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

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

References to "LUKOIL", "the Company", "the Group", "we" or "us" are references to OAO LUKOIL and its 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.

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 2006	1st quarter of 2005	Change
Sales (including excise and export tariffs)	**14,943**	10,557	41.5%
Net Income	**1,689**	1,180	43.1%
EBITDA	**2,806**	1,959	43.2%
Earnings per share of common stock (US dollars)			
Basic earnings	**2.04**	1.45	40.7%
Diluted earnings	**2.04**	1.43	42.7%
Crude oil production by our subsidiaries (thousands of tonnes)	**22,109**	21,004	5.3%
Crude oil production by the Group including our share in equity associates (thousands of tonnes)	**22,979**	21,982	4.5%
Refined products produced by our subsidiaries (thousands of tonnes)	**11,279**	10,033	12.4%

During the first quarter of 2006 our net income was $1,689 million, which is $509 million more than in the same period of 2005.

This increase resulted from favorable price conditions, increased refining margins, production, refining and effective cost control. However, the growth of our net income was bounded by growth of taxes linked to international crude oil price. This restraining factor, 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 refining and transport operations, marketing and trading of crude oil, natural gas and refined products

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

Other businesses include banking, finance 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 the "Domestic crude oil and refined products prices" section on page 4 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, cost of crude oil refining and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows, but we do present the financial data for each in Note 21 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. In June 2005 LUKOIL and ConocoPhillips finalized the creation of a joint venture to develop resources in the northern Timan-Pechora area of the European region of the Russian Federation. The joint venture is governed by LUKOIL and ConocoPhillips in equal parts, but with effective ownership interests of 70% and 30%, respectively. The joint venture was formed by selling to ConocoPhillips an effective 30% interest in our wholly owned subsidiary OOO Narianmarneftegaz for $529 million.

Recent developments

In June 2006, a Group company acquired 100% of the share capital of Khanty-Mansiysk Oil Corporation ("KMOC") from Marathon Oil Corporation for $853 million (including $249 million repayment of KMOC debt), which is subject to finalisation of working capital and other adjustments in accordance with the purchase agreement. KMOC is a Delaware company, which owns approximately 95% of the share capital of OAO Khantymansiyskneftegazgeologia and 100% of the share capital of OAO Paitykh Oil and OAO Nazymgeodobycha ("KMOC subsidiaries"). KMOC subsidiaries operate oil and gas fields in the West Siberian region of the Russian Federation.

At the end of May 2006 the Group sold the remaining interest in OAO Bank Petrocommerce for $33 million.

During the period from November to December 2005, a Group company acquired 51% of the share capital of OAO Primorieneftegaz for $261 million. OAO Primorieneftegaz is a Russian oil and gas exploration company operating in the European Russia. Subsequently, in May 2006, a Group company acquired the remaining 49% of the share capital of OAO Primorieneftegaz for 4.165 million shares of common stock of the Company (at a market value of approximately $314 million), thereby increasing the Group's ownership stake in OAO Primorieneftegaz to 100%.

During the period from October 14 to December 5, 2005 a Group company acquired 100% of the share capital of Nelson Resources Limited ("Nelson") for $1,951 million. Nelson is an exploration and production company operating in western Kazakhstan. Nelson owns an effective 76% interest in the Karakuduk field, 50% interest in Alibekmola, Kozhasai, North Buzachi and Arman fields. In addition, Nelson holds an option to acquire a 25% interest in two exploration blocks in the Kazakhstan sector of the Caspian Sea – South Zhambai and South Zaburunye. The purpose of the acquisition was to increase the Group's presence in the Kazakhstan oil and gas sector and its international oil and gas reserves.

In November 2005 a Group company acquired the remaining 50% of the share capital of ZAO SeverTEK for $318 million from Neste Oil Corporation (including $98 million repayment of ZAO SeverTEK long-term debt). The acquisition increased the Group's ownership stake in ZAO SeverTEK to 100%. ZAO SeverTEK is an exploration and production company operating within the Komi Republic of the Russian Federation.

In July 2005 a Group company acquired 66.0% of the share capital of OOO Geoilbent for $180 million. OOO Geoilbent is an exploration and production company operating in the West Siberian region of the Russian Federation. All decisions over OOO Geoilbent's financing and operating activities require approval by at least a 66.7% majority of the voting rights. Since the minority shareholder of OOO Geoilbent holds substantive participating rights, the Group accounts for its investment in OOO Geoilbent using the equity method of accounting.

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 gas stations and 132 retail diesel fuel outlets, wholesale of refined oil products as well as production and sale of lubricants.

Main macroeconomic factors affecting our results of operation

Change 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 our revenues. During the first quarter of 2006 the Brent crude oil price fluctuated between $56-$66 per barrel. Crude oil prices remained high mainly due to certain political factors such as international concerns about the Iranian nuclear program, instability in Nigeria and the Russia-Ukraine gas crisis, as well as fundamental factors such as an increase in worldwide crude oil consumption and OPEC policy. According to the International Energy Agency (IEA) in the first quarter of 2006 the world demand for crude oil and, subsequently, refined products amounted to 85.2 million barrels per day, which is 0.8% more than in the first quarter of 2005. Based on OPEC's data, its actual daily production in the first quarter of 2006 reached 29.9 million barrels a day, or 1.6% more than in the first quarter of 2005. This situation can be viewed as an indicator that crude oil prices will remain relatively high in a medium-term perspective, however, there are some factors, which may cause price correction.

Substantially all of the crude oil that we export is the Urals blend. The following table shows the average crude oil and refined product prices for the first quarters of 2006 and 2005 based on Northern Europe averages.

	1st quarter of		Change
	2006	2005	
	(in US dollars per bbl, except for figures in percent)		
Brent crude	61.79	47.62	29.8%
Urals crude (CIF Mediterranean)*	58.26	43.21	34.8%
Urals crude (CIF Rotterdam)*	58.15	42.54	36.7%
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam)	287.53	175.01	64.3%
Diesel fuel (FOB Rotterdam)	542.68	432.47	25.5%
High-octane gasoline (FOB Rotterdam)	564.86	436.51	29.4%

* The Company sells crude oil on foreign markets on various delivery terms. Thus, our average realized sale price of oil on international markets differs from the average prices of the 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. Essentially, crude oil prices on traditional international markets should be higher than those in Russia due to incremental transportation cost incurred to deliver the crude oil from the Russian border to the markets, and export tariffs. However, 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. In general, retail prices on refined products in Russia are comparable to those in the USA.

The table below represents average domestic wholesale prices on refined products for respective periods of 2006 and 2005.

	1st quarter of 2006	1st quarter of 2005	Change
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil	169.35	65.05	160.3%
Diesel fuel	448.49	365.31	22.8%
High-octane gasoline (Regular)	511.33	407.32	25.5%
High-octane gasoline (Premium)	563.42	446.48	26.2%

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 ruble appreciation.

	1st quarter of 2006	1st quarter of 2005
Ruble inflation (CPI)	5.0%	5.2%
Nominal appreciation /(devaluation) of the exchange rate (ruble to US dollar)	3.5%	(0.3)%
Real appreciation of the exchange rate (ruble to US dollar)	8.8%	4.9%
Average exchange rate for the period (ruble to US dollar)	28.16	27.84
Exchange rate at the end of the period (ruble to US dollar)	27.76	27.83

Tax burden

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

		1st quarter of 2006*	1st quarter of 2005*	Change
Export tariffs on crude oil	$/tonne	167.28	89.20	87.5%
Export tariffs on refined products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	129.94	58.74	121.2%
Liquid fuels (fuel oil)	$/tonne	69.98	44.05	58.9%
Excise on refined products				
High-octane gasoline	RUR/tonne	3,629.00	3,629.00	–
Low-octane gasoline	RUR/tonne	2,657.00	2,657.00	–
Diesel fuel	RUR/tonne	1,080.00	1,080.00	–
Motor oils	RUR/tonne	2,951.00	2,951.00	–
Mineral extraction tax				
Crude oil	RUR/tonne	2,207.93	1,514.94	45.7%
Natural gas	RUR/1,000 m^3	147.00	135.00	8.9%

* Average values.

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

		1st quarter of		Change
		2006*	2005*	
Excise on refined products				
High-octane gasoline	USD/tonne	128.86	130.35	(1.1)%
Low-octane gasoline	USD/tonne	94.35	95.44	(1.1)%
Diesel fuel	USD/tonne	38.35	38.79	(1.1)%
Motor oils	USD/tonne	104.79	106.00	(1.1)%
Mineral extraction tax				
Crude oil	USD/tonne	78.40	54.42	44.1%
Natural gas	USD/1,000 m^3	5.22	4.85	7.6%

* Average values.

During the first quarter of 2006 the tax rates specific to the oil industry in Russia rose significantly compared to respective period of the previous year. These increases primarily resulted from growth of the Urals crude oil price. Below presented methods of rates calculation for such taxes. Excise on refined products in Russia remained on the same level as in 2005.

Crude oil extraction tax rate. Effective from January 1, 2005, the base rate is 419 rubles per metric tonne extracted 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 blend international market price for a tax period is less than or equal to $9.00 per barrel. Each $1.00 per barrel increase in the international Urals blend price over the threshold ($9.00 per barrel) results in an increase of the tax rate by $1.61 per tonne extracted (or $0.22 per barrel extracted using a conversion factor of 7.33). According to the tax legislation in force this method of the crude oil extraction tax calculation will be applied until December 31, 2006. Currently Russian legislative authorities are considering amendments to the current mineral extraction tax legislation intended to diversify the tax rate depending on the exploration stage and exhaustion of a particular oil field.

Natural gas extraction tax rate. Mineral extraction tax on natural gas production is calculated using a flat rate. From time to time Russian legislative authorities amend the tax rate. The current rate of 147 rubles per thousand of cubic meters of natural gas extracted is effective since January 1, 2006.

Crude oil export duty rate is calculated on a three-layer 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 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 blend 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 blend 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 blend price over the layer's lower bound results in an increase of the crude oil export duty rate by $0.45 per barrel exported. Each $1.00 dollar per barrel increase in the Urals blend price over $25.00 per barrel results in an increase of the crude oil export duty rate by $0.65 per barrel exported.

Export duty rates on refined products are set by the Russian government. The rate of export duty depends on internal demand for 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.

Operational highlights

Crude oil production

In the first quarter of 2006 we increased our total daily crude oil production by 4.6% compared to the first quarter of 2005 (including the Company's share in equity associates) and produced 169.4 million barrels, or 23.0 million tonnes.

	1st quarter of 2006	1st quarter of 2005	Change
Daily production of crude oil, including Company's share in equity associates (thousand barrels per day)	1,882	1,800	4.6%
Own refinery throughput (thousand barrels per day)	978	861	13.6%

The following table represents our production in the first quarters of 2006 and 2005 by major regions.

(thousands of tonnes)	1st quarter of 2006	Change to 2005			1st quarter of 2005
		Total %	Change in structure	Organic growth	
Western Siberia	14,142	0.8%	87	24	14,031
Komi Republic	2,861	18.2%	378	62	2,421
Ural region	2,610	3.9%	–	99	2,511
Volga region	744	0.5%	–	4	740
Timano-Pechora (Nenetsky Autonomous District)	445	2.1%	(16)	25	436
Other in Russia	490	19.8%	(8)	89	409
Crude oil production in Russia	21,292	3.6%	441	303	20,548
Crude oil produced internationally	817	79.2%	427	(66)	456
Total crude oil produced by consolidated subsidiaries	**22,109**	**5.3%**	**868**	**237**	**21,004**
Our share in crude oil production of equity associates:					
in Russia	383	(12.2)%	(66)	13	436
outside of Russia	487	(10.1)%	–	(55)	542
Total crude oil production	**22,979**	**4.5%**	**802**	**195**	**21,982**

The main oil production region of the Company is Western Siberia. In the oil fields of Western Siberia the Company produced 64.0% of its crude oil in the first quarter of 2006 (66.8% in the first quarter of 2005). In order to maintain stable organic growth of oil production in traditional production regions we constantly improve and optimize our oil production methods. As a result, our average well debits increased from 11.00 tonnes a day in the first quarter of 2005 to 11.15 tonnes a day in the first quarter of 2006. Nevertheless, organic growth in Western Siberia was lower in the first quarter of 2006 compared to the same period of 2005 due to the extremely cold weather that covered the region this winter and forced us to reduce crude oil production during periods of extreme cold. The slowdown in organic growth was compensated by structural changes. As a result of acquisition of the remaining interest in ZAO SeverTEK and increase of our share in ZAO Tursunt in late 2005, we began consolidating these former equity associates, which are exploration and production companies operating within Komi Republic and the West Siberian region of the Russian Federation, respectively. The structural growth in international production was caused by our acquisition of Nelson in October-December of 2005.

In addition to our production, we purchase crude oil 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. Then 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			
	2006		2005	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	2,903	396	1,400	191
Crude oil purchases internationally	10,438	1,424	15,019	2,049
Total crude oil purchased	**13,341**	**1,820**	**16,419**	**2,240**

The volume of crude oil purchased in Russia in the first quarter of 2006 was 205 thousand tonnes more than in the same period of 2005 as a result of an increase in purchases from our associates. This trend reflects structural changes in the Group: crude oil purchases in the first quarter of 2006 include results of transactions with OOO Geoilbent, our associate acquired in July 2005. The volume of crude oil purchased internationally during the first quarter of 2006 decreased by 625 thousand tonnes compared to the first quarter of 2005, which was caused by growth of the refined products' share of our marketing activity.

Gas production

In the first quarter of 2006 we produced 3,139 million cubic meters of commercial gas (including our share in equity associates), an increase of 137.6% compared to the first quarter of 2005. This increase was mainly caused by production from the Nakhodkinskoe gas field, which totaled 1,775 million cubic meters of natural gas in the first quarter of 2006. We started production on the Nakhodkinskoe gas field in April 2005. This is the first stage of development of the Bolshekhetskaya basin fields in the Yamalo-Nenetsky Autonomous District. The field's planned production capacity of 10 billion cubic meters per year is expected to be achieved in 2007.

	1st quarter of		Change
	2006	2005	
Daily gas production, including Company's share in equity associates (thousand BOE per day)*	205	86	137.6%

* Millions of cubic meters are translated into thousand BOE using a conversion rate of 5.89.

Refining and marketing

We operate four refineries located in European Russia and three refineries located overseas – in Bulgaria, Ukraine and Romania. In August 2005 we commenced a wide-scale upgrade of the Odessa refinery. The upgrade program is scheduled for three years.

Production of refined products at our refineries in the first quarter of 2006 increased by 12.4% as compared to the first quarter of 2005. Russian refineries increased production by 14.0%. The overseas refineries increased production by 5.9%.

In late 2004 we began changing the refined products mix at our refineries in order to produce higher quality and more profitable products. In particular, in the first quarter of 2006 we produced 1,459 thousand tonnes of Euro 4 and Euro 5 diesel fuel at our Russian refineries (in the first quarter of 2005 – 434 thousand tonnes).

Along with own production of refined products we refine our crude oil at third parties' refineries. In Russia we processed 797 thousand tonnes of crude oil during the first quarter of 2006 in order to supply our network in the Ural region (in the first quarter of 2005 – 199 thousand tonnes). To supply our retail networks in Eastern Europe we processed 316 thousand tonnes of crude oil in Belorussia in the first quarter of 2006 (in the respective period of 2005 we processed 292 thousand tonnes in Belorussia and Serbia).

In the first quarter of 2006 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 retail operations in the USA, Baltic states and some other regions. The total volume of refined products purchased from third parties for wholesale and to supply retail networks was 9,230 thousand tonnes or $4,649 million in the first quarter of 2006 (6,814 thousand tonnes or $2,608 million in the same period of 2005). The increase was a result of expansion of our marketing activities and continuing development of the existing retail chains outside of Russia and structural changes in the retail networks we operate. In particular, in March 2005 we acquired a retail network in Finland.

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

The following tables represent volumes of refined products produced and purchased.

	1st quarter of	
	2006	**2005**
	(thousand of tonnes)	(thousand of tonnes)
Refined products produced at the Group refineries in Russia	9,154	8,027
Refined products produced at the Group refineries outside of Russia	2,125	2,006
Total refined products produced at the Group refineries	**11,279**	**10,033**
Refined products purchased in Russia	296	304
Refined products purchased internationally	9,253	6,825
Total refined products purchased	**9,549**	**7,129**

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. There is a constraint on the ability of Russian companies to export their crude oil due to limited capacity of Russian transportation infrastructure on the most profitable export routes.

In order to overcome such limits Transneft extended the capacity of the Baltic Pipeline System up to 65 million tonnes per year. This allowed us to increase the volume of crude oil exported via the Primorsk terminal in the first quarter of 2006 up to 2,786 thousand tonnes, or 175 thousand tonnes more than in the same period of 2005.

The crude oil transported by Transneft is the Urals blend – a mix of crude oils of various qualities, therefore Russian companies, which produce crude oil of a higher quality, can not obtain benefits from selling it using Transneft's pipeline.

However, additional access to international markets bypassing Transneft export routes can be obtained through rail transport, by tankers or by our own export infrastructure. Our export infrastructure includes the Vysotsk terminal in the Leningrad region, Varandey terminal in the Nenetsky Autonomous District and the Izhevskoye terminal in the Kaliningrad region. In the first quarter of 2006 the Company exported 2.7% of crude oil produced, or 603 thousand tonnes, by means other than Transneft (2,682 thousand tonnes in the first quarter of 2005), including 594 thousand tonnes through our own export infrastructure (1,047 thousand tonnes in the first quarter 2005). Decrease in crude oil exported through own terminals is explained by the fact that in the third quarter of 2005 we ceased the export of crude oil through the Vysotsk terminal due to increased capacity of the Baltic Pipeline System. Currently we use the terminal to export refined products; in the first quarter of 2006 we exported 1,756 thousand tonnes of refined products (in the first quarter of 2005 – 409 thousand tonnes). In the future the terminal will be used to export both crude oil and refined products depending on market conditions.

The volumes of crude oil exported from Russia by our subsidiaries are summarized as follows:

	1st quarter of			
	2006		**2005**	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Export of crude oil using Transneft export routs	73,930	10,086	65,662	8,958
Export of crude oil bypassing Transneft	4,420	603	19,659	2,682
Total crude oil export	**78,350**	**10,689**	**85,321**	**11,640**

In the first quarter of 2006 we exported 4.3 million tonnes of refined products, an increase of 48.3% compared to the same period of 2005.

Three months ended March 31, 2006 compared to three months ended March 31, 2005

Results of operations

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 first quarter of 2005.

	1st quarter of		Change
	2006	2005	
Revenues			
Sales (including excise and export tariffs)	14,943	10,557	41.5%
Equity share in income of affiliates	98	59	66.1%
Total revenues	**15,041**	**10,616**	**41.7%**
Costs and other deductions			
Operating expenses	(900)	(782)	15.1%
Cost of purchased crude oil, petroleum and chemical products	(5,300)	(3,380)	56.8%
Transportation expenses	(848)	(837)	1.3%
Selling, general and administrative expenses	(761)	(512)	48.6%
Depreciation, depletion and amortization	(408)	(284)	43.7%
Taxes other than income taxes	(1,771)	(1,297)	36.5%
Excise and export tariffs	(2,685)	(1,775)	51.3%
Exploration expense	(35)	(36)	(2.8)%
Gain (loss) on disposals and impairments of assets	8	(17)	–
Income from operating activities	**2,341**	**1,696**	**38.0%**
Interest expense	(62)	(55)	12.7%
Interest and dividend income	27	18	50.0%
Currency translation gain (loss)	92	(12)	–
Other non-operating (expense) income	(25)	13	–
Minority interest	(10)	(22)	(54.5)%
Income before income taxes	**2,363**	**1,638**	**44.3%**
Current income taxes	(769)	(490)	56.9%
Deferred income taxes	95	32	196.9%
Total income tax expense	**(674)**	**(458)**	**47.2%**
Net income	**1,689**	**1,180**	**43.1%**
Per share of common stock (in US dollars):			
Net income			
Basic	2.04	1.45	40.7%
Diluted	2.04	1.43	42.7%

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

Sales revenues

Sales breakdown	1st quarter of 2006		2005	
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS	3,566	23.9%	3,414	32.3%
Export and sales to CIS	237	1.6%	51	0.5%
Domestic sales	49	0.3%	9	0.1%
	3,852	**25.8%**	**3,474**	**32.9%**
Refined products				
Export and sales on international markets				
Wholesale	6,780	45.4%	3,888	36.8%
Retail	1,506	10.1%	1,024	9.7%
Domestic sales				
Wholesale	1,352	9.0%	942	8.9%
Retail	528	3.5%	367	3.5%
	10,166	**68.0%**	**6,221**	**58.9%**
Petrochemicals				
Export and sales on international markets	298	2.0%	331	3.1%
Domestic sales	139	0.9%	113	1.1%
	437	**2.9%**	**444**	**4.2%**
Other	**488**	**3.3%**	**418**	**4.0%**
Total sales	**14,943**	**100.0%**	**10,557**	**100.0%**

Sales volumes	1st quarter of 2006		2005	
Crude oil	(thousands of barrels)			
Export and sales on international markets other than CIS	62,144		81,209	
Export and sales to CIS	7,088		2,705	
Domestic sales	2,206		726	
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than CIS	8,478	28.0%	11,079	39.8%
Export and sales to CIS	967	3.2%	369	1.3%
Domestic sales	301	1.0%	99	0.4%
	9,746	**32.2%**	**11,547**	**41.5%**
Refined products	(thousands of tonnes)			
Export and sales on international markets				
Wholesale	13,662	45.2%	9,756	35.0%
Retail	1,638	5.4%	1,414	5.1%
Domestic sales				
Wholesale	4,373	14.4%	4,397	15.8%
Retail	853	2.8%	714	2.6%
	20,526	**67.8%**	**16,281**	**58.5%**
Total sales volume of crude oil and refined products	**30,272**	**100.0%**	**27,828**	**100.0%**

Realized average sales prices	1st quarter of 2006		2005	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	57.39	420.66	42.04	308.15
Oil (CIS)	33.39	244.74	18.80	137.83
Refined products				
Wholesale		496.30		398.60
Retail		919.34		723.97
Average realized price within Russia				
Oil	22.30	163.43	12.56	92.05
Refined products				
Wholesale		309.18		214.18
Retail		619.34		514.33

During the first quarter of 2006 our revenues increased by $4,386 million, or 41.5%, compared to the first quarter of 2005.

The total volume of crude oil and refined products sold amounted to 30.3 million tonnes, which is 8.8% more than in the first quarter of 2005. Our revenues from crude oil sales increased by $378 million, or 10.9%. Our sales of refined products increased by $3,945 million, or 63.4%.

Sales of crude oil and refined products on the international markets, including the CIS, accounted for 81.8% of total sales volume in the first quarter of 2006 compared to 81.2% in the first quarter of 2005.

The increase in sales was principally due to the following:

- favorable price conditions (see "Change in the price of crude oil and refined products" on page 4)
- increase in total volume of crude oil production (see "Crude oil production" on page 7)
- increase in marketing activities (see page 8)
- increase in crude oil refining, resulting from an increase of refining margin

Sales of crude oil

During the first quarter of 2006 the Company increased its sales of crude oil on the domestic market compared to the first quarter of 2005 by 202 thousand tonnes, or 204.0%.

In order to obtain benefits from increased refined products prices in Russia and on international markets and due to a higher level of export tariff on crude oil compared to export tariffs on refined products we decreased the volume of crude oil exported from Russia by 951 thousand tonnes, or 8.2%, compared to the first quarter of 2005.

Sales of refined products

Sales of refined products made up 68.0% of our total revenues (67.8% in terms of volumes sold) compared to 58.9% (58.5% – in terms of volumes) in the first quarter of 2005. The portion of our domestic refined product sales in the first quarter of 2006 was 17.2% of the total tonnes sold (in the first quarter of 2005 – 18.4%), but represented 12.5% of our total revenues (in the first quarter of 2005 – 12.4%). The decrease of this portion was due to expansion of marketing activities outside of Russia.

The average realized wholesale price on refined products outside of Russia increased by $97.70 per tonne, or 24.5%, compared to the first quarter of 2005. Volumes of refined products sold outside of Russia increased by 3,906 thousand tonnes, or 40.0%. As a result, our revenue from wholesale of refined products outside of Russia increased by $2,892 million, or 74.4%.

In the first quarter of 2006 retail sales of refined products outside of Russia increased by 224 thousand tonnes, or by 15.8%, compared to first quarter of 2005. The increase was a result of continuing development of the existing retail chains outside of Russia and structural changes in the retail networks we operate. In particular, in March 2005 we acquired a retail network in Finland. Average retail prices increased up to $919.34 per tonne, or by 27.0%. As a result, our revenue from retail sales increased by $482 million, or 47.1%. In the first quarter of 2006 revenue from retail sales was 18.2% (in the first quarter of 2005 – 20.8%) of total refined products sales 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 first quarter of 2006 remained on the same level as in respective period of 2005. The average domestic realized price on refined products increased by $95.00 per tonne, or 44.4%. As a result, our revenue from wholesale of refined products on the domestic market increased by $410 million, or 43.5%.

Retail sales within Russia in the first quarter of 2006 increased by 139 thousand tonnes, or 19.5%, compared to the first quarter of 2005. Average retail prices increased up to $619.34 per tonne, or by 20.4%. As a result, our revenue from retail sales increased by $161 million, or 43.9%. Revenue from retail sales was 28.1% of total refined products sales in Russia in the first quarter of 2006 (in the first quarter of 2005 – 28.0%).

Sales of petrochemical products

Revenue from sales of petrochemical products slightly decreased by $7 million, or 1.6%, compared to the same period of 2005. The main reason for this was a decrease of production in our Ukrainian petrochemical plant caused by unfavorable price conditions on petrochemicals in the first quarter of 2006.

Sales of other products

Other sales include revenues from sales of gas, gas refined products and other services provided and goods not related to our primary activities (such as electricity, heat, etc.) sold by our production and marketing companies. Other sales increased by $70 million, or 16.7%, as a result of sales of other products produced by the Company, primarily gas and gas refined products, and increased activity in providing other services to third parties.

Equity share in income of affiliates

Our share in the income of affiliates in the first quarter of 2006 increased by $39 million, or 66.1%, compared to the first quarter of 2005 due to a general increase in profitability of our crude oil production affiliates, in particular due to an increase in the net income of ZAO Turgai-Petroleum, which is our 50% interest affiliate company developing the Kumkol oil field in Kazakhstan. The Group's share in the net income of ZAO Turgai-Petroleum in the first quarter of 2006 was $40 million, which represents an increase of $29 million as compared to the same period of 2005.

Operating expenses

Operating expenses include the following types of costs:

	1st quarter of	
	2006	**2005**
	(millions of US dollars)	
Crude oil extraction expenses	501	401
Refining expenses	176	149
Petrochemical expenses	61	57
Other operating expenses	364	327
Change in operating expenses in crude oil and refined products inventory originated within the Group	(202)	(152)
Total operating expenses	**900**	**782**
Cost of purchased crude oil, petroleum and chemical products	**5,300**	**3,380**

Compared to the first quarter of 2005, operating expenses increased by $118 million, or 15.1%, which is mainly explained by the growth of crude oil extraction expenses.

Real appreciation of the ruble against the US dollar is a significant factor affecting our operating expenses in Russia. For the twelve months period ended March 31, 2006 the real ruble appreciation was 10.9%.

Crude oil 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, property insurance of extraction equipment and other similar costs.

Expenses of the Company's oil 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.

In the first quarter of 2006 our extraction expenses rose by $100 million, or 24.9%, compared to the same period of 2005. The increase resulted from growth of crude oil produced by our subsidiaries up to 22.1 million tonnes, or by 5.3%, compared to the first quarter of 2005, increased expenses on repairs, overhaul and artificial stimulation of reservoirs, and effects of the real ruble appreciation. Our average extraction cost per barrel increased from $2.61 to $3.09 per barrel, or by 18.4%, compared to the first quarter of 2005. Comparison of the current data with the average extraction cost per barrel in the fourth quarter of 2005 gives an increase of 8.1%. One of the reasons for the increase was the slowdown in production in Western Siberia due to cold weather. Taking into account significant share of fixed overheads in the extraction costs, this led to growth of the extraction cost per barrel.

Refining expenses at our refineries increased by $27 million, or 18.1%, in the first quarter of 2006 compared to the first quarter of 2005.

Refining expenses of our domestic refineries increased by 19.0%, or $20 million as a result of increased production volume and due to effect of the real ruble appreciation.

Refining expenses of our international refineries increased by 15.9%, or $7 million, as a result of increased production.

Operating expenses of petrochemical companies increased by $4 million, or by 7.0%, compared to the first quarter of 2005.

Other operating expenses include natural gas extraction expenses, operating expenses of our gas processing plants, and the costs of other services provided and goods not related to primary activities (such as electricity, heat, etc.) sold by our production and marketing companies, and operating expenses of other non-core businesses of the Group. Other operating expenses also include transportation costs associated with the delivery of crude oil from the Group's exploration and production entities to the Group's refineries, and processing fees paid to third parties' refineries. Other operating expenses increased by $37 million compared to the first quarter of 2005. This was due to increased volumes of our crude oil refined on the third parties' refineries and volume growth of the other products sales (primarily gas and gas refined products).

Change in operating expenses in crude oil and refined products inventory originated within the Group includes extraction and refining expenses related to crude oil and refined products produced by the Group during the reporting period, but not sold to third parties.

Before 2006 such amounts included changes in inventory balances related to mineral extraction tax, export tariffs and transportation expenses. Starting from the first quarter of 2006 such changes are reflected in the corresponding income statements lines. Since the Group's management assesses the effect of this change in classification on the presentation of the income statement for the 2005 year as not material, no reclassifications were made to comparatives.

Cost of purchased crude oil, petroleum and chemical products increased by $1,920 million in the first quarter of 2006, or 56.8%, compared to the same period of the previous year due to a significant increase in volumes of crude oil and refined products trading in the first quarter of 2006 by 1,923 thousand tonnes, or about 21.0%, compared to the first quarter of 2005 and growth of market prices for 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 our transportation expenses in the first quarter of 2006 by $11 million, or 1.3%, compared to the first quarter of 2005. At the same time growth of transportation tariffs in the Russian Federation was partly compensated by optimization of our crude oil export deliveries by routes.

According to the Federal Statistics Service of the Russian Federation, during the twelve months period ended March 31, 2006 transportation tariffs increased as follows: transportation of oil by pipeline transport – 34.1% (including certain specific tariffs established for individual parts of the Transneft pipeline which did not have a material impact on transportation expenses of the Group), transportation of refined products by pipeline transport – 17.2%, railway transport – 13.4%.

Average transportation tariffs weighted by volumes of the Group's crude oil and refined products export deliveries to different locations changed in the first quarter of 2006 compared to the same period of the previous year as follows: sea shipping tariffs decreased by 25.9%; crude oil pipeline tariffs increased by 31.3%; railway tariffs for refined products transportation increased by 28.9%.

Selling, general and administrative expenses

Our selling, general and administrative expenses increased by $249 million, or 48.6%, compared to the first quarter of 2005. The above-mentioned expenses include general business expenses, payroll costs (excluding extraction entities' and refineries' production staff costs), 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.

The increase in selling, general and administrative expenses was a result of general expansion of our operations primarily outside of Russia. These expenses were also affected by an increase in costs related to a share-based compensation program for management in the first quarter of 2006, which was $203 million compared to $33 million in the first quarter of 2005. At the same time we partially mitigated an effect of the real ruble appreciation.

Selling, general and administrative expenses for the first quarter 2006 also included $20 million of expenses related to our Finnish subsidiaries acquired in March 2005 and $20 million of expenses related to Nelson, which we acquired in October-December of 2005.

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 $124 million, or 43.7%, compared to the first quarter of 2005. The increase was a result of the Company's capital expenditures and corresponding growth of depreciable assets, also the increase included $44 million of depreciation, depletion and amortization expenses related to Nelson acquisition.

Taxes other than income taxes

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

	1st quarter of			
	2006		2005	
	In Russia	International	In Russia	International
	(millions of US dollars)			
Mineral extraction tax	1,599	–	1,117	–
Social security taxes and contributions	86	11	74	8
Property tax	49	6	80	5
Other taxes	12	8	7	6
	1,746	**25**	**1,278**	**19**
Total		**1,771**		**1,297**

The increase in taxes other than income taxes resulted primarily from a $482 million increase in mineral extraction tax, which is linked to international crude oil prices (see "Tax burden" on page 5).

Excise and export tariffs

Our excise and export tariffs include taxes on sales of refined products and export tariffs on export of crude oil and refined products. Excise and export tariffs increased by $910 million, or 51.3%, compared to the first quarter of 2005. The increase in export tariff expenses resulted from a growth in export tariff rates (see "Tax burden" on page 5). The increase in international excise taxes on refined products resulted from commencement of our operations in Finland, and an increase in volumes of products sold by our international subsidiaries.

	1st quarter of			
	2006		2005	
	In Russia	International	In Russia	International
	(millions of US dollars)			
Excise tax and sales taxes on refined products	167	577	144	507
Export tariffs	1,938	3	1,123	1
	2,105	**580**	**1,267**	**508**
Total		**2,685**		**1,775**

Exploration expenses

During the first quarter of 2006 the amount charged to exploration expense remained on the same level as in the first quarter of 2005.

Gain (loss) on disposals and impairments of assets

Gain on disposals of assets in the first quarter of 2006 amounted to $8 million compared to $17 million loss in the first quarter of 2005.

These gains and losses include the financial result from disposals of a number of non-core assets and individually insignificant impairments on non-performing business units.

Interest expense

Interest expense in the first quarter of 2006 increased by $7 million compared to the first quarter of 2005. The increase is explained by accrued interest expense related to the loan of $1,934 million, which the Group obtained to finance the acquisition of Nelson. At the same time this factor was compensated in the first quarter of 2006 by refinancing of our long-term indebtedness with lower interest rates.

Income taxes

Our total income tax expense increased by $216 million, or 47.2%, compared to the first quarter of 2005, due to an increase of income before income tax by $725 million, or 44.3%.

Our effective income tax rate in the first quarter of 2006 was 28.5% (in the first quarter of 2005 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.

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

	1st quarter of	
	2006	**2005**
Income before income taxes	**2,363**	**1,638**
Add back:		
Depreciation and amortization	408	284
Interest expense	62	55
Interest and dividend income	(27)	(18)
EBITDA	**2,806**	**1,959**

Liquidity and capital resources

	1st quarter of 2006	2005
	(million US dollars)	
Net cash provided by operating activities	1,276	729
Net cash used in investing activities	(1,169)	(1,109)
Net cash (used in) provided by financing activities	(101)	322
Net debt	3,322	2,971
Current ratio	2.18	1.76
Total debt to equity	18%	19%
Long term debt to long term debt and equity	12%	10%

Our primary source of cash flow is funds generated from our operations. During the first quarter of 2006 cash generated by operating activities was $1,276 million, an increase of $547 million compared to the first quarter of 2005. In the first quarter of 2006 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 expenses.

Moreover, in the first quarter of 2006 our operating cash inflows were significantly affected by an increase of working capital by $671 million compared to January 1, 2006. This was mainly caused by:

- an increase in trade accounts and notes receivable by $593 million, which resulted from an increase in the price of crude oil and refined products and expansion of marketing activities
- an increase of inventory by $736 million, which resulted from increased volumes of crude oil and refined products in stock and increased purchase prices.

At the same time, the change in working capital was partly compensated by:

- an increase in trade accounts and notes payable by $268 million, which resulted from an increase in volumes of purchased crude oil and refined products and growth of related prices
- a decrease in current VAT and excise recoverable balance by $452 million.

During the first quarter of 2006 the Company spent $1,108 million on capital investments and acquisitions of interests in other companies, which was $13 million more than in the first quarter of 2005. In the first quarter of 2006 we paid $23 million (a decrease of $187 million compared to the first quarter of 2005) mainly for acquisitions of minority interests in our subsidiaries.

In the first quarter of 2006 the result of our financing activity was an outflow of $101 million compared to an inflow of $322 million in the respective period of 2005. This reduction of cash inflow resulted from redemption of long-term indebtedness, which was $402 million more than in the first quarter of 2005. In addition, in the first quarter of 2006 the Group made an advance amounting to $150 million for the purchase of the Company's stock under our capital management program.

Analysis of capital expenditures

	1st quarter of 2006	2005
	(millions of US dollars)	
Exploration and production		
Russia	728	571
International	111	83
Total exploration and production	839	654
Refining, marketing and distribution		
Russia	177	157
International	106	103
Total refining, marketing and distribution	283	260
Chemicals		
Russia	19	5
International	7	5
Total chemicals	26	10
Other	15	14
Total capital expenditures*	**1,163**	**938**
Acquisitions of subsidiaries**		
Exploration and production		
Russia	–	–
International	–	–
Total exploration and production	–	–
Refining, marketing and distribution		
Russia	9	1
International	–	219
Total refining, marketing and distribution	9	220
Chemicals		
Russia	–	–
International	–	–
Total chemicals	–	–
Other	14	–
Less cash acquired	**–**	**(10)**
Total	**23**	**210**

* Including non-cash transactions.
** Including prepayments related to acquisitions of subsidiaries and minority shareholding interest.

Capital expenditures, including non-cash transactions, during the first quarter of 2006 amounted to $1,163 million, $225 million more than in the same period of the previous year. The growth was mainly caused by expenditures in our exploration and production segment, which increased by $185 million compared to the first quarter of 2005. The growth in exploration and production capital expenditures in new regions amounted to $34 million. The capital expenditures in traditional exploration regions of the Western Siberia increased by $57 million.

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

Exploration and production	1st quarter of 2006	2005
	(millions of US dollars)	
Northern Timano-Pechora	219	141
Yamal	58	86
Caspian region	45	61
Total	**322**	**288**