

LUKOIL FINANCIAL POLICY AND SECURITIES

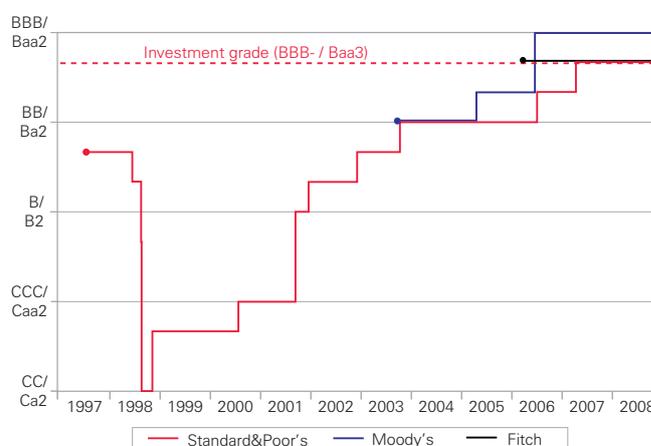
Financial policy

The main strategic mission of LUKOIL Group is to increase shareholder value. The Company therefore pursues a finance and credit policy aimed at minimizing the cost of capital deployed at reasonable risk levels. LUKOIL's finance and credit policy is tough and well-balanced, with strict controls over the volume and structure of Company debt. The policy includes a linkage between the scale of Company debt and the scale of its business.

In its financial policy LUKOIL strives to maintain the following ratios:

- Debt to capital – less than 30%
- Secured debt to total debt – less than 20%
- Debt under guarantee of the holding company to total debt – more than 80%
- Short-term debt to total debt – from 20 to 35%
- Debt at fixed interest to total debt – from 25 to 35%
- Total borrowings to EBITDA – less than 300%
- Net debt to equity – less than 55%
- Interest expense to EBITDA – less than 25%

Dynamics of LUKOIL credit rating



History of corporate borrowings

LUKOIL makes borrowings on Russian and international capital markets in order to achieve objectives of its financial and credit policy and, most importantly, to reduce the cost of capital in use. The market views the Company as a highly dependable borrower and offers LUKOIL better debt financing terms than are available to other privately owned Russian companies.

Bonds

Date		Maturity, years	Face value, roubles	Quantity, th. units	Annual coupon	Type of placement	Current status
13.07.95	Registered non-documentary bonds convertible to common shares	1	5,000	460	–	Open subscription	Cancelled at conversion in 1996 (1 bond = = 170 shares)
17.05.99	Documentary bearer bonds	4	1,000	3,000	6%*	Open subscription	Redeemed in 2003
16.04.04	Documentary bearer bonds	5	1,000	6,000	7.25%	Open subscription	Placed
23.11.06	Documentary bearer bonds	5	1,000	8,000	7.1%	Open subscription	Placed
23.11.06	Documentary bearer bonds	7	1,000	6,000	7.4%	Open subscription	Placed

Eurobonds

Date		Maturity, years	Face value, \$	Quantity, th. units	Annual coupon	Current status
06.05.97	Convertible eurobonds	5	1,000	230	3.5%	Redeemed in 2002
03.11.97	Convertible eurobonds	6	1,000	350	1%	Redeemed in 2003
29.11.02	Convertible eurobonds	5	1,000	350	3.5%	Redeemed in 2007
31.05.07	Eurobonds	10	100,000	5	6.356%	Placed
31.05.07	Eurobonds	15	100,000	5	6.356%	Placed

* Rate was subject to change depending on the dollar exchange rate.

LUKOIL shares

Shares of LUKOIL are among the most liquid and attractive instruments on the Russian stock market today and are also traded intensively on foreign markets (the London Stock Exchange, several German exchanges and the US over-the-counter market). Company market capitalization has grown by 38% over the last 5 years. LUKOIL is thus achieving one of its main strategic goals – to increase shareholder value and ensure full access to markets for investment capital.

In 2008 trading in Company shares represented 14% of trading on the RTS, 13% of trading on the MICEX and over 17% of trading in shares of foreign issuers on the IOB section of the LSE.

Authorized and issued share capital currently consists of 850.6 mln shares. Depository Receipts have been issued on 68.0% of these shares. Over 50,000 individuals and legal entities worldwide are Company shareholders.

LUKOIL's dividend policy is characterized by strict observance of shareholder rights and maintenance of a balance of interests between shareholders and the Company. In accordance with the policy, LUKOIL pays out no less than 15% of consolidated net income under US GAAP as dividends each year, ensuring a high rate of return. The Company has increased its dividends per share year by year: the payment for 2008 was 50 roubles (\$1.50), which is 19% more than in 2007.

History of Company share capital

1993

The overall privatization plan is approved and a first issue of LUKOIL shares is registered, consisting of 8,184,213 common shares with par value of 1,000 roubles each.

The Russian Government takes 90.77% of share capital and remaining shares are distributed to employees or kept back for share swaps with subsidiaries.

1994

The first privatization sales of LUKOIL shares are held and organized trading of Company shares on the secondary market begins. As a result, the share of the Russian Government in share capital declines to 80.54%. A further 3,320,463 common shares and 379,527 preferred shares are issued, increasing share capital to 11,884,203 shares.

1995

The Company carries out 2 share splits, dividing one share with 1,000 roubles par value into 40 shares with par value of 25 roubles each. The first annual general meeting of shareholders decides on further issue of 189,364,351 common and 49,830,784 preferred shares, which are placed by closed subscription among shareholders of subsidiaries in exchange for shares of those subsidiaries in order to consolidate Company assets. As a result, Company share capital consists of 714,563,255 shares with par value of 25 roubles. The government stake in share capital decreases to 55% due to a number of auctions and cash sales, and due to the policy of consolidating subsidiaries. Atlantic Richfield Company (ARCO) becomes a major shareholder and a strategic partner of LUKOIL upon acquisition of a 6.3% stake in LUKOIL capital for \$250 mln through a purchase of convertible bonds and their further conversion into common shares.

1996

LUKOIL becomes one of the first Russian companies to place American Depository Receipts (ADRs) on the international market. LUKOIL ADRs start trading on German stock exchanges and the US over-the-counter market. About 20% of Company share capital is converted into ADRs.

As part of the privatization program, bonds issued in 1995 are converted into LUKOIL shares owned by the Federal Government, representing 11% of share capital. This operation

LUKOIL share price, \$



and further investment auctions and cash sales reduce the Government stake in LUKOIL share capital to 33%.

1997

Full consolidation of shares of main LUKOIL subsidiaries is completed through their exchange for shares of the Company. For this purpose a new issue of 19,800,000 common and 12,200,000 preferred shares is carried out. The shares are placed by subscription among shareholders of subsidiaries in exchange for shares of the subsidiaries. As a result, Company share capital increases by 4.5% to 746,563,255 shares. The Government stake in share capital declines to 27%.

1999

The Company issues 69,000,000 new common shares to be swapped for 11,500,000 preferred shares (at a rate of 1 preferred for 6 common). The swap increases share capital to 815,563,255 shares. The Government stake in share capital declines to 24%.

2000

In accordance with a Russian Government decision, a 9% stake in LUKOIL, owned by the Government, is sold via a commercial competition with investment conditions to the Cyprus company, Reforma Investment Ltd, for \$200.005 mln. A cash auction is also held, at which the Government sells 1% of the Company. As a result, the Government stake in LUKOIL declines to 14% by the end of the year.

2001

LUKOIL issues 35,000,000 new shares for conversion of Company eurobonds and for purchase of other assets. The new issue increases share capital by 4.3% to 850,563,255 shares. All of the Company's preferred shares are converted into common shares at a rate of 1 to 1 (in many cases at other companies, preferred shares were converted at rates of 1 to several, leading to dilution of share capital).

2002

LUKOIL becomes the first Russian Company to obtain a full secondary listing on the London Stock Exchange. Company common shares begin to trade on the LSE in ADR form. A 5.9% Russian Government stake in LUKOIL is placed on the London Stock Exchange for \$775 mln. The Russian Government stake in the Company declines to 7.59% after the sale.

2003

Official LSE data in March 2003 show that LUKOIL shares are the most liquid instruments in their group: LUKOIL shares represent 36.6% of LSE trading in shares of companies from Central and Eastern Europe.

2004

The Property Ministry of the Russian Federation completes privatization of LUKOIL by offering the remaining 7.59% Government stake for sale at auction. An affiliate of the US company ConocoPhillips wins the auction, buying the stake for \$1.988 bln (\$30.76 per share). LUKOIL thus becomes fully privately owned.

2005

LUKOIL changes the ratio between Depositary Receipts and common shares in its two most liquid Depositary Receipt programs: from 1 Depositary Receipt representing 4 common shares to 1 Depositary Receipt representing 1 common share. The main purpose of the change is to increase liquidity and thus make Depositary Receipts more attractive for all types of investors.

2006

ConocoPhillips increases its stake in LUKOIL share capital to 20%, as stipulated in the Shareholder Agreement. LUKOIL decides to buy back its own shares to maximum value of \$3 bln in 2006–2008 (including \$782 mln in 2006).

2007

LUKOIL places two equal tranches of Eurobonds with maturities of 10 and 15 years for a total of \$1 billion. Coupon rate on the 10-year tranche was 6.356%, and the rate on the 15-year tranche was 6.656%. The Company continued its share buy-back program in 2007, spending \$712 million in the course of the year.

2008

Authorized and issued share capital remained unchanged and consisted of 850.563 mln shares. Purchase of treasury stock amounted to \$219 mln. Besides, treasury stock was used as payment for 95.53% of UGK TGK-8.

TAX ENVIRONMENT

LUKOIL's business is subject to taxation inside and outside Russia. The scale of the Company's business inside Russia means that its situation as a taxpayer is mainly defined by taxes, payable in that country. In 2004–2008 taxes paid in Russia represented 85% of all tax payments by LUKOIL. The main taxes paid by the Group are listed below.

Corporate income tax

Date introduced: 1992

Object: income received by an organization, reduced by incurred costs, defined in accordance with Russian tax law

Tax payers: Russian and foreign organizations, which carry out business or have a source of income in the Russian Federation

Tax rate: 20–24%. Maximum income tax rate is lowered from 24% to 20% effective from January 1, 2009.

Impact on Company business: payment of income tax by the Company decreased by 8.1% in 2008 compared with 2007 and totalled \$3,222 mln. The effective income tax rate in 2008 was 25.9%, which is higher than the maximum statutory rate of 24%. This is attributable to the fact that some costs incurred in the current period were not tax deductible or only deductible to a certain limit

Corporate property tax

Date introduced: 1992

Object: real estate and other property of organizations, which is classed on the balance sheet as fixed assets

Tax payers: Russian and foreign organizations, carrying out business and/or having property in Russia

Tax rate: set by regional parliaments; the maximum rate is 2.2%

Impact on Company business: Company spending on property tax in 2008 was \$405 mln, which is \$92 mln more than in 2007

Unified social tax

Date introduced: 2001

Object: wages and other disbursements paid to individuals under employment and other civil law contracts (except those paid to individual entrepreneurs)

Tax payers: entities, which make the above payments and disbursements to individuals (employees)

Tax rate: regressive scale (maximum rate – 26%, on taxable

annual wages and disbursements per employee up to a level of 280,000 roubles, calculated cumulatively from the start of the year)

The unified social tax is paid to the federal budget, to the social insurance fund and to medical insurance fund

Impact on Company business: Company spending in 2008 on social taxes and charges was \$512 mln, which is 15.8% more than in 2007

Mineral extraction tax (oil)

Date introduced: 2002

The mineral extraction tax replaced three forms of payment for use of mineral resources, which existed previously – sub-soil resource tax, payments to finance replacement of mineral resources, and excise payments on oil and gas condensate.

Object: mineral resources, extracted on territory under Russian jurisdiction

Tax payers: organizations and individual entrepreneurs, who qualify as extractors of minerals under Russian law

Base tax rate (2005–2008): 419 roubles per ton (applicable tax rate is calculated each month using a coefficient which reflects changes in world prices for oil)

Average rate in 2008: 3,329.1 roubles per ton

Impact on Company business: the mineral extraction tax, together with export duties, is the most significant part of the tax burden on oil companies. In 2008 LUKOIL paid \$12.27 bln as mineral extraction tax (32% of total tax payment by the Company)

Mineral extraction tax (gas)

Date introduced: 2002

Object: gas produced on territory under Russian jurisdiction

Tax payers: organizations and individual entrepreneurs, who qualify as extractors of minerals under Russian law

Tax rate (2008): 147 roubles per th. cm for natural gas and 0 roubles per th. cm for associated petroleum gas

VAT

Date introduced: 1992

Object: sale and transfer of goods, services and property rights

Amendments to the mineral extraction tax were approved in 2008 and came into force from 2009. The amendments change the untaxed minimum oil price from \$9 to \$15 per barrel and make it no longer necessary to use direct accounting for oil production volumes in order to obtain tax remissions at fields with high-viscosity oil. The amendments also offer mineral extraction tax holidays to companies, which explore and produce hydrocarbons at offshore fields. (The tax holidays last 10 years for companies, which only produce hydrocarbons, and 15 years for companies involved in both exploration and production). The tax holiday ends when cumulative production reaches 35 mln tons. In addition, the amendments envisage seven-year tax holidays for companies, which carry out hydrocarbon exploration and production on the Yamal Peninsula and in Timan-Pechora.