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

The following represents management's analysis of the financial performance and condition of OAO LUKOIL and significant trends that may affect future performance. It should be read in conjunction with our interim US GAAP consolidated financial statements and notes thereto.

References to "LUKOIL", "the Company", "the Group", "we" or "us" are references to OAO LUKOIL and its consolidated subsidiaries and associates. All dollar amounts are in millions of US dollars, unless otherwise indicated. Tonnes of crude oil produced are translated into barrels using conversion rates characterizing the density of oil from each of our oilfields. Tonnes of crude oil purchased as well as other operational indicators expressed in barrels are translated into barrels using an average conversion rate of 7.33 and billions of cubic feet into millions of oil equivalent barrels using a conversion rate of 0.167.

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

Key financial and operational results

	1st quarter of		Change, %
	2005	2004	
Sales (including excise and export tariffs)	**10,557**	6,512	62.1%
Net Income	**1,180**	819	44.1%
EBITDA	**1,959**	1,412	38.7%
Earnings per share of common stock (US dollars)			
Basic earnings	**1.45**	1.00	45.0%
Diluted earnings	**1.43**	0.99	44.4%
Crude oil production by consolidated subsidiaries (thousands of tonnes)	**21,004**	20,174	4.1%
Gas production by consolidated subsidiaries (million cubic metres)	**1,254**	1,223	2.5%
Refined products produced at the Group refineries (thousands of tonnes)	**10,033**	9,393	6.8%

During the 1st quarter of 2005 net income was $1,180 million, which is $361 million more than in the same period of 2004.

The increase in net income resulted from favorable price conditions in the 1st quarter of 2005 and improved cost control. However, an increased tax burden has restrained growth of our profitability. These restraining factors as well as other drivers impacting the results of our operations are considered below in detail.

Segment information

Our operations are divided into three main business segments:

- **Exploration and Production** – which includes our exploration, development and production operations relating to crude oil and natural gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, Uzbekistan, the Middle East, Northern Africa and Colombia

- **Refining, Marketing and Distribution –** which includes marketing and trading of crude oil, natural gas and refined products, and refining and transport operations

- **Chemicals** – which include processing and trading of petrochemical products

Other businesses include banking and finance, construction and other activities. Each of our three 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 section "Domestic crude oil prices" on page 3, 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 and need for investment resources at oil producing companies within the Group. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of that segment's underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows, but we do present the financial data for each in Note 15 to our consolidated financial statements.

Operating developments

Strategic Partnership with ConocoPhillips

In September 2004, LUKOIL entered into a Shareholder agreement forming a broad-based strategic alliance with ConocoPhillips. Within the framework of the partnership LUKOIL and ConocoPhillips plan to set up in 2005 a joint venture in the Nenetsky Autonomous District to develop LUKOIL's oil reserves in the northern Timan-Pechora area. The joint venture will be governed by LUKOIL and ConocoPhillips in equal parts, but with effective interest of 70% and 30% respectively. It is expected that the joint venture's crude oil production will reach approximately 200 thousand barrels per day by 2008. The joint venture will be formed on the basis of our 100% subsidiary OOO Narianmarneftegaz, which crude oil production in the 1st quarter of 2005 was approximately 13 thousand barrels per day.

Acquisitions in 2005

In March 2005, we acquired 100% interest in Oy Teboil Ab and Suomen Petrooli Oy, which are incorporated in Finland, for $160 million. Oy Teboil Ab and Suomen Petrooli Oy are mainly engaged in the operation of 289 retail petrol service stations and 132 retail diesel fuel outlets, wholesale of refined oil products as well as production and sale of lubricants.

In January 2005 a Group company acquired an additional 22% interest in LUKOIL Neftochim Bourgas AD for $56 million (20.7% interest was acquired from a related party for $52 million). The acquisition increased the Group's ownership stake in LUKOIL Neftochim Bourgas AD to 93.2%.

Main macroeconomic factors affecting our results of operations

Change in the price of crude oil and refined products

The price at which we can sell crude oil and refined products is the primary driver of our revenues. During the 1st quarter of 2005 crude oil prices were steadily high due to growth of the world economy, driven mainly by the USA and China, and increased worldwide crude oil consumption. In the 1st quarter of 2005, due to the continuing growth in demand in the USA and China, prolonged late winter cold snap in the US East Coast, certain geopolitical tensions, refining and distribution bottlenecks in some major consuming regions, crude oil prices reached their historical records (OPEC Reference basket) in absolute terms. According to International Energy Agency, in the 1st quarter of 2005 worldwide crude oil consumption was 84.3 million barrels per day, or 2.3% more than in the same period of 2004. OPEC forecasts a 4.1% growth of the world economy in 2005 and estimates that the worldwide crude oil consumption will reach the level of 84.0 million barrels per day in 2005, or 2.3% more than in 2004 (data as of April, 2005). In response to this in March, 2005 the OPEC decided to increase daily production up to 27.5 million barrels a day. However, based on OPEC's data, actual daily production in the 1st quarter of 2005 reached 29.5 million barrels a day, or 1.3 million barrels a day more than in the same period of the 2004 – near to OPEC's full capacity. This situation can be viewed as an indicator that crude oil prices will remain steadily high in a medium-term perspective.

Substantially all of the crude oil that we sell for export is the Urals blend. The following table shows the average crude oil export prices for respective periods of 2004 and 2005 and refined product prices based on Northern Europe averages:

	1st quarter of		Change, %
	2005	2004	
	(in US dollars per bbl, except for figures in percent)		
Brent crude	47.62	32.03	48.7%
Urals crude (CIF Mediterranean)*	43.21	29.00	49.0%
Urals crude (CIF Rotterdam)*	42.54	29.09	46.2%
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam)	175.01	138.23	26.6%
Diesel fuel (FOB Rotterdam)	432.47	274.72	57.4%
High-octane gasoline (FOB Rotterdam)	436.51	334.98	30.3%

Source: Platts.

* The Company sells crude oil on foreign markets on various delivery terms. Thus the average realized sale price of oil on international markets differs from the average prices of Urals crude on Mediterranean and Northern Europe markets.

Domestic crude oil prices

Crude oil prices in Russia have remained below world levels primarily due to constraints on the ability of Russian oil companies to export their crude oil, which has led to large regional surpluses in Russia and increased domestic supplies. As substantially all crude oil produced in Russia is produced by vertically integrated oil companies such as ours, there is no concept of a benchmark domestic market price for crude oil. Most transactions are between affiliated entities within vertically integrated groups. There is also a market within Russia for residual crude oil that is produced but not refined or exported by one of the vertically integrated oil companies. Prices for this oil are 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 as a result of the regional imbalances referred to above and competitive and economic conditions in those regions.

Domestic refined product prices

Domestic prices for refined products are determined to some extent by world market prices, but they are also directly affected by local demand, competition and prices imposed on government-directed sales. In general, retail prices on refined products in Russia are comparable to those in the USA. For example, during the 1st quarter of 2005 the average retail price on regular gasoline in the USA was about 51 cents per litre, an increase of 34.2% compared to the same period of 2004. In central regions of European Russia the average retail price on gasoline of the same quality (95 octane) during the 1st quarter of 2005 was 53 cents per litre, an increase of 29.3% compared to the 1st quarter of 2004.

The table below represents average domestic wholesale prices on refined products for respective periods of 2004 and 2005.

	1st quarter of 2005	1st quarter of 2004	Change, %
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil	65.05	57.83	12.5%
Diesel fuel	365.31	228.67	59.8%
High-octane gasoline (Regular)	407.32	323.66	25.8%
High-octane gasoline (Premium)	446.48	374.36	19.3%

Source: Kortes (excluding VAT).

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenues 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, the movements of ruble inflation and exchange rates can significantly affect the results of our operations. In particular, our operating margins are generally adversely affected by real appreciation of the ruble against the US dollar, because this will generally cause our costs to increase in US dollar terms relative to our revenues.

The following table gives data on inflation in Russia, the nominal change in the ruble–dollar exchange rate, and the level of real rouble appreciation.

	1st quarter of 2005	1st quarter of 2004
Ruble inflation (CPI)	5.2%	3.6%
Nominal (devaluation)/appreciation of the exchange rate (ruble to US dollar)	(0.3)%	3.3%
Real appreciation of the exchange rate (ruble to US dollar)	4.9%	7.2%
Average exchange rate for the period (ruble to US dollar)	27.84	28.67
Exchange rate at the end of the period (ruble to US dollar)	27.83	28.49

Change in tax rates and export tariffs

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

		1st quarter of 2005*	1st quarter of 2004*	Change, %
Export tariffs on crude oil	$/tonne	89.20	32.98	170.5%
Export tariffs on refined products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	58.74	29.18	101.3%
Liquid fuels (fuel oil)	$/tonne	44.05	29.18	51.0%
Excise on refined products				
High-octane gasoline	RUR/tonne	3,629.00	3,360.00	8.0%
Low-octane gasoline	RUR/tonne	2,657.00	2,460.00	8.0%
Diesel fuel	RUR/tonne	1,080.00	1,000.00	8.0%
Motor oils	RUR/tonne	2,951.00	2,732.00	8.0%
Mineral extraction tax	RUR/tonne	1,514.94	848.40	78.6%

* Average values.

During the 1st quarter of 2005 our tax burden rose significantly compared to the previous year. Average crude oil export tariffs increased by 170.5% compared to the 1st quarter of 2004. Approximately 87% of the increase related to growth of crude oil prices, and the remaining 83% resulted from changes in the duty rate calculations effective June 2004 (see below). Export tariffs on gasoline, kerosene, jet fuel, diesel fuel and gasoils increased by 101.3%. Excise on refined products increased by approximately 8.0%.

The mineral extraction tax rate increased by 78.6% compared to the 1st quarter of 2004. This resulted from an increase of the Urals crude price and a change in the tax calculation method effective from January 1, 2005.

The mineral extraction tax rate is determined as follows. Effective from January 1, 2005, the base rate is set at 419 Rubles per metric tonne extracted (in the 1st quarter of 2004 – 347 rubles) and is adjusted depending on the international market price of the Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals international market price for a tax period is less than or equal to $9.00 per barrel (before January 1, 2005 the lower non-taxable threshold was $8.00 per barrel). As a result each $1.00 per barrel increase in the international Urals price over the threshold ($9.00 per barrel) will effectively result in an increase of the tax rate by $1.61 per tonne extracted (or $0.22 per barrel extracted using a conversion factor of 7.33). In the 1st quarter of 2004 each $1.00 per barrel increase in the international Urals price over the threshold ($8.00 per barrel) effectively resulted in an increase of the tax rate by $1.38 per tonne extracted (or 0.19 cents per barrel extracted using a conversion factor of 7.33).

In June 2004 the Russian government introduced a new crude oil export duty rate with a three-layer progressive scale. The rate is zero when the average Urals international market price is less than or equal to approximately $15.00 per barrel ($109.50 per metric tonne). If the Urals price is in a layer between $15.00 and $20.00 per barrel ($146.00 per metric tonne), each $1.00 per barrel increase in the Urals price over the layer's lower bound results in an increase of the crude oil export duty rate by $0.35 per barrel exported. If the Urals price is in a layer between $20.00 and $25.00 per barrel ($182.50 per metric tonne), each $1.00 per barrel increase in the Urals price over the layer's lower bound results in an increase of the crude oil export duty rate by $0.45 per barrel exported. If the Urals price is above $25.00 per barrel, each $1.00 dollar per barrel increase in the Urals price over this limit results in the increase of the crude oil export duty rate by $0.65 per barrel exported.

Before June 2004 the crude oil export duty rate was calculated as follows. The rate was zero when the average Urals international market price was less than or equal to approximately $15.00 per barrel. If the Urals price was in a layer between $15.00 and $25.00 per barrel, each $1.00 per barrel increase in the Urals price over the layer's lower bound resulted in increase of the crude oil export duty rate by $0.35 per barrel exported. If the Urals price was above $25.00 per barrel, each $1.00 dollar per barrel increase in the Urals price over this limit resulted in the increase of the crude oil export duty rate by $0.40 per barrel exported.

Export duty rates on refined products are set by the Russian government. The size of export duty depends on internal demand on refined products and international crude oil market conditions. Crude oil and refined products exported to CIS countries, other than Ukraine, are not subject to export duties.

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

	1st quarter of		**Change, %**
	2005*	**2004***	
	(in USD dollars per tonne)		
Excise on refined products			
High-octane gasoline	130.35	117.21	11.2%
Low-octane gasoline	95.44	85.82	11.2%
Diesel fuel	38.79	34.88	11.2%
Motor oils	106.00	95.31	11.2%
Mineral extraction tax	54.42	29.60	83.9%

* Average values.

Operational highlights

Oil production

In line with our long-term strategy we increased our total daily oil production by 4.5% (including the Company's share in equity associates) compared to the 1st quarter of 2004 and produced 162,019 thousand barrels (21,982 thousand tonnes) during the quarter ended March 31, 2005.

	1st quarter of 2005	1st quarter of 2004	Change, %
Daily production of crude oil, including Company's share in equity associates (thousand barrels per day)	1,800	1,706	5.5%
Refinery throughput (thousand barrels per day)	861	818	5.3%

The main oil production region of the Company is Western Siberia. In the oil fields of Western Siberia the Company produced 66.8% of its total production of crude oil in the 1st quarter of 2005 (67.7% in the 1st quarter of 2004). The increase of production in Western Siberia was 2.8%. The organic growth of oil production resulted from improvement and optimization of oil production methods. As a result our average well debits increased from 10.5 tonnes a day in the 1st quarter of 2004 to 11.0 tonnes a day in the 1st quarter 2005, or by 4.8%. Commencement of oil production in new oil fields in the Nenetsky Autonomous District led to an increase of oil production in this region more than 1.4 times compared to the 1st quarter of 2004. Thus, the total organic growth of the oil production in the 1st quarter of 2005 was 3.9% compared to the 1st quarter of 2004. In the third quarter of 2004 we started commercial production at Kravtsovskoye (D-6), a Baltic offshore field. In the 1st quarter of 2005 we produced 92 thousand tonnes of crude oil from this field, and we expect that annual crude oil production will reach 700 thousand tonnes by 2007. The structural growth in international production volumes in the 1st quarter of 2005 was caused by consolidation of the Company's share in the Meleiha Hydrocarbon License Agreement as a result of an increase in our share of LUKAgip N.V. at the end of 2004.

The following table represents our production in 2005 and 2004 by major regions excluding our share in equity associates:

(thousands of tonnes)	1st quarter of 2005	Change to 2004			1st quarter of 2004
		Total %	Change in structure	Organic growth	
Western Siberia	14,031	2.8%	–	380	13,651
Komi Republic	2,421	2.6%	–	61	2,360
Ural region	2,511	0.6%	–	14	2,497
Volga region	740	0.5%	–	4	736
Timano-Pechora (Nenetsky Autonomous District)	436	43.0%	7	124	305
Other in Russia	409	28.2%	–	90	319
Crude oil production in Russia	**20,548**	**3.4%**	**7**	**673**	**19,868**
Crude oil produced internationally	**456**	**49.0%**	**28**	**122**	**306**
Total crude oil produced	**21,004**	**4.1%**	**35**	**795**	**20,174**

In addition to our production, we purchase crude oil from third parties in Russia and on international markets. In Russia we primarily purchase crude oil from associated producing companies and other producers, including vertically integrated companies that lack refining capacity or are unable to export their crude oil. We may either refine or export purchased crude oil. Crude oil purchased on international markets is used mostly for marketing activities and, on certain occasions, for supplying our overseas refineries.

	1st quarter of			
	2005		2004	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	1,400	191	4,492	613
Crude oil purchases internationally	15,019	2,049	16,191	2,209
Total crude oil purchased	**16,419**	**2,240**	**20,683**	**2,822**

The volume of crude oil purchased in Russia in the 1st quarter of 2005 was 191 thousand tonnes, or 422 thousand tonnes less than in the 1st quarter of 2004. The volume of crude oil purchased internationally decreased by 160 thousand tonnes. The decreases in purchases were primarily due to growth of crude oil export by the Company's domestic producers.

Gas production

In the 1st quarter of 2005 we produced 1,321 million cubic metres of gas (including the our share in equity associates), an increase of 3.0% compared to the 1st quarter of 2004. In April, 2005 we started commercial production on the Nakhodkinskoe gas field. This is a first stage of development of the Bolshekhetskaya basin fields in the Yamalo-Nentsky Autonomous District. We estimate production output from the field will reach 11 billion cubic metres in 2005-2006 and the field's planned production capacity of 10 billion cubic metres per year will be achieved in 2007. Development of the Bolshekhetskaya basin fields is a core element of our gas business strategy.

	1st quarter of		Change, %
	2005	2004	
Gas production, including Company's share in equity associates (thousand BOE per day)	86	83	3.6%

Refining and marketing

We operate four refineries located in European Russia and three refineries located overseas – in Bulgaria, Ukraine and Romania. Our Romanian refinery, Petrotel-LUKOIL S.A., was undergoing significant upgrades until October 2004. In October 2004, we put Petrotel-LUKOIL back into operation.

In the 1st quarter of 2005 the production of refined products increased by 6.8% as compared to the same period of the previous year. Production on Russian refineries remained on the same level, while the overseas refineries increased production by 52.8% primarily due to recommencement of production by Petrotel-LUKOIL.

In the 1st quarter of 2005 we continued to expand our marketing activities in Western Europe, South-East Asia, Northern and Central America. Our marketing activities mainly include wholesale and bunkering operations in Western Europe and South-East Asia as well as supply our retail networks in the USA, Baltic states and some other regions. The total volume of refined products, purchased from third parties for wholesale was 5,473 thousand tonnes or $1,924 million in the 1st quarter of 2005 (3,324 thousand tonnes or $798 million in the 1st quarter of 2004). The total volume of refined products purchased from third parties for supply the retail network during the 1st quarter of 2005 was 1,341 thousand tonnes or $684 million (852 thousand tonnes or $377 million in the 1st quarter of 2004).

In Russia we purchase refined products on occasion, primarily to manage supply chain bottlenecks.

The following table represents volumes of refined products produced and purchased:

	1st quarter of 2005 (thousand of tonnes)	1st quarter of 2004 (thousand of tonnes)
Refined products produced at the Group refineries in Russia	8,027	8,080
Refined products produced at the Group refineries outside of Russia	2,006	1,313
Total refined products produced	**10,033**	**9,393**
Refined products purchased in Russia	304	265
Refined products purchased internationally	6,825	4,435
Total refined products purchased	**7,129**	**4,700**

Export of crude oil and refined products from Russia

We transport a significant portion of our crude oil through Transneft's trunk oil pipeline system. Access to the Transneft crude oil export pipeline network is allocated quarterly, based on recent volumes produced and delivered through the pipeline and proposed export destinations. The Russian Government places restrictions on access to the Transneft export network, which limits our ability to export via this method because of a need to ensure that sufficient volumes of crude oil remains in Russia to meet domestic requirements and capacity constraints of the crude oil pipeline network.

At the same time additional access to international markets bypassing Transneft export routes is obtained through rail transport or by tankers. Moreover, in the second quarter of 2004 we put into operation the first stage of our Vysotsk terminal and loaded the first tankers with crude oil. In the 1st quarter of 2005 the Company exported 12.8% of crude oil produced (2,682 thousand tonnes) by means other than Transneft, including 677 thousand tonnes (113 thousand tonnes in the same period of 2004) through our own export infrastructure, which includes the Vysotsk terminal and terminal in Varandey (the Nenetsky Autonomous District).

	1st quarter of 2005		1st quarter of 2004	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Export of crude oil using Transneft export routs	65,662	8,958	71,636	9,773
Export of crude oil bypassing Transneft	19,659	2,682	11,024	1,504
Total crude oil export	**85,321**	**11,640**	**82,660**	**11,277**

In late 2004 capacity of the Baltic Pipeline System rose up to 50 million tonnes of crude oil per year. This allowed us to increase the volume of crude oil exported via Primorsk terminal in the 1st quarter of 2005 up to 2,611 thousand tonnes, or 839 thousand tonnes more, than in the same period of 2004.

In the 1st quarter 2005 we begin to export crude oil to China. The volume exported was 613 thousand tonnes (in the 1st quarter of 2004 we did not export crude oil to China).

In the 1st quarter of 2005 we decreased refined products export by 2.9 million tonnes, or 11.0%, compared to the same period of 2004 due to growth of domestic demand on refined products.

Three months ended March 31, 2005 compared to three months ended March 31, 2004

The table below details certain income and expense items from our consolidated statements of income for the periods indicated. All items are presented in millions of US dollars, except for earnings per share data and percentage of changes to the 1st quarter of 2004.

	1st quarter of 2005	1st quarter of 2004	Change, %
Revenues			
Sales (including excise and export tariffs)	10,557	6,512	62.1%
Equity share in income of affiliates	59	70	15.7%
Total revenues	**10,616**	**6,582**	**61.3%**
Costs and other deductions			
Operating expenses	(782)	(660)	18.5%
Cost of purchased crude oil, petroleum and chemical products	(3,380)	(1,827)	85.0%
Transportation expenses	(837)	(649)	29.0%
Selling, general and administrative expenses	(512)	(471)	8.7%
Depreciation, depletion and amortization	(284)	(248)	14.5%
Taxes other than income taxes	(1,297)	(740)	75.3%
Excise and export tariffs	(1,775)	(857)	107.1%
Exploration expense	(36)	(30)	20.0%
Loss on disposal and impairment of assets	(17)	(25)	(32.0)%
Income from operating activities	**1,696**	**1,075**	**57.8%**
Interest expense	(55)	(68)	(19.1)%
Interest and dividend income	18	42	(57.1)%
Currency translation (loss)/gain	(12)	59	–
Other non-operating income	13	46	(71.7)%
Minority interest	(22)	(16)	37.5%
Income before income taxes	**1,638**	**1,138**	**43.9%**
Current income taxes	(490)	(311)	57.6%
Deferred income taxes	32	(8)	–
Total income tax expense	**(458)**	**(319)**	**43.6%**
Net income	**1,180**	**819**	**44.1%**
Per share of common stock (in US dollars):			
Net income			
Basic	1.45	1.00	45.1%
Diluted	1.43	0.99	44.5%

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

Sales revenues

Sales breakdown	1st quarter of 2005		2004	
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS	3,414	32.3%	2,089	32.1%
Export and sales to CIS	51	0.5%	168	2.6%
Domestic sales	9	0.1%	68	1.0%
	3,474	**32.9%**	**2,325**	**35.7%**
Refined products				
Export and sales on international markets				
Wholesale	3,888	36.8%	2,079	31.9%
Retail	1,024	9.7%	619	9.5%
Domestic sales				
Wholesale	942	8.9%	627	9.6%
Retail	367	3.5%	229	3.5%
	6,221	**58.9%**	**3,554**	**54.5%**
Petrochemicals				
Export and sales on international markets	331	3.1%	219	3.4%
Domestic sales	113	1.1%	72	1.1%
	444	**4.2%**	**291**	**4.5%**
Other	**418**	**4.0%**	**342**	**5.3%**
Total sales	**10,557**	**100.0%**	**6,512**	**100.0%**

Sales volumes	1st quarter of 2005		2004	
	(thousands of barrels)			
Crude oil				
Export and sales on international markets other than CIS	81,209		74,480	
Export and sales to CIS	2,705		9,830	
Domestic sales	726		5,270	
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than CIS	11,079	39.8%	10,161	39.3%
Export and sales to CIS	369	1.3%	1,341	5.2%
Domestic sales	99	0.4%	719	2.8%
	11,547	**41.5%**	**12,221**	**47.3%**
Refined products	(thousands of tonnes)			
Export and sales on international markets				
Wholesale	9,756	35.0%	7,756	30.1%
Retail	1,414	5.1%	969	3.7%
Domestic sales				
Wholesale	4,397	15.8%	4,322	16.7%
Retail	714	2.6%	576	2.2%
	16,281	**58.5%**	**13,623**	**52.7%**
Total sales volume of crude oil and refined products	**27,828**	**100.0%**	**25,844**	**100.0%**

Realized average sales prices	1st quarter of 2005		2004	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	42.04	308.15	28.05	205.57
Oil (CIS)	18.80	137.83	17.10	125.32
Refined products				
Wholesale		398.60		268.00
Retail		723.97		639.37
Average realized price within Russia				
Oil	12.56	92.05	12.81	93.93
Refined products				
Wholesale		214.18		144.93
Retail		514.33		398.22

During the 1st quarter of 2005 sales revenues increased by $4,045 million, or 62.1%, compared to the same period of 2004.

The total volume of crude oil and refined products sold amounted to 27.8 million tonnes, which is 7.7% more than that sold in the 1st quarter of 2004. Our revenues from crude oil sales increased by $1,149 million, or 49.4%. Our sales of refined products increased by $2,667 million, or 75.0%.

Sales of crude oil and refined products on the international markets, including the CIS, accounted for 81.3% of total sales volume in the 1st quarter of 2005 compared to 78.3% in the 1st quarter of 2004.

The increase in sales was principally due to the following:

- favorable price conditions: international crude oil market prices were at a ten-year high (see "Change in the price of crude oil and refined products" on page 3)
- increase in total volume of crude oil production (see "Oil production" on page 6)
- increase in marketing activities (see page 7)
- decrease of crude oil sales in Russia and increase in volumes exported on international markets (see "Export of crude oil and refined products from Russia" on page 8)

Sales of crude oil

During the 1st quarter of 2005 the Company decreased its sales of crude oil on the domestic market compared to the same period of the previous year by 620 thousand tonnes, or 86.2%. This change was caused by an increase in volumes exported by the Company's domestic producers and a decrease in crude oil purchases in Russia.

During the 1st quarter of 2005 we increased exports of crude oil on international markets by the Company's domestic producers by 363 thousand tonnes. The increase in export sales, along with an increase in the average realized export price of crude oil on international markets (other than CIS) from $28.05 to $42.04 per barrel, allowed us to obtain an additional $277 million in revenues.

Sales of refined products

Sales of refined products made up 58.9% of our total sales revenues (58.5% in terms of volumes sold) compared to 54.5% (52.7% – in terms of volumes) in the 1st quarter of 2004. The portion of our domestic refined product sales in the 1st quarter of 2005 was 18.4% of total tonnes sold (1st quarter of 2004: 18.9%), but represented 12.4% of our total sales revenue (1st quarter of 2004: 13.1%).

The average realized wholesale price on refined products outside of Russia increased by $130.60 per tonne, or 48.7%, compared to the 1st quarter of 2004. Volumes of refined products sold outside of Russia increased by 2,000 thousand tonnes, or 25.8% (see also "Refining and marketing" on page 7). As a result, our revenues from wholesale of refined products outside of Russia increased by $1,809 million, or 87.0%.

In the 1st quarter of 2005 retail sales of refined products outside of Russia increased by 445 thousand tonnes, or by 45.9%, compared to the same period of 2004. The increase was a result of continuing development of the existing retail chains outside of Russia and structural changes in the retail network we operate. In particular, in May 2004, we acquired an additional retail network in the USA. Average retail prices increased up to $723.97 per tonne, or by 13.2%. As a result, our revenues from retail sales increased by $405 million, or 65.4%. In the 1st quarter of 2005 revenue from retail sales was 20.8% of total sales of refined products outside of Russia. Our international retail sales include supplies of refined products to third parties' retail networks within the bounds of long-term contracts with pricing similar to retail pricing.

Wholesale of refined products within Russia in the 1st quarter of 2005 increased by 75 thousand tonnes, or 1.7%, as compared to the same period in 2004. The average domestic realized price on refined products increased by $69.25 per tonne, or 47.8%. As a result, our revenues from wholesale of refined products on the domestic market increased by $315 million, or 50.2%.

Retail sales within Russia in the 1st quarter of 2005 increased by 138 thousand tonnes, or 24.0%, compared to the same period in 2004. Average retail prices increased up to $514.33 per tonne, or by 29.2%. As a result, our revenues from retail sales increased by $138 million, or 60.3%. Revenue from retail sales was 28.0% of total sales of refined products in Russia in the 1st quarter of 2005.

Sales of petrochemical products

Revenues from sales of petrochemical products increased by $153 million, or 52.6%, during the 1st quarter of 2005. This was mainly due to an increase of production volume up to 622 thousand tonnes, or by 12.5%, compared to the same period in 2004, and an increase in average realized prices.

Sales of other products

Other sales increased by $76 million, or 22.2%, as a result of sales of other products produced by the Company, and also increased activity in providing other services to third parties.

Equity share in income of affiliates

Our share in the income of affiliates in the 1st quarter of 2005 decreased by $11 million, or 15.7%, compared to the 1st quarter of 2004, primarily due to a decrease in the net income of ZAO Turgay-Petroleum. ZAO Turgay-Petroleum, our 50% interest affiliate company, is a partner in the Turgay-Petroleum joint venture developing the Kumkol field in Kazakhstan. The Group's share in the net income of ZAO Turgay-Petroleum in the 1st quarter of 2005 amounted $11 million that represents an decrease of $10 million as compared to the same period of the previous year.

Operating expenses

Operating expenses include the following types of costs:

	1st quarter of 2005	1st quarter of 2004
	(millions of US dollars)	
Extraction expenses	401	371
Refining expenses	155	130
Petrochemical expenses	51	45
Other operating expenses	175	114
Total operating expenses	**782**	**660**
Cost of purchased crude oil, petroleum and chemical products	**3,380**	**1,827**

Compared to the 1st quarter of 2004, operating expenses increased by $122 million, or 18.5%.

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

Expenses of the Company's production enterprises related to the sale of services and goods (such as electricity, heat, etc.) that do not relate to core activities have been excluded from extraction expenses and are included in other operating costs.

Extraction expenses rose by $30 million, or 8.1%, compared to the respective period of 2004. The increase in total extraction expenses resulted from an increase in volumes of oil produced by our subsidiaries from 20,174 million tonnes in the 1st quarter of 2004 to 21,004 million tonnes in the 1st quarter of 2005 as well as a 16.0% real ruble appreciation during the year ended March 31, 2005. These were mitigated by increase of average well debits from 10.5 tonnes a day in the 1st quarter of 2004 to 11.0 tonnes a day in the 1st quarter 2005. As a result our average extraction cost per barrel increased from $2.51 to $2.61 per barrel, or by 4.0% (average extraction cost calculated using an average tonnes to barrels conversion rate of 7.33).

Refining expenses at our refineries increased by $25 million, or 19.2%, in the 1st quarter of 2005 compared to the 1st quarter of 2004.

Refining expenses of our domestic refineries increased by 12.9%, or $12 million, primarily as a result of real ruble appreciation.

Refining expenses of our international refineries increased by 35.1%, or $13 million, primarily due to the recommencement of operations of our Romanian refinery Petrotel-LUKOIL after modernization.

Operating expenses of petrochemical companies increased by $6 million, or 13.3%, compared to the 1st quarter of 2004, as result of an increase in volumes produced.

Other operating expenses include the costs of other services provided and goods not related to primary activities (such as electricity, heat, etc.) sold by our production companies, and operating expenses of other non-core businesses of the Group. Other operating expenses also include costs associated with the delivery of crude oil from the Group's exploration and production entities to the Group's refineries, as well as the amount of the change in crude oil and refined products inventory at the Group's marketing entities. Other operating expenses increased by $61 million, or 53.5%, as compared to the 1st quarter of 2004 primarily as a result of an increased activity in providing other services to third parties and change in crude oil and refined products inventory in the 1st quarter of 2005.

Cost of purchased crude oil, petroleum and chemical products increased by $1,553 million in the 1st quarter of 2005, or 85.0%, compared to the same period of the previous year due to a significant increase in volumes of crude oil and refined products purchased for resale in the 1st quarter of 2005 by 1,628 thousand tonnes and growth of market prices on crude oil and petroleum products.

Transportation expenses

The increase in the total volume of sales together with the increase in transportation tariffs led to growth of transportation expenses in the 1st quarter of 2005 by $188 million, or 29.0%, compared to the 1st quarter of 2004.

During the twelve months period ended March 31, 2005, transportation tariffs increased as follows: pipeline transport – 39.5%, including increase of Transneft's tariff – 11.6%, sea shipping – (0.4)% (weighted average by volumes transported to different locations), railway transport – 8.8%.

Selling, general and administrative expenses

Our selling, general and administrative expenses increased by $41 million, or 8.7%, compared to the 1st quarter of 2004. The above-mentioned expenses include general business expenses, payroll costs (excluding extraction entities' and refineries' production staff cost), insurance costs (except for property insurance related to oil and gas, and refinery equipment), costs of maintenance of social infrastructure, movement in bad debt provision and other expenses.

An increase in selling, general and administrative expenses is a result of real ruble appreciation by 16.0% during the twelve months period ended March 31, 2005. At the same time, the increase was compensated by decrease in bad debt provision expense. During the 1st quarter of 2005 the bad debt expense was $5 million, while for the same period of 2004 the bad debt expense amounted to $22 million.

Depreciation, depletion and amortization

Depreciation, depletion and amortization expenses include depletion of assets fundamental to production, depreciation of other productive and non-productive assets and certain intangible assets. Our depreciation, depletion and amortization expenses increased by $36 million, or 14.5%, compared to the 1st quarter of 2004. The increase was a result of the Company's capital expenditure program and corresponding growth of depreciable assets. This increase was partly compensated by upward revisions of the Company's proved reserves and, consequently, an increase in estimated useful economic life of fixed assets.

Taxes other than income taxes

Taxes other than income taxes include mineral extraction tax, property tax and social taxes.

	1st quarter of			
	2005		2004	
	In Russia	International	In Russia	International
	(millions of US dollars)			
Mineral extraction tax	1,117	–	595	–
Social security taxes and contributions	74	8	87	8
Property tax	80	5	31	4
Other taxes	7	6	9	6
	1,278	**19**	**722**	**18**
Total		**1,297**		**740**

The increase in taxes other than income taxes resulted primarily from a $522 million increase in mineral extraction tax, which is linked to international crude oil prices (see "Change in tax rates and export tariffs" on page 4). Social taxes and contributions in Russia decreased by $13 million, or 14.9%, compared to the same period of the previous year due to changes in the unified social tax rates calculation effective from January, 2005. Property tax in Russia increased on $49 million primarily due to recalculation of domestic property tax related to 2002 and 2003.

Excise and export tariffs

Our excise and export tariffs include duties on sales of refined products and export tariffs on export of crude oil and refined products. Excise and export tariffs increased by $918 million, or 107.1%, compared to the 1st quarter of 2004. The increase in export tariff expenses resulted from an increase in export tariff rates (see "Change in tax rates and export tariffs" on page 4) and also an increase in volumes exported. The increase in international excise taxes on refined products resulted from an increase in volumes of products sold across our international group, primarily in the USA.

	1st quarter of			
	2005		**2004**	
	In Russia	**International**	**In Russia**	**International**
	(millions of US dollars)			
Excise tax and sales taxes on refined products..........	144	507	118	320
Export tariffs..	1,123	1	416	3
	1,267	**508**	**534**	**323**
Total...		**1,775**		**857**

Exploration expenses

The costs we incur in our exploratory drilling efforts are capitalized to the extent that our exploration efforts are successful and otherwise are charged to expenses of the current period. During the 1st quarter of 2005 the amount charged to exploration expense increased in comparison with the same period of the previous year by $6 million, or by 20.0%.

Loss on disposal and impairment of assets

Loss on disposal and impairment of assets in the 1st quarter of 2005 was $17 million compared to $25 million in the 1st quarter of 2004.

Interest expense

Interest expense in the 1st quarter of 2005 decreased by $13 million compared to the same period of 2004 primarily due to sale of our ownership interest in OAO Bank Petrocommerce in the third quarter of 2004.

Income taxes

Our total income tax expense increased by $139 million, or 43.6%, compared to the same period of 2004, due to an increase of income before income tax by $500 million, or 43.9%.

Our effective tax rate in the 1st quarter of 2005 was 28.0% (in the 1st quarter of 2004 it was 28.0%), which is higher than the maximum statutory rate for the Russian Federation (24%). This is attributable to the fact that some costs incurred during the period are not tax deductible or only deductible to a certain limit.

Liquidity and capital resources

	1st quarter of 2005	1st quarter of 2004
	(million US dollars)	
Net cash provided by operating activities	729	409
Net cash used in investing activities	(1,109)	(1,013)
Net cash provided by financing activities	322	282
Net debt	2,971	3,921
Current ratio	1.76	1.60
Total debt to equity	19%	28%
Long term debt to long term debt and equity	10%	13%

Our primary source of cash flow is funds generated from our operations. During the 1st quarter of 2005 cash generated by operating activities was $729 million, an increase of $320 million compared to the 1st quarter of 2004. In the 1st quarter of 2005 cash inflow from operating activity was impacted by the following factors:

- increase in revenue
- increase in amount of income tax paid
- increase in volume of export sales and, consequently, prepayment of custom fees, export duties and transportation tariffs.

Moreover, in the 1st quarter of 2005 our operating cash inflows was significantly affected by an increase of working capital (excluding effect of acquisitions) by $727 million compared to January 1, 2005. This was mailnly caused by:

- increase in trade accounts and notes receivable by $595 million resulted from expansion of our marketing activities in international markets
- growth of inventory by $333 million resulted from increased volumes of crude oil and refined products in stock, and increased purchase prices.

At the same time, this change in working capital was partly compensated by an increase in accounts payable related to mineral extraction tax by $211 million due to rise of the tax rate.

During the 1st quarter of 2005 the Company spent $1,095 million on capital investments and acquisitions of interests in other companies, which was $358 million more than in the 1st quarter of 2004 due to acquisitions of shares in companies Oy Teboil Ab and Suomen Petrooli Oy and increase of our share in LUKOIL Neftochim Burgas AD. Capital expenditures including non-cash transactions during the 1st quarter of 2005 amounted to $938 million, which was $177 million more than in the same period of the previous year. The growth in capital expenditures in new regions amounted to $88 million.

In the 1st quarter of 2005 cash inflows related to financing activities was $322 million, an increase of $40 million compared to the same period of the previous year. This resulted from a decrease in purchases and sales of treasury stock.

Analysis of capital expenditures *

	1st quarter of 2005	1st quarter of 2004
	(millions of US dollars)	
Exploration and production		
Russia	571	467
International	83	41
Total exploration and production	654	508
Refining, marketing and distribution		
Russia	157	152
International	103	88
Total refining, marketing and distribution	260	240
Chemicals		
Russia	5	5
International	5	3
Total chemicals	10	8
Other	14	5
Total capital expenditures	**938**	**761**
Acquisitions of subsidiaries		
Exploration and production		
Russia	–	–
International	–	–
Total exploration and production	–	–
Refining, marketing and distribution		
Russia	1	–
International	219	–
Total refining, marketing and distribution	220	–
Chemicals		
Russia	–	–
International	–	–
Total chemicals	–	–
Other	–	–
Less cash acquired	**(10)**	**–**
Total	**210**	**–**

* Including non-cash transactions.

The table below shows our capital expenditures included into exploration and production expenditures above on new promising oil regions.

Exploration and production	**1st quarter of 2005**	**1st quarter of 2004**
	(millions of US dollars)	
Northern Timano-Pechora	141	84
Yamal	86	98
Caspian region	61	18
Total	**288**	**200**

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

	1st quarter of 2005	**1st quarter of 2004**
Income before income taxes	**1,638**	**1,138**
Add back:		
Depreciation and amortization	284	248
Interest expense	55	68
Interest and dividend income	(18)	(42)
EBITDA	**1,959**	**1,412**