment of \$1,760 million for purchase of equity linked notes.

#### CREDIT RATING

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

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

Fitch Ratings affirmed the Company's long-term issuer default rating of 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 2012, a construction agreement for a heavy-residue hydrocracking complex at Group refinery LUKOIL Neftochim Bourgas AD in Bulgaria was signed. Commissioning of the complex is expected in 2015. The amount of capital commitment under this agreement is approximately \$1.1 billion.

Group companies have commitments for capital expenditure contributions in the amount of \$363 million related to various production sharing agreements over the next 25 years.

The Company 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. The Group estimates the amount of capital commitment under this agreement for 2013 to be approximately \$232 million.

The Group signed a number of agreements for the years 2012-2015 for construction of offshore platforms in the Caspian region. The Group estimates the amount of this capital commitment to be approximately \$1,346 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. Currently the Group is approving certain amendments to the capital construction program, including its extension to the end of 2014. As of December 31, 2012, the Group estimates the amount of this commitment to be approximately \$303 million.

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

(millions of US dollars)	Total	2013	2014	2015	2016	2017	After
<b>On balance sheet</b>							
Short term debt	126	126	-	-	-	-	-
Long-term bank loans and borrowings	867	280	194	180	129	46	38
Long-term non-bank loans and borrowings	420	19	400	-	-	-	1
6.375% Non-convertible US dollar bonds, maturing 2014	898	-	898	-	-	-	-
2.625% Convertible US dollar bonds, maturing 2015	1,436	-	-	1,436	-	-	-
6.356% Non-convertible US dollar bonds, maturing 2017	500	-	-	-	-	500	-
7.250% Non-convertible US dollar bonds, maturing 2019	596	-	-	-	-	-	596
6.125% Non-convertible US dollar bonds, maturing 2020	998	-	-	-	-	-	998
6.656% Non-convertible US dollar bonds, maturing 2022	500	-	-	-	-	-	500
7.40% Russian ruble bonds, maturing 2013	198	198	-	-	-	-	-
Capital lease obligations	82	35	45	1	1	-	-
<b>TOTAL</b>	<b>6,621</b>	<b>658</b>	<b>1,537</b>	<b>1,617</b>	<b>130</b>	<b>546</b>	<b>2,133</b>
<b>Off balance sheet</b>							
Operating lease obligations	475	119	106	73	48	34	95
Capital commitments in PSAs	363	177	18	18	18	18	114
Capital commitments of power generating segment	303	226	77	-	-	-	-
Capital commitments in LUKOIL-Neftochim Bourgas AD	1,130	818	308	4	-	-	-
Obligation under contract with ZAO Globalstroy-Engineering	232	232	-	-	-	-	-
Obligation under contracts for the development of the V. Filanovsky oilfield	1,346	126	1,220 <sup>(1)</sup>	-	-	-	-

<sup>(1)</sup> Amount for 2014 and 2015.

## 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. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts’ ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was dismissed from the lawsuit. The Colorado Supreme Court found, however, that the trial court made a procedural error by failing to hold an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company and remanded the case to the Colorado Court of Appeals to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). The Colorado Court of Appeals declined to dismiss the case based on forum non conveniens and the case was remanded to the District Court. In June 2009, three creditors of ADC filed an Involuntary Bankruptcy Petition putting ADC into bankruptcy. In November 2009, after adding a claim, ADC removed the case from the District Court to the US Bankruptcy Court. On October 28, 2010, the Bankruptcy Court granted the Company’s Motion for Remand and Abstention and remanded the case to the Denver District

Court. On October 20, 2011, the Denver District Court dismissed all claims against the Company for lack of jurisdiction. ADC filed notice of appeal on April 17, 2012. On August 23, 2012, the Court of Appeals affirmed the Denver District Court’s dismissal for lack of jurisdiction. ADC filed a Petition for Rehearing which was denied on September 20, 2012. ADC then filed a petition for Writ of Certiorari in the Colorado Supreme Court on October 18, 2012. The Company filed its Response to the Writ on November 1, 2012. The Colorado Supreme Court has not indicated yet if it will consider this case. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group’s financial condition.

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 Federal Court case, the Company has filed a Motion to Dismiss and discovery has been stayed pending further action. 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.

## BUSINESS COMBINATIONS

### *Purchase price allocation*

Accounting for the acquisition of a business requires the allocation of the purchase price to the various assets and liabilities of the acquired business. For most assets and liabilities, purchase price allocation is accomplished by recording the asset or liability at its estimated fair value. The most difficult estimations of individual fair values are those involving property, plant and equipment and identifiable intangible assets. We use all available information to make these fair value determinations and, for major business acquisitions, typically engage an outside appraisal firm to assist in the fair value determination of the acquired long-lived assets. We have, if necessary, up to one year after the acquisition closing date to finish these fair value determinations and finalize the purchase price allocation.

### *Principles of consolidation*

Our consolidated financial statements include the financial position and results of the Company, controlled subsidiaries of which the Company directly or indirectly owns more than 50% of the voting interest, unless non-controlling stockholders have substantive participating rights, and variable interest entities where the Group is determined to be the primary beneficiary. Other significant investments in companies of which the Company directly or indirectly owns between 20% and 50% of the voting interest and over which it exercises significant influence but not control, are accounted for using the equity method of accounting. Investments in companies of which the Company directly or indirectly owns more than 50% of the voting interest but where non-controlling stockholders have substantive participating rights are accounted for using the equity method of accounting. Undivided interests in oil and gas joint ventures are accounted for using the proportionate consolidation method. Investments in other companies are recorded at cost.

## REVENUE RECOGNITION

Revenues are recognized when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed or determinable. Revenues include excise on petroleum products sales and duties on export sales of crude oil and petroleum products.

Revenues from non-cash sales are recognized at the fair market value of the crude oil and petroleum products sold.

## SUCCESSFUL EFFORTS ACCOUNTING FOR OIL AND GAS ACTIVITIES

Accounting for oil and gas activities is subject to special accounting rules that are unique to the oil and gas industry. Property acquisitions, successful exploratory wells, all development costs (including development dry holes and the Group’s share of operators’ expenses during the development stage of production sharing and risk service contracts) and support equipment and facilities are capitalized. Artificial stimulation and well work-over costs are included in operating expenses as incurred.

### *Property acquisition costs*

For individually significant undeveloped properties, management periodically performs impairment test based on exploration and drilling efforts to date. For undeveloped properties that individually are relatively small, management exercises judgment and determines a periodic property impairment charge as required that is reported in loss on disposals and impairments of assets.

### *Exploratory costs*

For exploratory wells, drilling costs are temporarily capitalized, or “suspended”, on the balance sheet, pending a judgmental determination of whether potentially economic oil and gas reserves have been discovered by the drilling effort. If a judgment is made that the well did not encounter potentially economic oil and gas quantities, the well costs are expensed as a dry hole and are reported in exploration expense. Exploratory wells that are judged to have discovered potentially economic quantities of oil and gas and that are in areas where a major capital expenditure would be required before production could begin, remain capitalized on the balance sheet as long as additional exploratory appraisal work is under way or firmly planned. There is no periodic impairment assessment of suspended exploratory well costs. Management continuously monitors the results of the additional appraisal drilling and seismic work and expensed the suspended well costs as dry holes when it judges that the potential field does not warrant further exploratory efforts in the near term.

Other exploratory expenditures, including geological and geophysical costs are expensed as incurred.

### PROVED OIL AND GAS RESERVES

Due to the inherent uncertainties and the necessarily limited nature of reservoir data, estimates of reserves are inherently imprecise, require the application of judgment and are subject to change as additional information becomes available. The estimates are made using all available geological and reservoir data as well as historical production data. Estimates are reviewed and revised as appropriate. Revisions occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Company's plans.

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas liquids including condensate and natural gas that geological and engineering data demonstrate with reasonable certainty can be recovered in future years from known reservoirs under existing economic and operating conditions. Reserves are considered proved if they can be produced economically as demonstrated by either actual production or conclusive formation tests. Proved reserves do not include additional quantities of oil and gas reserves that may result from applying secondary or tertiary recovery techniques not yet tested and determined to be economic. The proved reserves include volumes which are recoverable up to and after license expiry dates. Proved developed reserves are the quantities of proved reserves expected to be recovered through existing wells with existing equipment and operating methods.

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. The Subsoil Law of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. Since the law applies both to newly issued and old licenses and the Group has currently renewed over 50% of its licenses, management believes that licenses will be renewed upon their expiration for the remainder of the economic life of each respective field.

### IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets, such as oil and gas properties (other than unproved properties), other property, plant, and equipment, and purchased intangibles subject to amortization, are assessed for impairment whenever events or changes in circumstances

indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future cash flows expected to be generated by that group. If the carrying amount of an asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by writing down the carrying amount to the estimated fair value of the asset group, generally determined as discounted future net cash flows. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale are presented separately in the appropriate asset and liability sections of the balance sheet.

### DEFERRED INCOME TAXES

Deferred income tax assets and liabilities are recognized in respect of future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purposes of the consolidated financial statements and their respective tax bases and in respect of operating loss and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse and the assets be recovered and liabilities settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in profit or loss in the reporting period which includes the enactment date.

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income in the reporting periods in which the originating expenditure becomes deductible. In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that the deferred income tax assets will be realized. In making this assessment, management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies.

An income tax position is recognized only if the uncertain position is more likely than not of being sustained upon examination, based on its technical merits. A recognized income tax position is measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

### ASSET RETIREMENT OBLIGATIONS

Under various laws, contracts, permits and regulations, the Group has legal obligations to remove tangible equipment and restore



the land or seabed at the end of operations at production sites. The largest asset retirement obligations of the Group relate to wells and oil and gas production facilities and pipelines. The Group records the fair value of liabilities associated with such obligations when incurred. Estimating the future asset retirement obligations costs necessary for this accounting calculation involves significant estimates and judgments by management. Most of these obligations are many years in the future and the contracts and regulations often have vague descriptions of what removal practices and criteria will have to be met when the removal event actually occurs. Asset removal technologies and costs are constantly changing, as well as political, environmental, safety and public relations considerations.

### CONTINGENCIES

Certain conditions may exist as of balance sheet dates that may result in losses, but the impact of which will only be resolved when one or more future events occur or fail to occur. The Group is required to both determine whether a loss is probable based on judgment and interpretation of laws and regulations and determine whether the loss can be reasonably estimated. If our assessment of a contingency indicates that it is probable that a material loss will arise, and the amount of the liability can be estimated, then

the estimated liability is accrued and charged to profit or loss.

If our assessment indicates that a potentially material loss is not probable, but is only reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability is disclosed in the notes to our consolidated financial statements. Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed. The Company's management continually monitor known and potential contingent matters and make appropriate charges to profit or loss when warranted by circumstance.

### USE OF DERIVATIVE INSTRUMENTS

The Group's derivative activity is limited to certain petroleum products marketing and trading operations hedging of commodity price risks. Currently this activity involves the use of futures and swaps contracts together with purchase and sale contracts that qualify as derivative instruments. The Group accounts for these activities under the mark-to-market methodology in which the derivatives are revalued each accounting period. Resulting realized and unrealized gains or losses are presented in profit or loss on a net basis. Unrealized gains and losses are carried as assets or liabilities on the consolidated balance sheet.

## RECENT ACCOUNTING PRONOUNCEMENTS

In December 2011, the FASB issued ASU No. 2011-11, *"Disclosures about Offsetting Assets and Liabilities."* This ASU requires entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. ASU No. 2011-11 is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods, and should be applied retrospectively.

In January 2013, the FASB issued ASU No. 2013-01 *"Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities,"* which clarifies that ordinary trade receivables and receivables are not in the scope of ASU No. 2011-11. The Group is evaluating the effect of the adoption of ASU No. 2011-11 and does not expect any material impact on its results of operations, financial position or cash flows.

## 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.*

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