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

The following report contains a discussion and analysis of the financial position of OAO LUKOIL as of December 31, 2014 and the results of its operations for each of the years ended December 31, 2014, 2013 and 2012, as well as significant factors that may affect its future performance. It should be read in conjunction with our US GAAP consolidated financial statements, including notes and supplementary information on oil and gas exploration and production activities.

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

This report includes forward-looking statements – words such as "believes," "anticipates," "expects," "estimates," "intends," "plans," etc. – that reflect management's current estimates and beliefs, but are not guarantees of future results. Please see "Forward-looking statement" on page 33 for a discussion of some factors that could cause actual results to differ materially.

Key financial and operational results

	2014	Change to 2013, %	2013	Change to 2012, %	2012
	(millions of US dollars)				
Sales	144,167	1.9	141,452	1.6	139,171
Net income attributable to OAO LUKOIL	4,746	(39.4)	7,832	(28.8)	11,004
Adjusted net income attributable to OAO LUKOIL[(1)]	7,087	(31.1)	10,281	(6.6)	11,004
EBITDA	15,982	(4,1)	16,668	(11.9)	18,915
Adjusted EBITDA[(1)]	18,426	(4.3)	19,255	1.8	18,915
Taxes other than income taxes, excise and export tariffs	(34,256)	(5.2)	(36,137)	(1.0)	(36,502)
Earning per share of common stock attributable to OAO LUKOIL:	(US dollars)				
Basic	6.29	(39.4)	10.38	(28.3)	14.47
Diluted	6.20	(39.1)	10.18	(28.2)	14.17
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	844,469	5.1	803,825	1.2	794,332
Daily hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	2,314	5.1	2,202	1.5	2,170
Crude oil and natural gas liquids produced by the Group including our share in equity affiliates (thousands of barrels)	726,955	6.3	683,822	1.0	677,023
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	19,968	(2.1)	20,391	2.3	19,934
Refined products produced by the Group including our share in equity affiliates (thousands of tonnes)	64,118	(0.1)	64,196	0.7	63,773
Hydrocarbon proved reserves including our share in equity affiliates (millions of BOE)	17,585	1.1	17,401	0.6	17,296

(1) Adjusted for the loss on impairment of assets and dry hole related write-offs (for details see p. 24).

In 2014, net income attributable to OAO LUKOIL decreased by $3,086 million, or by 39.4%, while our EBITDA decreased by $686 million, or by 4.1%, compared to 2013. Our net income in 2014 was affected by a decrease of hydrocarbon prices, especially in the fourth quarter. It was also affected by the impairment losses and write-offs related to our upstream and downstream assets in the total amounts of $2,123 million and $218 million, respectively (net of tax and non-controlling interest). Adjusted for non-recurring losses, our net income decreased by $3,194 million, or by 31.1%, compared to 2013. At the same time, our adjusted EBITDA decreased by $829 million, or by 4.3%. In 2014, our EBITDA was supported by commencement of cost compensation at West Qurna-2 project in Iraq. In 2014, the Group generated free cash flow of $0.9 billion.

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 No. 1403, issued on November 17, 1992. Under this decree, on April 5, 1993, the Government of the Russian Federation transferred to the Company 51% of the voting shares of fifteen enterprises. Under Government Resolution No. 861 issued on September 1, 1995, a further nine enterprises were transferred to the Group during 1995. Since 1995, the Group has carried out a share exchange program to increase its shareholding in each of 24 founding subsidiaries to 100%. From formation, the Group has expanded substantially through consolidation of interests, acquisition of new companies and establishment of new businesses. Now LUKOIL is a global energy company operating through its subsidiaries in 34 countries on four continents.

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

Our operations are divided into four main business segments:

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

Each of our four main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the “Domestic crude oil and refined products prices” section on page 10, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of crude oil refining and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments’ underlying financial position and results of operations. For this reason, we do not analyse either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 22 “Segment information” to our consolidated financial statements.

Recent developments and outlook

The following has been achieved in 2014:

Exploration and production

- 17 new oil and gas fields were brought into production, the best result since 2003 (2013 – 9 oil and gas fields).
- 14 new oilfields discovered, the best result within since 2001 years.
- Crude oil production increased by 7.0% as a result of commencement of crude oil production on the West Qurna-2 oilfield in Iraq.
- In Russia, crude oil production commenced on the Imilorskoye oilfield, one of the largest undeveloped oilfields in Western Siberia.

Refining

- The Company continued the construction of the second catalytic cracking unit at the Nizhny Novgorod refinery.
- Our joint venture with OAO Russian Railways commenced the production of lubricants and greases.

Marketing

- In line with the strategy to optimize our downstream operations, the Group sold 100% shares in our distribution companies in Hungary, Czech Republic and Slovakia.

Other

- The Company commenced the development of the world's largest new kimberlite pipe, first diamonds produced and sold.

These and other achievements in 2014 are described in detail further in this report.

Changes in Group structure

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

On August 11, 2014, in line with the strategy to optimize downstream portfolio a Group company signed an agreement with AMIC Energy Management GmbH ("AMIC") to sell 100% of the Group's interest in LUKOIL Ukraine, a distribution company operating in Ukraine. Closing of the transaction is subject to customary approvals by regulatory authorities.

On August 1, 2014, in line with the strategy to optimize its downstream operations Group companies signed agreements with Slovnaft Česká Republica, Spol. s.r.o. and Norm Benzinkút Kft to sell 100% of shares in LUKOIL Slovakia s.r.o., LUKOIL Hungary Ltd. and LUKOIL Czech Republic s.r.o. These transactions were finalized in December 2014 at the selling price of €98 million (approximately $123 million) which is subject to certain working capital adjustments.

On April 15, 2014, a Group company entered into a contract with a Sinopec group company, to sell for $1.2 billion the Group's 50% interest in Caspian Investment Resources Ltd., an exploration and production company operating in Kazakhstan. Subsequent to December 31, 2014, Sinopec group company failed to close the sale and purchase under the contract, arguing that the conditions precedent had not been satisfied by the agreed longstop date of January 15, 2015. The Group contends that those conditions precedent were satisfied prior to the longstop date. On February 9, 2015, the Group company commenced arbitration proceedings in London against Sinopec group companies seeking damages. The quantum of that claim remains to be determined.

In December 2013, after approval by European regulatory authorities, the Group acquired the remaining 20% interest in the joint venture which operates the ISAB refinery complex (ISAB) for €446 million (approximately $613 million) after final adjustments, increasing its stake in the joint venture from 80% to 100%. This transaction was exercised in line with the initial agreement on the establishment of the joint venture signed in 2008. This agreement gave the second investor, ERG S.p.A., a step-by-step put option to sell its share in the joint venture to the Group. The Group obtained control over ISAB in September 2012, when within this agreement, it acquired a 20% interest in the joint venture for €494 million (approximately $621 million) and increased its stake to 80%.

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

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

West Qurna-2 project

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

The Group launched the "Mishrif Early Oil" stage on the West Qurna-2 field and reached the planned production of 120 thousand barrels per day in March 2014. According to the service agreement, costs are compensated after this level of production is achieved and maintained during any 90 days within a 120-day period. In June 2014, we met this term. Therefore, in 2014, the Group accrued revenue from the West Qurna-2 project in the total amount of $3,682 million, consisting of cost recovery of $3,616 million and remuneration fee of $66 million. This revenue was classified as crude oil sales revenue. Attributable amount of 6,087 thousand tonnes, or 41,749 thousand barrels, of crude oil was included in Group's crude oil production for 2014 that represented approximately 55% of total production from the field. Positive impact of cost compensation on Group's EBITDA for 2014 amounted to $3,105 million.

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

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

Sectorial sanctions against the Russian companies

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

Resource base

The table below summarizes the net proved reserves of consolidated subsidiaries and our share in equity affiliates under the standards of the US Securities and Exchange Commission (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, 2015 and 2014.

(millions of BOE)	January 1, 2015	Changes in 2014: Production[(1)]	Changes in 2014: Extensions, discoveries and changes in structure	Changes in 2014: Revision of previous estimates	January 1, 2014
Western Siberia	9,586	(431)	365	(95)	9,747
Timan-Pechora	2,491	(124)	265	30	2,320
Ural region	2,303	(121)	102	36	2,286
Volga region	1,250	(64)	38	38	1,238
Other in Russia	196	(14)	10	4	196
Outside Russia	1,759	(123)	48	220	1,614
Proved oil and gas reserves	**17,585**	**(877)**	**828**	**233**	**17,401**
Probable oil and gas reserves	**6,823**				**6,613**
Possible oil and gas reserves	**3,375**				**3,596**

[(1)] Gas production shown before own consumption.

The Company's proved reserves as of January 1, 2015 amount to 17,585 million BOE and comprise of 13,594 million barrels of crude oil and 23,946 billion cubic feet of gas. The incremental replacement of production by additional proved reserves in 2014 amounted to 121%.

The increase in proved reserves related to geological exploration and production drilling totaled 815 million BOE and was a result of the exploration operations in the traditional regions of the Company's operations in Russia and abroad. Outside of Russia, the increase was largely a result of the commencement of production at the West Qurna-2 oilfield and including additional volumes in proved reserves of Mishrif formation.

Positive revision of previous estimates mainly related to our project in Azerbaijan where a Group company, within an international consortium, started the second phase of development of Shakh-Deniz field.

The increase in proved reserves in Timan-Pechora was due to the commencement of production by OOO Bashneft-Polus, where the Group holds a 25.1% interest.

Operational highlights

Hydrocarbon production

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

	2014	2013	2012
	(thousand BOE per day)		
Crude oil and natural gas liquids production[1]			
Consolidated subsidiaries			
Western Siberia	970	996	1,014
Timan-Pechora	313	302	309
Ural region	308	297	286
Volga region	136	120	77
Other regions in Russia	38	38	38
Total in Russia	1,765	1,753	1,724
Iraq[2]	114	–	–
Other regions outside Russia	60	65	69
Total outside Russia	174	65	69
Total consolidated subsidiaries	**1,939**	**1,818**	**1,793**
Our share in equity affiliates			
in Russia	11	8	8
outside Russia	42	47	49
Total share in equity affiliates	**53**	**55**	**57**
Total crude oil and natural gas liquids	**1,992**	**1,873**	**1,850**
Natural gas production available for sale[3]			
Consolidated subsidiaries			
Western Siberia	187	187	183
Timan-Pechora	14	14	12
Ural region	19	17	15
Volga region	6	6	7
Total in Russia	226	224	217
Total outside Russia	87	95	94
Total consolidated subsidiaries	**313**	**319**	**311**
Share in equity affiliates			
in Russia	1	1	1
outside Russia	8	9	8
Total share in production of equity affiliates	**9**	**10**	**9**
Total natural gas available for sale	**322**	**329**	**320**
Total daily hydrocarbon production	**2,314**	**2,202**	**2,170**
	(US dollar per BOE)		
Hydrocarbon extraction expenses	5.74	5.58	5.04
- in Russia	5.19	5.59	5.03
- outside Russia	9.82	5.43	5.07
	(millions of US dollars)		
Hydrocarbon extraction expenses	4,718	4,335	3,861
- in Russia	3,762	4,021	3,562
- outside Russia	956	314	299
Exploration expenses	1,104	602	364
- in Russia	332	218	205
- outside Russia	772	384	159
Mineral extraction tax	11,647	12,410	12,354
- in Russia	11,596	12,333	12,261
- outside Russia	51	77	93

(1) Natural gas liquids produced at the Group gas processing plants.
(2) Compensation oil that represents approximately 55% of production from the West Qurna-2 field in 2014.
(3) Including petroleum gas sold to third parties.

We undertake exploration for, and production of, crude oil and natural gas in Russia and internationally. In Russia, our major oil producing subsidiaries are OOO LUKOIL-Western Siberia, OOO LUKOIL-Komi and OOO LUKOIL-PERM. Exploration and production outside of Russia is performed by our 100% subsidiary LUKOIL Overseas Holding GmbH. This has stakes in PSA’s and other projects in Kazakhstan, Azerbaijan, Uzbekistan, Romania, Iraq, Saudi Arabia, Egypt, Ghana, Cote d’Ivoire, and Norway.

Crude oil production. In 2014, we produced (including the Company's share in equity affiliates) 97.2 million tonnes, or 713.1 million barrels, of crude oil.

The following table represents our crude oil production in 2014 and 2013 by major regions.

(thousands of tonnes)	2014	Change to 2013 Total, %	Change in structure	Organic change	2013
Western Siberia	46,840	(2.8)	–	(1,368)	48,208
Timan-Pechora	15,814	3.8	–	582	15,232
Ural region	14,585	4.4	34	580	13,971
Volga region	6,659	14.8	657	201	5,801
Other regions in Russia	1,911	0.4	–	8	1,903
Crude oil produced in Russia	85,809	0.8	691	3	85,115
Iraq[1]	6,087	100.0	–	6,087	–
Other regions outside of Russia	2,860	(9.0)	–	(283)	3,143
Crude oil produced internationally	8,947	184.7	–	5,804	3,143
Total crude oil produced by consolidated subsidiaries	**94,756**	**7.4**	**691**	**5,807**	**88,258**
Our share in crude oil produced by equity affiliates:					
in Russia	519	41.8	(17)	170	366
outside Russia	1,933	(11.5)	–	(250)	2,183
Total crude oil produced	**97,208**	**7.0**	**674**	**5,727**	**90,807**

[1] Compensation oil that represents approximately 55% of production from the West Qurna-2 field in 2014.

The main oil producing region for the Company is Western Siberia where we produced 49.4% of our crude oil in 2014 (54.6% in 2013).

Crude oil production in Western Siberia continued to decline due to natural depletion of reserves and an increase in water cut. Nevertheless, this was compensated for by the acquisitions of new upstream properties, development of greenfields, successful employment of new technologies and an increase in drilling footage. As a result, our daily domestic crude oil and natural gas liquids production volumes increased by 0.7%, compared to 2013.

The structural increase in our domestic production was a result of the acquisition of a 100% share of ZAO Samara-Nafta and an increase in the Group's ownership in ZAO Kama-oil from 50% to 100% during the second quarter of 2013. At the same time, the transfer of ZAO Kama-oil from affiliates to subsidiaries led to some structural decrease in the affiliates' production in Russia.

The increase in our international production was a result of commencement of commercial production at the West Qurna-2 oilfield in Iraq (for details see p. 4).

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

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

	2014 (thousand of barrels)	2014 (thousand of tonnes)	2013 (thousand of barrels)	2013 (thousand of tonnes)	2012 (thousand of barrels)	2012 (thousand of tonnes)
Purchases in Russia	7,579	1,034	5,447	743	1,994	272
Purchases for trading internationally	150,492	20,531	48,416	6,605	28,170	3,843
Purchases for refining internationally	88,239	12,038	75,607	10,315	91,713	12,512
Total crude oil purchased	**246,310**	**33,603**	**129,470**	**17,663**	**121,877**	**16,627**

A significant part of our crude oil purchases is for processing. Compared to 2013, our purchases for processing at international refineries increased by 16.7% as a result of the increase of crude oil refining at ISAB. Moreover, in 2014, our purchases for trading increased significantly compared to 2013.

Production of gas and natural gas liquids. In 2014, we produced 19,968 million cubic meters (117.5 million BOE) of gas available for sale (including our share in equity affiliates), that is 2.1% less than in 2013.

Our major gas field is the Nakhodkinskoe field, where we produced 8,247 million cubic meters of natural gas in 2014 (8,272 million cubic meters in 2013). Our international gas production decreased by 8.4%, compared to 2013, largely due to lower production in Uzbekistan.

In 2014, the output of natural gas liquids at the Group gas processing plants in Western Siberia, Ural and Volgograd regions of Russia was 13.9 million BOE, compared to 13.7 million BOE in 2013.

Refining, marketing and trading

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

In December 2013, the Group increased its stake in ISAB to 100% after acquisition of the remaining 20% share. Initially, in December 2008, the Group acquired a 49% interest in ISAB, then increased its interest to 60% in April 2011 and to 80% in September 2012, when control over the refinery was obtained and ISAB became our consolidated subsidiary, rather than an equity affiliate.

Compared to 2013, the total volume of refined products produced by the Group (including our share in production at the Zeeland refinery) didn’t change significantly. Production volumes at our Russian refineries increased slightly above the level of 2013, while the production of our international refineries decreased by 1.6%. Sharp decrease in production at the Zeeland refinery by 20.3% due to overhauls in the second quarter of 2014 was partially compensated by the increase of production at ISAB.

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

The following table summarizes key figures for our refining activities.

	2014	**2013**	**2012**
		(thousand barrels per day)	
Refinery throughput at the Group refineries	1,263	1,240	1,128
- in Russia	909	909	890
- outside Russia[1]	354	331	238
Refinery throughput at affiliated refineries[1]	74	92	195[2]
Refinery throughput at third party refineries	37	31	53
Total refinery throughput	**1,374**	**1,363**	**1,376**
		(thousands of tonnes)	
Production of the Group refineries in Russia	43,673	43,426	42,468
Production of the Group refineries outside Russia	16,780	16,170	11,541
Production at affiliated refineries	3,665	4,600	9,764[2]
Refined products produced by the Group including our share in affiliated refinery	**64,118**	**64,196**	**63,773**
Refined products produced at third party refineries	1,687	1,439	2,472
Total refined products produced	**65,805**	**65,635**	**66,245**
		(millions of US dollars)	
Refining expenses at the Group refineries	2,059	2,170	1,669
- in Russia	1,078	1,156	1,141
- outside Russia	981	1,014	528
Refining expenses at affiliated refineries outside of Russia	191	228	702[2]
Refining expenses at third party refineries	75	58	96
Capital expenditures	2,318	2,184	1,406
- in Russia	1,691	1,393	988
- outside Russia	627	791	418

[1] Including refined product processed.
[2] Including 60% share of ISAB production up to September 2012.

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

The Group retails its refined products in 23 countries through nearly 5.3 thousand petrol stations (including franchisees). Most of the stations operate under the LUKOIL brand.

The table below summarizes figures for our trading activities.

	2014	**2013**	**2012**
		(thousands of tonnes)	
Retail sales	16,126	15,741	15,424
Wholesale sales	102,103	101,529	97,558
Total refined products sales	**118,229**	**117,270**	**112,982**
Refined products purchased in Russia	2,041	2,298	1,772
Refined products purchased internationally	58,910	58,172	52,761
Total refined products purchased	**60,951**	**60,470**	**54,533**

In December 2014, in line with the strategy to optimize its downstream operations, Group companies sold 100% of shares in LUKOIL Slovakia s.r.o., LUKOIL Hungary Ltd. and LUKOIL Czech Republic s.r.o. that together operated approximately 140 petrol stations.

In August 2014, a Group company signed an agreement with AMIC to sell 100% of the Group's interest in LUKOIL Ukraine, a distribution company operating 240 petrol stations in Ukraine. Closing of the transaction is subject to customary approvals by regulatory authorities.

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

	2014		**2013**		**2012**	
	(thousands of barrels)	(thousands of tonnes)	(thousands of barrels)	(thousands of tonnes)	(thousands of barrels)	(thousands of tonnes)
Exports of crude oil using Transneft export routes	172,306	23,507	185,500	25,307	223,185	30,448
Exports of crude oil bypassing Transneft	46,370	6,326	47,770	6,517	31,418	4,286
Total crude oil exports	**218,676**	**29,833**	**233,270**	**31,824**	**254,603**	**34,734**
Exports of refined products		**23,377**		**23,419**		**22,537**

In 2014, the volume of our crude oil export from Russia decreased by 6.3%, compared to 2013, and we exported 34.8% of our domestic crude oil production (37.4% – in 2013). The decrease of crude oil export was a result of higher volumes of domestic sales.

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

In 2014, the Company exported 1,499 thousand tonnes of light crude oil through the Eastern Siberia – Pacific Ocean pipeline. This allowed us to preserve the premium quality of crude oil and thus increased the efficiency of export, compared to export to traditional Western markets.

In 2014, the volume of our exported refined products from Russia didn't change significantly compared to 2013. Primarily, we export from Russia diesel fuel, fuel oil and gasoil. These products accounted for approximately 88.6% of our exported refined products volumes.

In 2014, our revenue from export of crude oil and refined products from Russia both to Group companies and third parties amounted to $19,195 million and $15,711 million, respectively ($22,885 million for crude oil and $17,309 million for refined products in 2013).

Power generation

In 2014, we continued to develop the power generation sector of our business as part of our strategic development program. This new sector encompasses all aspects of the power generation business, from generation to transmission and sale of heat and electrical power. Our power generation business sector now includes OOO LUKOIL-Volgogradenergo, OOO LUKOIL-Kubanenergo, OOO LUKOIL-Astrakhanenergo, OOO LUKOIL-Rostovenergo, OOO LUKOIL-Stavropolenergo, OOO LUKOIL-TTK, OOO LUKOIL-Ecoenergo, our own power generating facilities at our oil and gas fields in Russia and power generators in Bulgaria and Romania. Our total output of electrical energy was 17.1 billion kW-h in 2014 (15.7 billion kW-h in 2013 and 15.4 billion kW-h in 2012). In 2014, our total output of heat energy was approximately 14.1 million Gcal (13.6 million Gcal in 2013 and 14.7 million Gcal in 2012).

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 the first half of 2014, the price for the Brent crude oil was increasing and reached its peak of $115.32 in the middle of June, but then turned into a sharp downward trend and dropped to $54.97 in the end of December. In the fourth quarter of 2014, the average Brent crude oil price was 24.9% lower, compared to the third quarter of 2014.

Substantially all the crude oil the Group exports is Urals blend. The following table shows the average crude oil and refined product prices in 2014 and 2013.

	2014	Change to 2013, %	2013	Change to 2012, %	2012
	(in US dollars per barrel, except for figures in percent)				
Brent crude	98.95	(8.9)	108.66	(2.7)	111.67
Urals crude (CIF Mediterranean) (1)	97.95	(9.3)	108.03	(2.3)	110.55
Urals crude (CIF Rotterdam) (1)	97.23	(9.5)	107.38	(2.6)	110.19
	(in US dollars per metric tonne, except for figures in percent)				
Fuel oil 3.5% (FOB Rotterdam)	527.06	(10.9)	591.43	(6.3)	631.08
Diesel fuel 10 ppm (FOB Rotterdam)	855.17	(8.9)	938.66	(4.2)	980.00
High-octane gasoline (FOB Rotterdam)	918.87	(6.9)	986.86	(4.8)	1,036.14

Source: Platts.

(1) The Company sells crude oil on foreign markets on various delivery terms. Thus, our average realized sales 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 2014, 2013 and 2012.

	2014	Change to 2013, %	2013	Change to 2012, %	2012
	(in US dollars per metric tonne, except for figures in percent)				
Fuel oil	243.13	(28.8)	341.32	6.6	320.29
Diesel fuel	734.10	(13.7)	850.78	2.2	832.71
High-octane gasoline (Regular)	806.66	(2.8)	829.69	1.9	813.94
High-octane gasoline (Premium)	834.17	(7.0)	897.10	3.2	869.33

Source: InfoTEK (excluding VAT).

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenue is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, ruble inflation and movements of exchange rates can significantly affect the results of our operations. In particular, a depreciation of the ruble against the US dollar generally causes our costs to decrease in US dollar terms, and vice versa. The appreciation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 10.6% in 2014, compared to 2013.

In the fourth quarter of 2014, the ruble depreciated significantly against the US dollar. Average ruble-dollar exchange rate in the fourth quarter of 2014 was 47.42 rubles per US dollar, a 45.8% increase compared to the same period of 2013 and a 31.0% increase compared to the third quarter of 2014.

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

	2014	2013	2012
Ruble inflation (CPI), %	11.4	6.5	6.6
Average exchange rate for the period (ruble to US dollar)	38.42	31.85	31.09
Exchange rate at the end of the period (ruble to US dollar)	56.26	32.73	30.37

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 2014, 2013 and 2012, the tax charge on the operations in Russia was approximately 88% of our total tax charge.

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

The effective rates of total taxes and tariffs (total taxes, including income taxes, taxes other than on income and excise and export tariffs, divided by income before taxes and tariffs) for 2014, 2013 and 2012, respectively, were 89%, 84% and 78%. In 2014, tax expenses in Russia were about 54% 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.

		2014	Change to 2013, %	2013	Change to 2012, %	2012
Export tariffs on crude oil	$/tonne	366.53	(6.5)	392.14	(3.0)	404.15
Export tariffs on refined products						
Middle distillates (jet fuel), liquid fuels (fuel oil) and gasoils	$/tonne	241.88	(6.5)	258.78	(3.0)	266.70
Light distillates	$/tonne	329.83	(6.5)	352.91	(3.0)	363.72
Diesel fuel	$/tonne	238.52	(7.8)	258.78	(3.0)	266.70
Mineral extraction tax						
Crude oil	RUR/tonne	5,827.45	9.3	5,329.58	5.2	5,065.95
Crude oil	$/tonne(1)	151.67	(9.4)	167.34	2.7	162.93

(1) Translated to US dollars using average ruble-dollar exchange rates.

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

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

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

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

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

Natural gas extraction tax rate. The mineral extraction tax on natural gas produced by independent producers in Russia was calculated using a flat rate until July 1, 2014. The rate was 471 rubles per thousand cubic meters during the first half of 2014, 265 rubles per thousand cubic meters in the first half of 2013 and 402 rubles – in the second half of 2013.

Starting from July 1, 2014, the base rate amounts to 35 rubles per thousand cubic meters and is adjusted depending on average wholesale natural gas price in Russia, share of gas production in total hydrocarbon production of particular taxpayer, and complexity of particular gas field. In the second half of 2014, actual average natural gas extraction tax rate calculated for our major gas field – Nakhodkinskoe in Western Siberia amounted to 132.06 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. From October 1, 2011 to December 31, 2013, the maximum increase of export duty rate was $0.60 per barrel for each $1.00 per barrel increase in the Urals blend price. From January 1, 2014 to December 31, 2014, the maximum increase of export duty rate was $0.59 per barrel for each $1.00 per barrel increase in the Urals blend price.

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

A special export duty regime is in place for certain greenfields. The list of the oilfields where the reduced rate is applied includes our Yu. Korchagin and V. Filanovsky oilfields located in the Caspian Sea and extra-heavy crude oil fields in Timan-Pechora.

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

	From January 1, 2014 to December 31, 2014	**Prior to January 1, 2014**
Multiplier for:		
Light distillates (except for gasolines), middle distillates (jet fuel), gasoils, liquid fuels (fuel oil), motor and other oils, other products....	0.66	0.66
Diesel fuel...	0.65	0.66
Gasolines...	0.90	0.90

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

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

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

Excise rates on refined products in Russia are tied to the ecological class of fuel. Excise tax rates for 2014, 2013 and 2012 are listed below. The rates in US dollars were translated from rubles using average ruble-dollar exchange rates.

		2014	Change to 2013, %	2013	Change to 2012, %	2012
Gasoline						
Below Euro-3	RUR/tonne	11,110.00	10.0	10,100.00	26.6	7,976.37
Euro-3	RUR/tonne	10,725.00	10.0	9,750.00	27.7	7,633.37
Euro-4	RUR/tonne	9,916.00	13.2	8,761.64	28.4	6,822.00
Euro-5	RUR/tonne	6,450.00	18.4	5,448.99	(8.8)	5,977.91
Diesel fuel						
Below Euro-3	RUR/tonne	6,446.00	10.0	5,860.00	39.5	4,199.55
Euro-3	RUR/tonne	6,446.00	10.0	5,860.00	44.4	4,058.33
Euro-4	RUR/tonne	5,427.00	8.2	5,017.68	40.9	3,562.00
Euro-5	RUR/tonne	4,767.00	7.9	4,417.68	35.5	3,260.36
Motor oils	RUR/tonne	8,260.00	10.0	7,509.00	23.7	6,072.00
Straight-run gasoline	RUR/tonne	11,252.00	10.0	10,229.00	30.7	7,824.00

		2014	Change to 2013, %	2013	Change to 2012, %	2012
Gasoline						
Below Euro-3	$/tonne	289.16	(8.8)	317.13	23.6	256.53
Euro-3	$/tonne	279.14	(8.8)	306.14	24.7	245.50
Euro-4	$/tonne	258.08	(6.2)	275.11	25.4	219.41
Euro-5	$/tonne	167.87	(1.9)	171.09	(11.0)	192.26
Diesel fuel						
Below Euro-3	$/tonne	167.77	(8.8)	184.00	36.2	135.06
Euro-3	$/tonne	167.77	(8.8)	184.00	41.0	130.52
Euro-4	$/tonne	141.25	(10.3)	157.55	37.5	114.56
Euro-5	$/tonne	124.07	(10.6)	138.71	32.3	104.86
Motor oils	$/tonne	214.98	(8.8)	235.78	20.7	195.29
Straight-run gasoline	$/tonne	292.85	(8.8)	321.18	27.6	251.63

Changes in tax and customs legislation in 2015

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

During the period from January 1, 2015 to December 31, 2015, the base mineral extraction tax rate increases to 766 rubles per tonne from 493 rubles per tonne in 2014. At the same time, during the period from January 1, 2015 to December 31, 2015, the limit for the increase of crude oil export duty rate per each $1.00 per barrel of international crude oil price increase decreases from $0.59 to $0.42 per barrel. Export duty rates on refined products are to be calculated by multiplying the current crude oil export duty rate by a coefficient according to the table below.

	From January 1, 2015 to December 31, 2015
Multiplier for:	
Light and middle distillates, diesel fuel	0.48
Gasolines	0.78
Straight-run gasoline	0.85
Fuel oil	0.76

Excise tax rates are amended as follows:

		From January 1, 2015
Gasoline		
Below Euro-3	RUR/tonne	7,300.00
Euro-3	RUR/tonne	7,300.00
Euro-4	RUR/tonne	7,300.00
Euro-5	RUR/tonne	5,530.00
Diesel fuel		
Below Euro-3	RUR/tonne	3,450.00
Euro-3	RUR/tonne	3,450.00
Euro-4	RUR/tonne	3,450.00
Euro-5	RUR/tonne	3,450.00
Motor oils	RUR/tonne	6,500.00
Straight-run gasoline	RUR/tonne	11,300.00

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

The Company and its Russian subsidiaries file income tax returns in Russia. With a few exceptions, income tax returns in Russia are open to examination by the Russian tax authorities for tax years beginning in 2012. A number of Group companies in Russia are paying income tax as a consolidated taxpayers' group ("CTG"). This allows taxpayers to offset taxable losses generated by certain participants of a CTG against taxable profits of other participants of the CTG.

Transportation of crude oil and refined products in Russia

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

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

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

In Russia, gas is mostly sold at the wellhead and then transported through the Unified Gas Supply System ("UGSS"). The UGSS is responsible for gathering, transporting, dispatching and delivering substantially all natural gas supplies in Russia and is owned and operated by OAO Gazprom. 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, 2014, compared to years ended December 31, 2013 and December 31, 2012

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

	2014	2013	2012
	(millions of US dollars)		
Revenues			
Sales (including excise and export tariffs)	144,167	141,452	139,171
Costs and other deductions			
Operating expenses	(10,115)	(10,086)	(9,359)
Cost of purchased crude oil, gas and products	(71,245)	(65,924)	(64,148)
Transportation expenses	(5,894)	(6,290)	(6,171)
Selling, general and administrative expenses	(3,858)	(3,849)	(3,755)
Depreciation, depletion and amortization	(8,816)	(5,756)	(4,832)
Taxes other than income taxes	(12,892)	(13,803)	(13,666)
Excise and export tariffs	(21,364)	(22,334)	(22,836)
Exploration expense	(1,104)	(602)	(364)
(Loss) gain on disposals and impairments of assets	(1,753)	(2,561)	30
Income from operating activities	**7,126**	**10,247**	**14,070**
Interest expense	(637)	(488)	(538)
Interest and dividend income	275	239	257
Equity share in income of affiliates	552	575	518
Currency translation loss	(355)	(443)	(512)
Other non-operating (expense) income	(189)	328	(72)
Income before income taxes	**6,772**	**10,458**	**13,723**
Current income taxes	(2,876)	(2,051)	(2,738)
Deferred income taxes	818	(780)	(60)
Total income tax expense	**(2,058)**	**(2,831)**	**(2,798)**
Net income	**4,714**	**7,627**	**10,925**
Net loss attributable to non-controlling interests	32	205	79
Net income attributable to OAO LUKOIL	**4,746**	**7,832**	**11,004**
Earning per share of common stock attributable to OAO LUKOIL (in US dollars):			
Basic	6.29	10.38	14.47
Diluted	6.20	10.18	14.17

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

Sales revenues

Sales breakdown	2014	2013	2012
	(millions of US dollars)		
Crude oil			
Export and sales on international markets other than Customs Union countries	32,109	22,350	24,414
Export and sales to Customs Union countries	1,552	1,920	1,622
Domestic sales	3,418	3,071	1,634
	37,079	**27,341**	**27,670**
Refined products			
Export and sales on international markets			
Wholesale	72,540	76,966	75,880
Retail	10,367	10,830	10,724
Domestic sales			
Wholesale	7,233	8,053	8,113
Retail	9,049	9,423	8,690
	99,189	**105,272**	**103,407**
Petrochemicals			
Export and sales on international markets	838	936	992
Domestic sales	272	886	418
	1,110	**1,822**	**1,410**
Gas and gas products			
Export and sales on international markets	2,165	2,295	2,385
Domestic sales	1,131	1,153	1,092
	3,296	**3,448**	**3,477**
Sales of energy and related services			
Sales on international markets	198	69	57
Domestic sales	1,434	1,506	1,337
	1,632	**1,575**	**1,394**
Other			
Sales on international markets	1,007	1,178	962
Domestic sales	854	816	851
	1,861	**1,994**	**1,813**
Total sales	**144,167**	**141,452**	**139,171**

Sales volumes	2014	2013	2012
Crude oil	(thousands of barrels)		
Export and sales on international markets other than Customs Union countries	345,485	207,021	222,466
Export and sales to Customs Union countries	33,535	37,881	31,622
Domestic sales	81,260	62,224	33,264
	460,280	**307,126**	**287,352**
Crude oil	(thousands of tonnes)		
Export and sales on international markets other than Customs Union countries	47,133	28,243	30,350
Export and sales to Customs Union countries	4,575	5,168	4,314
Domestic sales	11,086	8,489	4,538
	62,794	**41,900**	**39,202**
Refined products	(thousands of tonnes)		
Export and sales on international markets			
Wholesale	90,507	90,097	85,917
Retail	6,353	6,580	6,568
Domestic sales			
Wholesale	11,596	11,432	11,641
Retail	9,773	9,161	8,856
	118,229	**117,270**	**112,982**
Total sales volume of crude oil and refined products	**181,023**	**159,170**	**152,184**

Realized average sales prices		2014	2013	2012
Average realized price international				
Oil (excluding Customs Union countries)	($/barrel)	92.94	107.96	109.74
Oil (Customs Union countries)	($/barrel)	46.27	50.70	51.31
Refined products				
Wholesale	($/tonne)	801.48	854.26	883.18
Retail	($/tonne)	1,631.85	1,645.94	1,632.81
Average realized price within Russia				
Oil	($/barrel)	42.06	49.35	49.12
Refined products				
Wholesale	($/tonne)	623.77	704.48	696.91
Retail	($/tonne)	925.90	1,028.58	981.21

In 2014, our revenues increased by $2,715 million, or by 1.9%, compared to 2013 (in 2013, our revenues increased by $2,281 million, or by 1.6%, compared to 2012). Our revenues from crude oil sales increased by $9,738 million, or by 35.6% (in 2013, revenues from crude oil sales decreased by $329 million, or by 1.2%). Our revenues from sales of refined products decreased by $6,083 million, or by 5.8% (in 2013, revenues from sales of refined products increased by $1,865 million, or by 1.8%).

The changes in ruble-nominated revenues against 2013 were significantly affected by the nominal ruble devaluation by 17.1%.

Sales of crude oil

2014 vs. 2013

Despite the decrease of the international realized crude oil prices by 13.9%, our international sales revenue (beyond the Customs Union) increased by 43.7%, or by $9,759 million, compared to 2013. Our international sales volumes increased by 18,890 thousand tonnes, or by 66.9%, compared to 2013, as a result of increased volumes of crude oil trading and commencement of commercial production from the West Qurna-2 field.

In 2014, as a result of the ruble devaluation and the drop of international crude oil prices, our realized domestic crude oil price decreased by 14.8%, compared to 2013. At the same time, our domestic sales volumes increased by 2,597 thousand tonnes, or by 30.6%, which was largely demand driven and partly resulting from the increase in the volumes of crude oil production in Russia. As a consequence, in 2014, our domestic sales revenue increased by 11.3%, or by $347 million.

In 2014, our revenue from crude oil export from Russia both to the Group companies and third parties amounted to $19,195 million.

2013 vs. 2012

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

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

Sales of refined products

2014 vs. 2013

Compared to 2013, our revenue from the wholesale of refined products outside of Russia decreased by $4,426 million, or by 5.8%. The decrease in sales prices by 6.2% in 2014 was partially compensated by the increase in sales volumes by 0.5% compared to 2013.

In 2014, our realized retail prices outside of Russia decreased by 0.9% and volumes decreased by 3.4%, that resulted in the decrease of retail revenue by $463 million, or by 4.3%, compared to 2013.

In 2014, our revenue from the wholesale of refined products on the domestic market decreased by 10.2%, or by $820 million. A decrease in realized prices by 11.5% due to the ruble devaluation was partially compensated by an increase in sales volumes by 1.4%.

In 2014, our revenue from retail sales in Russia decreased by $374 million, or by 4.0%. As a result of ruble devaluation, our average domestic retail prices decreased by 10.0%, that was partially offset by the increase of retail sales volumes by 6.7%.

In 2014, our revenue from export of refined products from Russia both to Group companies and third parties amounted to $15,711 million.

2013 vs. 2012

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

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

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

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

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

Sales of petrochemical products

2014 vs. 2013

In 2014, our revenue from sales of petrochemical products decreased by $712 million, or by 39.1%. This was largely due to a significant decrease of domestic sales volumes, compared to 2013, as a result of cease of production at our plant in Stavropol region of Russia as a consequence of a fire at the plant in the end of February 2014.

2013 vs. 2012

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

Sales of gas and gas products

2014 vs. 2013

Sales of gas and gas refined products decreased by $152 million, or by 4.4%, compared to 2013.

In 2014, gas products wholesales revenue increased by $25 million, or by 2.1%. Average realized wholesale prices decreased by 5.9% and sales volumes for gas products increased by 8.6%. Retail gas products revenue decreased by $20 million, or by 3.2%, compared to 2013.

Natural gas sales revenue decreased by $157 million, or by 9.6%. The decrease was mainly due to lower production in Uzbekistan and the decrease in realized prices.

2013 vs. 2012

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

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

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

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

Sales of energy and related services

2014 vs. 2013

In 2014, our revenue from sales of electricity, heat and related services increased by $57 million, or by 3.6%, due to the acquisition of power generating company ISAB Energy in Italy in July 2014. In Russia, the effect of increased sales volumes was offset by the effect of ruble devaluation.

2013 vs. 2012

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

Sales of other products

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

2014 vs. 2013

In 2014, revenue from other sales decreased by $133 million, or by 6.7%. After the Group obtained full control over ISAB in December 2013, the refinery no longer provided processing services to third parties, which was the main reason for the decrease in other sales revenue compared to 2013. At the same time, since the second quarter of 2014, we increased revenue from rendering crude oil extraction services and since the third quarter of 2014, other sales also included revenue from sales of diamonds.

2013 vs. 2012

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

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

Operating expenses

Operating expenses include the following:

	2014	**2013**	**2012**
		(millions of US dollars)	
Hydrocarbon extraction expenses	4,718	4,335	3,861
Own refining expenses	2,059	2,170	1,669
Refining expenses at third parties and affiliated refineries	266	286	798
Cost of processing operations at ISAB	–	185	64
Expenses for crude oil transportation to refineries	1,036	1,265	1,241
Power generation and distribution expenses	838	717	619
Petrochemical expenses	182	320	303
Other operating expenses	1,016	808	804
Total operating expenses	**10,115**	**10,086**	**9,359**

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**.**

The changes in ruble-nominated operating expenses against 2013 were significantly affected by the nominal ruble devaluation by 17.1%.

In 2014, our operating expenses remained nearly on the level of the previous year (the increase by 0.3% compared to 2013).

In 2013, our operating expenses increased by $727 million, or by 7.8%, compared to 2012.

Hydrocarbon extraction expenses

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

2014 vs. 2013

In 2014, our extraction expenses increased by $383 million, or by 8.8%. In 2014, our extraction expenses included start-up costs and production expenses related to West Qurna-2 project in the amount of $640 million. In Russia, the increase in costs was compensated by the ruble devaluation.

Our average hydrocarbon extraction expenses increased from $5.58 per BOE in 2013 to $5.74 per BOE in 2014, or by 2.9%. This increase was largely due to write-off of certain start-up costs related to commencement of commercial production at West Qurna-2 oilfield in 2014.

2013 vs. 2012

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

Own refining expense

2014 vs. 2013

In 2014, our own refining expenses decreased by $111 million, or by 5.1%.

Refining expenses at our domestic refineries decreased by 6.7%, or by $78 million. The increase of expenses as a result of higher consumption of additives due to increased share of high-octane gasoline production and increased energy and overhaul costs was outweighed by the ruble devaluation.

Refining expenses at our international refineries decreased by 3.3%, or by $33 million. The decrease of expenses was largely against the background of high level of expenses of our Romanian refinery in 2013 due to overhauls which was partially outweighed by costs of our lubricants plant in Austria that we acquired at the beginning of 2014. Depreciation of euro to US dollar was also a factor of costs decrease.

2013 vs. 2012

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

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

Refining expenses at our international refineries increased by 92.0%, or by $486 million. The increase was mainly due to obtaining control over ISAB in September 2012.

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.

2014 vs. 2013

In 2014, refining expenses at third party and affiliated refineries decreased by 7.0%, or by $20 million, due to the decrease in production at the Zeeland refinery that resulted from overhaul in the second quarter of 2014.

2013 vs. 2012

In 2013, refining expenses at third party and affiliated refineries decreased by 64.2%, or by $512 million, as a result of obtaining control over ISAB in September 2012 and ceasing of crude oil processing at third party refineries in Belarus since September 2013.

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.

2014 vs. 2013

In 2014, our expenses for crude oil transportation to refineries decreased by $229 million, or by 18.1%, largely due to the decrease in volumes of supply of own crude oil from Russia to our refineries in Bulgaria and Romania.

2013 vs. 2012

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

Petrochemical expenses

2014 vs. 2013

In 2014, operating expenses of our petrochemical plants decreased by $138 million, or by 43.1%, compared to 2013. This was largely due to the cease of production at our plant in Stavropol region of Russia as a consequence of a fire at the plant in the end of February 2014, and ruble devaluation.

2013 vs. 2012

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

Power generation and distribution expenses

2014 vs. 2013

Our power generation and distribution expenses increased by $121 million, or by 16.9%, compared to 2013. The main reason for this increase was the acquisition of power generating company ISAB Energy in Italy in July 2014.

2013 vs. 2012

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

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.

2014 vs. 2013

In 2014, other operating expenses increased by $208 million, or by 25.7%, driven largely by changes in estimates of existing asset retirement obligations. Moreover, other operating expenses in 2014 included expenses of production of diamonds that commenced in the third quarter of 2014.

2013 vs. 2012

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

Cost of purchased crude oil, gas and products

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

2014 vs. 2013

In 2014, cost of purchased crude oil, gas and products increased by $5,321 million, or by 8.1%, largely as a result of the increase in crude oil trading volumes that was partially offset by the decrease in international crude oil prices.

In 2014, we recognized a $1,892 million net gain from hedging, compared to a $200 million net loss in 2013.

2013 vs. 2012

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

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

Transportation expenses

2014 vs. 2013

In 2014, transportation expenses decreased by $396 million, or by 6.3%, compared to 2013. The decrease of expenses as a result of the decrease in tariffs largely due to the ruble devaluation was partly offset by effect from increased volumes of crude oil trading, compared to 2013.

Our actual transportation tariffs related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed to 2013 as follows: crude oil pipeline tariffs decreased by 11.8%, railway tariffs for refined products transportation decreased by 15.6%, crude oil freight rates decreased by 38.9%, and refined products freight rates decreased by 13.5%.

2013 vs. 2012

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

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

Depreciation, depletion and amortization

2014 vs. 2013

In 2014, our depreciation, depletion and amortization expenses increased by $3,060 million, or by 53.2%, compared to 2013, which included $2,980 million related to the West Qurna-2 field, where we commenced commercial production in the second quarter of 2014.

2013 vs. 2012

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

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

2014 vs. 2013

Our share in income of affiliates decreased by $23 million, or by 4.0%, compared to 2013.

2013 vs. 2012

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

Taxes other than income taxes

	2014	2013	2012
		(millions of US dollars)	
In Russia			
Mineral extraction taxes	11,596	12,333	12,261
Social security taxes and contributions	465	517	493
Property tax	463	539	511
Other taxes	81	107	82
Total in Russia	**12,605**	**13,496**	**13,347**
International			
Mineral extraction taxes	51	77	93
Social security taxes and contributions	121	123	111
Property tax	39	32	24
Other taxes	76	75	91
Total internationally	**287**	**307**	**319**
Total	**12,892**	**13,803**	**13,666**

2014 vs. 2013

Our taxes other than income taxes decreased by $911 million, or by 6.6%, compared to 2013, which was driven largely by the decrease in the mineral extraction tax rate. The decrease in social security taxes and contributions and property tax in Russia against 2013 was mainly due to the ruble devaluation.

In 2014, application of the reduced rate for crude oil produced from depleted oilfields and the zero rate for crude oil produced from oilfields with extra heavy crude oil and from greenfields led to $2,164 million mineral extraction tax reduction ($1,921 million in 2013).

2013 vs. 2012

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

In 2013, application of the reduced rate for crude oil produced from depleted oilfields and the zero rate for crude oil produced from oilfields with extra heavy crude oil and from greenfields led to $1,921 million mineral extraction tax reduction ($1,490 million in 2012).

Excise and export tariffs

	2014	2013	2012
		(millions of US dollars)	
In Russia			
Excise tax on refined products	1,870	1,950	1,922
Crude oil export tariffs	9,362	10,030	11,315
Refined products export tariffs	5,961	6,263	5,561
Total in Russia	**17,193**	**18,243**	**18,798**
International			
Excise tax on refined products	3,792	3,598	3,355
Crude oil export tariffs	173	251	274
Refined products export tariffs	206	242	409
Total internationally	**4,171**	**4,091**	**4,038**
Total	**21,364**	**22,334**	**22,836**

2014 vs. 2013

In 2014, export tariffs decreased by $1,084 million, or by 6.5%. Compared to 2013, the volumes of crude oil export beyond the Customs Union decreased by 3.8% and crude oil export duty rate decreased by 6.5%, that was partially compensated by the movements of export tariffs in stock.

Outside Russia, the increase of excises was due to the increase of volumes of sales subject to excises mainly as a result of the acquisition of retail network in the Netherlands in the end of 2013.

2013 vs. 2012

Following the decrease of export duty rate and export volumes in 2013, our crude oil export tariffs decreased by $773 million, or by 4.4%. At the same time, compared to 2012, our refined products export tariffs increased as a result of the increase of volumes of refined products exported outside of the Customs Union.

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

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

Exploration expenses

2014 vs. 2013

In 2014, our exploration expenses increased by $502 million, or by 83.4%, that was a result of the increase in the amount of dry hole write-offs, compared to 2013. In 2014, as a result of adverse changes in economic environment, dry hole write-offs totaled $794 million and related to projects in Cote d'Ivoire in the amount of $240 million, in Ghana in the amount of $151 million, in other regions outside of Russia in the total amount of $264 million and in Russia in the amount of $139 million. In 2013, dry hole costs amounted to $314 million.

2013 vs. 2012

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

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

(Loss) gain on disposals and impairments of assets

2014 vs. 2013

In 2014, the Company recognized an impairment loss in the total amount of $1,673 million.

The Company recognized an impairment loss for its exploration and production assets in the amount of $916 million, including $761 million related to Tsentralno-Astrakhanskoe gas-condensate field in the Volga region of the Russian Federation and $139 million related to two oilfields in the Timan-Pechora region of the Russian Federation, due to the adverse changes in the economic environment.

An impairment loss in the amount of $218 million was recognized in the refining, marketing and distribution segment due to unfavorable market conditions.

In April 2014, the Group entered into an agreement to sell its 50% share in Caspian Investment Resources Ltd. The loss on expected disposal of this share was estimated at $358 million. For more details on this agreement, refer to page 3.

Moreover, the Group wrote off signing bonuses related to projects in Ghana in the amount of $45 million, in Sierra Leone in the amount of $50 million and in Cote d'Ivoire in the amount of $86 million.

In 2014, the cumulative impact of the above mentioned impairment losses (including the above mentioned dry hole write-offs) on the net income attributable to OAO LUKOIL totaled $2.3 billion and impact on our EBITDA totaled $2.4 billion.

2013 vs. 2012

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

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

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

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

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

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

In 2013, the cumulative impact of the above mentioned impairment losses (including the above mentioned dry hole write-offs) on net income attributable to OAO LUKOIL totaled $2.4 billion and impact on our EBITDA totaled $2.6 billion.

Interest expense

2014 vs. 2013

In 2014, our interest expense increased by $149 million, or by 30.5%, compared to 2013 as a result the increase in the long term debt.

2013 vs. 2012

Compared to 2012, we decreased our interest expense by $50 million, or by 9.3%.

Other non-operating (expense) income

2014 vs. 2013

In 2014, other non-operating expense represented amounts of individually insignificant gains and losses.

2013 vs. 2012

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

Income taxes

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

In 2014, our total income tax expense decreased by $773 million, or by 27.3%, compared to 2013. Our income before income tax decreased by $3,686 million, or by 35.2%.

In 2014, our effective income tax rate was 30.4% compared to 27.1% in 2013. The high level of our effective income tax rate in the periods considered was a result of non-deductible losses and write-offs as well as taxable currency translation gains reported by Russian subsidiaries.

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

	2014	2013	2012
		(millions of US dollars)	
Net income	**4,746**	**7,832**	**11,004**
Add back:			
Income tax expense	2,058	2,831	2,798
Depreciation and amortization	8,816	5,756	4,832
Interest expense	637	488	538
Interest and dividend income	(275)	(239)	(257)
EBITDA	**15,982**	**16,668**	**18,915**
Add back the loss on impairment of assets and dry hole related write-offs	2,444	2,587	–
Adjusted EBITDA	**18,426**	**19,255**	**18,915**

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

	2014	2013	2012
	(millions of US dollars)		
Net cash provided by operating activities	15,568	16,449	18,997
Net cash used in investing activities	(14,643)	(18,639)	(13,216)
Net cash provided by (used in) financing activities	1,060	1,029	(5,680)

Operating activities

Our primary source of cash flow is funds generated from our operations. In 2014, cash generated from operations decreased by 5.4%, compared to 2013, and amounted to $15,568 million.

Investing activities

In 2014, the amount of cash used in investing activities decreased by 21.4% largely against the background of significant acquisitions of licenses and subsidiaries in 2013.

Our capital expenditures, including non-cash transactions, remained on the level of the previous year and amounted to $15,391 million.

	2014	2013	2012
	(millions of US dollars)		
Capital expenditures, including non-cash transactions and prepayments			
Exploration and production			
Russia	8,151	8,325	7,085
International	3,731	3,483	1,888
Total exploration and production	11,882	11,808	8,973
Refining, marketing and distribution			
Russia	1,990	1,736	1,439
International	801	979	568
Total refining, marketing and distribution	2,791	2,715	2,007
Chemicals			
Russia	251	105	62
International	2	8	28
Total chemicals	253	113	90
Power generation and distribution	340	285	503
Other	125	513	277
Total capital expenditures	**15,391**	**15,434**	**11,850**

Capital expenditures in the exploration and production segment were flat to 2013. In Russia, despite the increase in volumes and cost of production drilling, capital expenditures decreased due to the effect of ruble devaluation. Internationally, we increased expenditures in Shakh-Deniz project in Azerbaijan and commenced exploration activities at our new projects in Ghana and Romania.

The increase of capital expenditures in domestic refining, marketing and distribution segment was due to continuing construction of a vacuum gasoil refinery complex at the Volgograd refinery and construction of a heavy residue processing complex and a power generation facility at our refinery in Perm.

Other capital expenditures mostly refer to investments of OAO Arkhangelskgeoldobycha, a Group company, involved in diamond deposits development in the Arkhangelsk region of Russia. The decrease of the respective capital expenditures was due to fulfillment of the most stages of the capital investment program at the deposits.

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

	2014	2013	2012
	(millions of US dollars)		
Yamal	520	338	476
Caspian region[1]	1,188	1,635	1,425
Ghana	314	20	13
Cote d'Ivoire	167	180	44
Iraq	1,439	2,040	924
Uzbekistan	838	657	477
Romania	189	7	–
Total	**4,655**	**4,877**	**3,359**

[1] Russian and international projects.

In 2014, we did not make significant investments in the acquisition of licenses, whereas in 2013, a Group company paid $835 million as a second 50% installment for the acquisition of the subsoil rights for the site that includes the Imilorskoye, West Imilorskoye and Istochnoye fields in Western Siberia. The first 50% payment was made in December 2012.

	2014	2013	2012
	(millions of US dollars)		
Acquisitions of subsidiaries and associates, including prepayments related to acquisitions and non-cash transactions			
Exploration and production			
Russia	97	2,397	200
International	73	–	22
Total exploration and production	170	2,397	222
Refining, marketing and distribution			
Russia	(225)	333	25
International	40	46	658
Total refining, marketing and distribution	(185)	379	683
Power generation and distribution	–	30	–
Less cash acquired	(34)	(21)	(19)
Total acquisitions	**(49)**	**2,785**	**886**

In 2014, the Group invested $90 million in a joint venture with OAO NK Bashneft, $74 million in a jet fuel operator in Russia and spent $35 million on the acquisition of ISAB Energy, power generating company in Italy. In 2013, the Company spent $2.1 billion for the acquisition of 100% of the shares of ZAO Samara-Nafta and $266 million for the acquisition of the remaining 50% of the shares of ZAO Kama-oil.

Moreover, in 2014, we received back an advance payment in amount of $367 million, related to planned acquisition in refining, marketing and distribution segment in Russia.

Financing activities

In 2014, net movements of short-term and long-term debt generated an inflow of $2,524 million, compared to an inflow of $4,125 million in 2013 and an outflow of $1,266 million in 2012.

In the fourth quarter of 2014, the Company received a loan from OAO Sberbank denominated in Russian rubles with an outstanding amount of 63 billion rubles ($1,120 million) as of December 31, 2014, maturing in 2017. Borrowings under this agreement bear interest at 12.66% per annum as of December 31, 2014.

In 2014, the Company received a loan from OAO Sberbank in the amount of $500 million, maturing in 2021. Borrowings under this agreement bear interest at twelve month LIBOR plus 2.75% per annum.

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

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

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

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

Credit rating

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

Moody's set the Company's long-term corporate family rating and long-term issuer rating of Ba1.

Fitch Ratings set the Company's long-term issuer default rating to BBB-.

Contractual obligations, other contingencies and off balance sheet arrangements

Capital commitments and contractual obligations

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

In February 2013, the Group started to construct a vacuum gasoil refinery complex at OOO LUKOIL-Volgogradneftepererabotka. Completion is expected at the end of 2015. As of December 31, 2014, the amount of capital commitment related to this construction is evaluated as $437 million.

In 2012, a construction agreement for a heavy-residue hydrocracking complex at LUKOIL Neftochim Bourgas AD in Bulgaria was signed. Commissioning of the complex is expected in 2015. As of December 31, 2014, the amount of capital commitment related to this construction is evaluated as $52 million.

Group companies have commitments for capital expenditure contributions in the amount of $253 million related to various production sharing agreements over the next 23 years.

The Company has signed a three-year agreement for the years 2013-2015 for drilling services with EDC Group Advisory Company Limited. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. As of December 31, 2014, the amount of capital commitment under this agreement for 2015 is evaluated as $861 million.

The Company has signed a strategic agreement for the ongoing provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. As of December 31, 2014, the amount of capital commitment under this agreement for 2015 is evaluated as $44 million.

The Group has signed a number of agreements for construction of offshore platforms in the Caspian region. As of December 31, 2014, the amount of this capital commitment is evaluated as $564 million.

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

(millions of US dollars)	Total	2015	2016	2017	2018	2019	After
On balance sheet							
Short term debt	**407**	407	–	–	–	–	–
Long-term bank loans and borrowings	**5,897**	242	249	2,303	1,640	702	761
Long-term non-bank loans and borrowings	**1**	–	–	–	–	–	1
2.625% Convertible US dollar bonds, maturing 2015	**1,488**	1,488	–	–	–	–	–
6.356% Non-convertible US dollar bonds, maturing 2017	**500**	–	–	500	–	–	–
3.416% Non-convertible US dollar bonds, maturing 2018	**1,500**	–	–	–	1,500	–	–
7.250% Non-convertible US dollar bonds, maturing 2019	**597**	–	–	–	–	597	–
6.125% Non-convertible US dollar bonds, maturing 2020	**998**	–	–	–	–	–	998
6.656% Non-convertible US dollar bonds, maturing 2022	**500**	–	–	–	–	–	500
4.563% Non-convertible US dollar bonds, maturing 2023	**1,500**	–	–	–	–	–	1,500
Capital lease obligation	**141**	31	18	17	18	20	37
TOTAL	**13,529**	**2,168**	**267**	**2,820**	**3,158**	**1,319**	**3,797**
Off balance sheet							
Operating lease obligations	**374**	146	61	46	38	33	50
Capital commitments in PSAs	**253**	102	20	20	6	6	99
Capital commitments of Volgograd Refinery	**437**	331	106	–	–	–	–
Obligation under contracts for the development of the V. Filanovsky oilfield	**564**	130	434 (1)	–	–	–	–
Capital commitments under contract with EDC Group Advisory Company Limited	**861**	861	–	–	–	–	–
Capital commitments of LUKOIL Neftochim Bourgas AD	**52**	52	–	–	–	–	–
Obligation under contract with ZAO Globalstroy-Engineering	**44**	44	–	–	–	–	–

(1) Amount for 2016 and 2017.

Litigation and claims

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

On January 6, 2012, ADC filed a lawsuit in the US District Court for the District of Colorado (federal court) reasserting almost identical claims asserted in the aforementioned lawsuit and dismissed by the Denver District Court (state court). In the Federal Court case, the Company has filed a Motion to Dismiss. On December 18, 2014, the federal court granted the motion based on lack of personal jurisdiction over the Company and the doctrine of forum non conveniens. ADC filed a notice of appeal and the case is now pending in the US Court of Appeals for the Tenth Circuit. 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.

In 2011, the Prahova Police Inspectorate (Fraud Investigation Unit), Romania, initiated an investigation of several Romanian third parties (individuals and companies) in connection with alleged tax evasion and money laundering. The investigation was later extended to PETROTEL-LUKOIL S.A., a Group company. In June 2014, the prosecutors with the Ploesti Court of Appeals (hereinafter – the "Prosecutor's office") issued an order on initiation of criminal proceedings against PETROTEL-LUKOIL S.A. refinery and its general director based on alleged tax evasion and money laundering. In September 2014, criminal proceedings were initiated against two other Group companies, LUKOIL LUBRICANTS EAST EUROPE S.R.L. and LUKOIL ENERGY & GAS ROMANIA S.R.L., for aiding and abetting tax evasion and money laundering. At the same time the Prosecutor's office has brought charges against PETROTEL-LUKOIL S.A. and its general director for tax evasion and money laundering. The amount of the claim is approximately €230 million. The following precautionary measures were adopted against the refinery: arrest of strategic inventory, fixed assets and money on accounts. The general director is subject to the undertaking not to leave the place. At the moment preliminary investigation of the criminal case is being conducted. According to preliminary estimate this investigation will take at least six months. At the same time, management of PETROTEL-LUKOIL S.A. and its tax and legal consultants are actively defending the lawful rights and interests of the refinery, providing all required reports, clarifications and comments, and preparing an exhaustive set of evidence for challenging the claims of the Prosecutor's office. 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.

Political situation

During 2014, there was an increase of political and economic instability in Ukraine. Though the Group's assets and operations in Ukraine are not material, the Group monitors the situation and assesses the risks associated with its operations in Ukraine. As of December 31, 2014, the Group recognized an impairment loss related to assets held for sale amounting to $85 million and relating to goodwill amounting to $19 million. Management believes that there are no other potential losses that can be identified and reasonably estimated with respect to situation in Ukraine at present.

Critical accounting policies

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

Forward-looking statements

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

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

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

These factors include:

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

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