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

The following report represents management's discussion and analysis of the financial condition and results of operations of OAO LUKOIL as of March 31, 2007 and for the three months ended March 31, 2006 and 2007 and significant trends that may affect its 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 subsidiaries and equity affiliates. 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 were translated into barrels using an average conversion rate of 7.33 barrels per tonne. Translations of cubic meters to cubic feet were made at the rate of 35.31 cubic feet per cubic meter. Translations of barrels of crude oil into barrels of oil equivalent ("BOE") were made at the rate of 1 barrel per BOE and of cubic feet into BOE at the rate of 6 thousand cubic feet per BOE.

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

Key financial and operational results

	3 months of		Change, %
	2007	**2006**	
Sales (including excise and export tariffs) (millions of US dollars)	15,652	14,943	4.7
Net income (millions of US dollars)	1,299	1,689	(23.1)
EBITDA (millions of US dollars)	2,432	2,806	(13.3)
Earnings per share of common stock (US dollars)			
Basic earnings	1.56	2.04	(23.5)
Diluted earnings	1.56	2.04	(23.5)
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	201,537	187,891	7.3
Crude oil production by the Group including our share in equity affiliates (thousands of tonnes)	24,431	22,979	6.3
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	3,581	3,139	14.1
Refined products produced by our subsidiaries (thousands of tonnes)	11,424	11,279	1.3

During the first quarter of 2007 our net income was $1,299 million, which is $390 million, or 23.1%, less than in the first quarter of 2006.

Our performance was influenced by the movements in the international crude oil and refined products prices, the increase in the export tariffs in Russia and an increase in the transportation tariffs, along with an increase in operating expenses. However, these negative factors were partly offset by increased hydrocarbon production. These and 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, Colombia, and Northern and Western Africa

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 7, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of refining crude oil and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However we present the financial data for each in Note 22 "Segment information" to our interim consolidated financial statements.

Executive overview

Recent developments

In December 2006, the Group entered into an agreement with ConocoPhillips, the related party, to purchase 376 petrol stations in Europe, including 156 in Belgium and Luxembourg, 49 in Finland, 44 in the Czech Republic, 30 in Hungary, 83 in Poland and 14 in Slovakia, for approximately $436 million. Under the agreement the purchase price is subject to finalization of working capital and other adjustments. On April 30, 2007, we completed the acquisition of the petrol stations located in Finland. We intend to re-brand these stations as Teboil stations within one year. On June 1, 2007, the acquisition of remaining petrol stations in other European countries was completed. The remaining petrol stations will be re-branded as LUKOIL stations.

In November 2006, a Group company entered into an agreement with Mittal Investments S.A.R.L. to sell 50% of its interest in Caspian Investment Resources Ltd. ("Caspian", formerly Nelson Resources Limited), which has exploration and production operations in western Kazakhstan, for $980 million. This transaction was completed on April 20, 2007. In addition, Mittal Investments S.A.R.L. paid a liability in the amount of approximately $175 million, which represented 50% of Caspian's outstanding debt to Group companies.

In January 2007, a Group company acquired the remaining 34.0% of the share capital of OOO Geoilbent for $300 million. The acquisition increased the Group's ownership in OOO Geoilbent to 100%. Prior to this acquisition the Group accounted for its investment using the equity method of accounting due to the fact that the minority shareholder held substantive participating rights. OOO Geoilbent is an exploration and production company operating in the West Siberian region of the Russian Federation.

In December 2006, the Group sold its 100% stakes in LUKOIL Shelf Limited and LUKOIL Overseas Orient Limited, which owned and operated the Astra jack-up rig for approximately $40 million.

In June 2006, the Group acquired 41.81% of the share capital of OAO Udmurtnefteproduct for $25 million. OAO Udmurtnefteproduct is a Russian refined product distribution company, operating more than 100 petrol stations in the Udmurt Republic of the Russian Federation.

In June 2006, a Group company acquired 100% of the share capital of Khanty-Mansiysk Oil Corporation ("KMOC") from Marathon Oil Corporation for $847 million (including $249 million repayment of KMOC debt), which is subject to finalization of working capital and other adjustments in accordance with the purchase agreement. KMOC 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's subsidiaries operate oil and gas fields in the West Siberian region of the Russian Federation.

In December 2005, the Company made a decision to sell ten tankers. A Group company finalized the sale of eight tankers in May 2006 for a price that approximated their carrying value of $190 million. The sale of the remaining two tankers is expected to be finalized in July 2007 for a price that approximates their carrying value of $75 million.

Operational highlights

Hydrocarbon production

	3 months of 2007	3 months of 2006	Change, %
Daily production of hydrocarbons, including Company's share in equity affiliates (thousand BOE per day)	2,239	2,087	7.3
- crude oil	2,005	1,882	6.5
- natural and petroleum gas*	234	205	14.1
Hydrocarbon extraction expenses (US dollar per BOE)	3.34	2.82	18.4

* Gas available for sale (excluding gas produced for our own consumption).

Crude oil production. In the first quarter of 2007 we increased our total daily crude oil production by 6.5% compared to the same period of 2006 (including the Company's share in equity affiliates) and produced 180.5 million barrels, or 24.4 million tonnes of crude oil.

The following table represents our production in the first quarters of 2007 and 2006 by major regions.

(thousands of tonnes)	3 months of 2007	Change to 2006			3 months of 2006
		Total, %	Change in structure	Organic growth	
Western Siberia	15,170	7.3	750	278	14,142
Komi Republic	3,045	6.4	–	184	2,861
Ural region	2,753	5.5	–	143	2,610
Volga region	740	(0.5)	–	(4)	744
Northern Timan-Pechora	528	18.7	–	83	445
Other in Russia	513	4.7	–	23	490
Crude oil production in Russia	22,749	6.8	750	707	21,292
Crude oil produced internationally	1,006	23.1	–	189	817
Total crude oil produced by consolidated subsidiaries	**23,755**	**7.4**	**750**	**896**	**22,109**
Our share in crude oil production of equity affiliates:					
in Russia	144	(62.4)	(250)	11	383
outside Russia	532	9.2	–	45	487
Total crude oil production	**24,431**	**6.3**	**500**	**952**	**22,979**

The main oil producing region of the Company is Western Siberia. In the oilfields of Western Siberia the Group's subsidiaries produced 63.9% of its crude oil in the first quarter of 2007 (64.0% in the same period of 2006). In order to maintain stable organic growth of oil production in traditional producing regions we constantly improve and optimize our oil production methods. As a result, our average production per well in the Russian Federation increased from 11.15 tonnes a day in the first quarter of 2006 to 11.25 tonnes a day in the first quarter of 2007. Along with organic growth, we increased crude oil production in Western Siberia due to acquisition of the remaining interest in OOO Geoilbent in January 2007, and dismantling by OOO LUKOIL-Western Siberia and Brazos Petroleum Overseas Limited (a Group affiliated company) their joint activity at the end of 2006. Before 2007, the crude oil production of Geoilbent and the joint activity were accounted for using equity method. Beginning from 2007, all crude oil production of former joint activity was transferred to OOO LUKOIL-Western Siberia. Also, in June 2006 we acquired KMOC, which subsidiaries produced 390 thousand tonnes of crude oil in the first quarter of 2007.

In addition to our production, we purchase crude oil in Russia and on international markets. In Russia we primarily purchase crude oil from affiliated producing companies and other producers, including vertically integrated oil 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 for trading activities, for supplying our overseas refineries or for processing at third parties refineries. During the first quarter of 2007 we purchased 248 thousand tonnes in order to process at our and at third parties' overseas refineries compared to 518 thousand tonnes in the first quarter of 2006.

	3 months of				
	2007		2006		Change, %
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	
Crude oil purchases in Russia	154	21	2,903	396	(94.7)
Crude oil purchases internationally	6,538	892	10,438	1,424	(37.4)
Total crude oil purchased	**6,692**	**913**	**13,341**	**1,820**	**(49.8)**

The volume of crude oil purchased in Russia during the first quarter of 2007 was 375 thousand tonnes less than in the same period of 2006 as a result of changes in Group structure. The crude oil purchased in the first quarter of 2006 included transactions with our former 66% equity affiliate OOO Geoilbent. In January 2007, we acquired the remaining 34% of OOO Geoilbent, thereby increasing the Group's ownership stake to 100%. The volume of crude oil purchased internationally during the first quarter of 2007 decreased by 532 thousand tonnes compared to the same period of 2006, which was the result of the decreased purchases of crude oil for our overseas refining and a decrease in our trading activities.

Gas production. In the first quarter of 2007 we produced 3,581 million cubic meters of gas available for sale (including our share in equity affiliates), an increase of 14.1% compared to the first quarter of 2006. This increase resulted from an increase in production from the Nakhodkinskoe gas field, which totaled 2,162 million cubic meters of natural gas in the first quarter of 2007 (1,775 million cubic meters in the same period of 2006).

In order to ensure continuous supply of the natural gas from the Nakhodkinskoe gas field to market, in October, 2003, we signed an agreement with OAO Gazprom. In accordance with the agreement OAO Gazprom undertakes to purchase the gas at the Yamburg Compressor Plant and to transport it through the Russian Unified Gas Supply System. In September 2006, we entered into an additional agreement with OAO Gazprom, under which OAO Gazprom undertakes to purchase at least 8 billion cubic meters of gas annually at a price of 1,059 rubles per 1,000 cubic meters.

Refining, marketing and trading

We operate four refineries located in European Russia and three refineries located overseas – in Bulgaria, Ukraine and Romania. In August 2005 we closed the Odessa refinery to commence a wide-scale upgrade. We plan to complete the upgrade and to put the Odessa refinery back into operation in the fourth quarter of 2007 with an annual capacity of 2.8 million tonnes.

Production of refined products at our refineries in the first quarter of 2007 was nearly the same as in the first quarter of 2006. Russian refineries increased production by 4.9%. Our refinery throughput in Russia in the first quarter of 2007 was lower by approximately 0.2 million tonnes than planned due to a fire at the Volgograd refinery in March 2007. We recovered the refinery's capacity at the end of April 2007. The production of overseas refineries decreased by 14.4% as a result of the planned upgrade of our Bulgarian refinery.

The Group is constantly improving the refined products mix at our refineries in order to produce higher quality and more profitable products. In the first quarter of 2007 we produced 1,673 thousand tonnes of Euro 4 and Euro 5 diesel fuel at our Russian refineries (in the first quarter of 2006 – 1,459 thousand tonnes), and 202 thousand tonnes of Euro 3 gasoline (in the first quarter of 2006 – 50 thousand tonnes).

Along with our own production of refined products we refined crude oil at third party refineries. In Russia we refined 897 thousand tonnes of crude oil at third party refineries during the first quarter of 2007, primarily to supply our network in the Ural region (in the first quarter of 2006 – 797 thousand tonnes). To supply our retail networks in Eastern Europe we refined 150 thousand tonnes of crude oil at third party refineries in Belorussia and Serbia in the first quarter of 2007 (in the first quarter of 2006 – 316 thousand tonnes). Beginning from March 2007, we suspended delivery of crude oil to Belorussia for refining due to changes in the customs legislation, which led to decreased profitability of such operations.

Our marketing and trading activities mainly include wholesale and bunkering operations in Western Europe, South-East Asia and Central America and retail operations in the USA, Eastern Europe, Baltic states and some other regions. The total volume of refined products purchased from third parties for wholesale and to supply retail networks was 9,002 thousand tonnes, or $4,388 million, in the first quarter of 2007 (9,230 thousand tonnes, or $4,649 million, in the first quarter of 2006).

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

The following table represents volumes of refinery throughput, refined products produced and purchased.

	3 months of 2007	3 months of 2006	Change, %
	(thousand barrels per day)		
Own refinery throughput	984	978	0.6
	(thousand of tonnes)		
Refined products produced at the Group refineries in Russia*	9,604	9,154	4.9
Refined products produced at the Group refineries outside Russia	1,820	2,125	(14.4)
Total refined products produced at the Group refineries	**11,424**	**11,279**	**1.3**
Refined products purchased in Russia	300	296	1.4
Refined products purchased internationally	9,062	9,253	(2.1)
Total refined products purchased	**9,362**	**9,549**	**(2.0)**

* Excluding production of mini refineries.

Exports of crude oil and refined products from Russia

Our export of crude oil from Russia in the first quarter of 2007 was at the same level as in the first quarter of 2006. During the first quarter of 2007, we exported from Russia 47.4% of our total domestic crude oil production (in the same period of 2006 – 50.2%). 1.9% of crude oil produced was exported bypassing the trunk oil pipeline system of OAO AK Transneft (“Transneft”) (in the first quarter of 2006 – 2.8%). We increased our exports through Transneft primarily by means of Baltic Pipeline System (“BPS”). The volume of crude oil, exported using the BPS (through the Primorsk terminal), increased in the first quarter of 2007 up to 3,698 thousand tonnes, or by 32.7%, compared to the same period of 2006.

The crude oil exported through our own export infrastructure was 417 thousand tonnes in the first quarter of 2007, 29.8% less than the same period of 2006 primarily due to a decrease in volumes exported through the Varandey terminal.

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

	3 months of 2007 (thousand of barrels)	3 months of 2007 (thousand of tonnes)	3 months of 2006 (thousand of barrels)	3 months of 2006 (thousand of tonnes)	Change, %
Exports of crude oil using Transneft export routes	75,785	10,339	73,930	10,086	2.5
Exports of crude oil bypassing Transneft	3,203	437	4,420	603	(27.5)
Total crude oil exports	**78,988**	**10,776**	**78,350**	**10,689**	**0.8**

The Group owns and operates the Vysotsk export terminal. Currently we use the terminal to export refined products: in the first quarter of 2007 we exported 2,288 thousand tonnes of refined products through this terminal (in the first quarter of 2006 – 1,756 thousand tonnes). In September 2006, we completed the construction of the Vysotsk terminal and expanded its capacity up to 11.6 million tonnes per year and total reservoir volume up to 460 thousand cubic meters. In the future we expect to use the terminal to export both crude oil and refined products, depending on market conditions.

In the first quarter of 2007, we exported from Russia 5.9 million tonnes of refined products, an increase of 37.2% compared to the same period of 2006. We export from Russia primarily diesel fuel, fuel oil and gasoil. These products accounted for approximately 86% of our refined products export volumes.

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 2007, the Brent crude oil price fluctuated between $50 and $70 per barrel and reached its peak of $68.64 at the end of March. At the same time, average Brent crude prices in the first quarter of 2007 were 6.5% lower compared to those in the same period of 2006.

The increase in crude oil prices that started in mid-January, 2007 was largely driven by geopolitical concerns rather than by fundamental factors as the market is adequately supplied with crude oil and stocks are at comfortable levels. In addition, such factors as refinery bottlenecks and early concerns regarding summer gasoline supplies have continued to support prices.

According to the International Energy Agency (IEA), in the first quarter of 2007 the world demand for crude oil and, subsequently, refined products increased by 0.5% compared to the same period of 2006, averaging 85.3 million barrels per day. IEA forecasts that world demand for crude oil in 2007 would be 85.7 million barrels per day, or 1.8% higher than in 2006. Based on OPEC data, its actual daily production in the first quarter of 2007 amounted to 29.99 million barrels per day, or 3.0% less than in 2006. OPEC has an obvious intention to maintain the price above $50 per barrel, which is mainly grounded by the oil price level in the budgets of OPEC countries. This situation can be viewed as an indicator that crude oil prices may remain relatively high in the medium-term.

Substantially all of the crude oil that we export is Urals blend. The following table shows the average crude oil and refined product prices for the first quarters of 2007 and 2006.

	3 months of		Change, %
	2007	**2006**	
	(in US dollars per barrel, except for figures in percent)		
Brent crude	57.76	61.79	(6.5)
Urals crude (CIF Mediterranean)*	54.26	58.26	(6.9)
Urals crude (CIF Rotterdam)*	54.36	58.15	(6.5)
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam)	247.37	287.53	(14.0)
Diesel fuel (FOB Rotterdam)	514.80	542.68	(5.1)
High-octane gasoline (FOB Rotterdam)	553.70	564.86	(2.0)

Source: Platts.

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

Domestic crude oil and refined products prices

Substantially all crude oil produced in Russia is produced by vertically integrated oil companies such as ours. As a result, most transactions are between affiliated entities within vertically integrated groups. Thus, there is no concept of a benchmark domestic market price for crude oil. The price of crude oil that is produced but not refined or exported by one of the vertically integrated oil companies is generally determined on a transaction-by-transaction basis against a background of world market prices, but with no direct reference or correlation. At any time there may exist significant price differences between regions for similar quality crude oil as a result of the competition and economic conditions in those regions.

Domestic prices for refined products are determined to some extent by world market prices, but they are also directly affected by local demand and competition.

The table below represents average domestic wholesale prices of refined products in the first quarters of 2007 and 2006.

	3 months of 2007	3 months of 2006	Change, %
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil	103.18	169.35	(39.1)
Diesel fuel	419.46	448.49	(6.5)
High-octane gasoline (Regular)	495.37	511.33	(3.1)
High-octane gasoline (Premium)	613.60	563.42	8.9

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, ruble inflation and movements of exchange rates can significantly affect the results of our operations. In particular, our operating margins are generally adversely affected by the 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 change in the ruble-dollar exchange rate, and the level of real ruble appreciation.

	3 months of 2007	3 months of 2006
Ruble inflation (CPI), %	3.4	5.0
Change of the ruble-dollar exchange rate, %	1.2	3.5
Real appreciation of the ruble against the US dollar*, %	4.7	8.8
Average exchange rate for the period (ruble to US dollar)	26.31	28.16
Exchange rate at the end of the period (ruble to US dollar)	26.01	27.76

* Devaluation of purchasing power of the US dollar in the Russian Federation was calculated on basis of the ruble-dollar exchange rates and the level of inflation in Russia.

Tax burden

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

		3 months of 2007*	3 months of 2006*	Change, %
Export tariffs on crude oil	\$/tonne	180.04	167.28	7.6
Export tariffs on refined products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	\$/tonne	133.61	129.94	2.8
Liquid fuels (fuel oil)	\$/tonne	71.94	69.98	2.8
Excise on refined products				
Straight-run gasoline	RUR/tonne	2,657.00	2,657.00	–
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	1,902.93	2,207.93	(13.8)
Natural gas	RUR/1,000 m^3	147.00	147.00	–

* Average values.

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

		3 months of		Change, %
		2007*	2006*	
Excise on refined products				
Straight-run gasoline	$/tonne	100.99	94.35	7.0
High-octane gasoline	$/tonne	137.93	128.86	7.0
Low-octane gasoline	$/tonne	100.99	94.35	7.0
Diesel fuel	$/tonne	41.05	38.35	7.0
Motor oils	$/tonne	112.16	104.79	7.0
Mineral extraction tax				
Crude oil	$/tonne	72.33	78.40	(7.7)
Natural gas	$/1,000 m^3	5.59	5.22	7.0

* Average values.

In the first quarter of 2007 the tax rates specific to the oil industry in Russia slightly increased compared to the first quarter of 2006, with exception of crude oil extraction tax. The decrease in the crude oil extraction tax was caused by the movements of the Urals crude oil price, which was lower in the first quarter of 2007 compared to the same period of the previous year. An increase in the export tariffs resulted from specific feature of tax rate calculation described below. The methods to determine the rates for such taxes are presented below.

Crude oil extraction tax rate. The base rate is 419 rubles per metric tonne extracted and it is adjusted depending on the international market price of Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals blend international market price for a tax period is less than or equal to $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). This method of determining the crude oil extraction tax was applied until December 31, 2006.

Effective from January 1, 2007, the crude oil extraction tax rate varies depending on the development and depletion of a particular oilfield. The tax rate is zero for extra-heavy crude oil and for crude oil produced in certain regions of Eastern Siberia, depending on the period and volume of production. For crude oil produced in other regions the tax rate calculation described above should be multiplied by a coefficient characterizing the depletion of a particular oilfield. The coefficient is equal to 1.0 for the oilfields with depletion below 80%. Each 1% increase of depletion of a particular oilfield above 80% results in a decrease of the coefficient by 0.035. The minimum value of the coefficient is 0.3. The depletion level assessment is based on crude oil production and reserves information reported to the Russian government.

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 has been 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.

The Russian government sets export tariff rates for two-month periods. The rates in a specific two-month period are based on Urals blend international market prices in the immediately preceding two months. Thus, the calculation method that the Russian government employs to determine export tariff rates results in a two-month gap between movements in crude oil prices and the revision of the export duty rate based on those crude oil prices.

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. On January 1, 2007, customs regulations between Russia and Belorussia were changed. Crude oil exported from Russia to Belorussia is now subject to export duties. The latest amendments made by customs authorities set a coefficient of 0.293 to be applied from February 1, 2007 to the regular export duty rate set by the Russian Government for calculation of export duty on crude oil exports from Russia to Belorussia.

Transportation of crude oil and refined products in Russia

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

Transportation of crude oil produced in Russia to refineries and export destinations is performed primarily through the trunk oil pipeline system of state-owned Transneft. 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 the limited capacity of Russian transportation infrastructure on the most profitable export routes. Moreover, the crude oil transported by Transneft is 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. Alternative access to international markets bypassing Transneft export routes can be obtained through railroad transport, by tankers, and own export infrastructure of oil producing companies. Our own export infrastructure includes the Vysotsk terminal in the Leningrad region, the Varandey terminal in the Nenetsky Autonomous District and the Izhevskoye terminal in the Kaliningrad region. We use the Varandey terminal to export crude oil produced by our joint venture with ConocoPhillips located in Northern Timan-Pechora. The Izhevskoye terminal exports crude oil primarily produced by OOO LUKOIL-Kaliningradmorneft, our subsidiary operating in the Kaliningrad region, and refined products.

Transportation of refined products in Russia is performed by railway transport and pipeline system of OAO AK Transnefteproduct. Russian railway infrastructure owned and operated by OAO Russian Railways. Both companies are state-owned. Besides transportation of refined products OAO Russian Railways provides oil companies with crude oil transportation services. We transport the major part of our refined products by railway transport.

As the activities of the above mentioned companies fall under the scope of natural monopolies, the fundamentals of their tariff policies are defined by the state authorities to ensure the balance of interests of the state and all participants in the transportation process. Transportation tariffs of natural monopolies are set by the Federal Service for Tariffs of the Russian Federation ("FST"). The tariffs are dependent on transport destination, delivery volume, distance of transportation, and several other factors. Changes in the tariffs depend on inflation forecasts by the Ministry of Economic Development and Trade of the Russian Federation, the investment needs of owners of transport infrastructure, other macroeconomic factors, and compensation of economically reasonable expenses, incurred by entities of natural monopolies. Tariffs are to be revised by FST at least annually.

According to the Federal Statistics Service of the Russian Federation, during the year ended March 31, 2007 transportation tariffs increased as follows: transportation of crude oil by pipeline – 7.7%, transportation of refined products by pipeline – 15.9%, transportation by railway – 7.8%. These amounts differ from actual changes in tariffs for transportation of crude oil and refined products by the Group for the period considered due to the specifics in the routes and geography of our supplies from the Russian transportation averages.

Three months ended March 31, 2007 compared to three months ended March 31, 2006

Results of operations

The table below details certain income and expense items from our consolidated statements of income for the periods indicated.

	3 months of		Change, %
	2007	**2006**	
	(millions of US dollars)		
Revenues			
Sales (including excise and export tariffs)	15,652	14,943	4.7
Equity share in income of affiliates	84	98	(14.3)
Total revenues	**15,736**	**15,041**	**4.6**
Costs and other deductions			
Operating expenses	(1,443)	(925)	56.0
Cost of purchased crude oil, gas and products	(5,050)	(5,344)	(5.5)
Transportation expenses	(987)	(779)	26.7
Selling, general and administrative expenses	(663)	(761)	(12.9)
Depreciation, depletion and amortization	(547)	(408)	34.1
Taxes other than income taxes	(1,829)	(1,771)	3.3
Excise and export tariffs	(3,268)	(2,685)	21.7
Exploration expense	(75)	(35)	114.3
Gain on disposals and impairments of assets	2	8	(75.0)
Income from operating activities	**1,876**	**2,341**	**(19.9)**
Interest expense	(77)	(62)	24.2
Interest and dividend income	29	27	7.4
Currency translation gain	42	92	(54.3)
Other non-operating expense	(19)	(25)	(24.0)
Minority interest	(14)	(10)	40.0
Income before income taxes	**1,837**	**2,363**	**(22.3)**
Current income taxes	(630)	(769)	(18.1)
Deferred income taxes	92	95	(3.2)
Total income tax expense	**(538)**	**(674)**	**(20.2)**
Net income	**1,299**	**1,689**	**(23.1)**
Basic earnings per share of common stock (in US dollars)	1.56	2.04	(23.5)
Diluted earnings per share of common stock (in US dollars)	1.56	2.04	(23.5)

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

Sales revenues

Sales breakdown	3 months of 2007	2006	Change, %
	(millions of US dollars)		
Crude oil			
Export and sales on international markets other than CIS	3,819	3,566	7.1
Export and sales to CIS	190	237	(19.8)
Domestic sales	82	49	67.3
	4,091	**3,852**	**6.2**
Refined products			
Export and sales on international markets			
Wholesale	6,918	6,780	2.0
Retail	1,599	1,506	6.2
Domestic sales			
Wholesale	1,202	1,352	(11.1)
Retail	720	528	36.4
	10,439	**10,166**	**2.7**
Petrochemicals			
Export and sales on international markets	347	298	16.4
Domestic sales	156	139	12.2
	503	**437**	**15.1**
Other	**619**	**488**	**26.8**
Total sales	**15,652**	**14,943**	**4.7**

Sales volumes	3 months of 2007	2006	Change, %
Crude oil	(thousands of barrels)		
Export and sales on international markets other than CIS	71,365	62,144	14.8
Export and sales to CIS	5,424	7,088	(23.5)
Domestic sales	3,115	2,206	41.2
Crude oil	(thousands of tonnes)		
Export and sales on international markets other than CIS	9,736	8,478	14.8
Export and sales to CIS	740	967	(23.5)
Domestic sales	425	301	41.2
	10,901	**9,746**	**11.9**
Refined products	(thousands of tonnes)		
Export and sales on international markets			
Wholesale	14,250	13,662	4.3
Retail	1,651	1,638	0.8
Domestic sales			
Wholesale	3,499	4,373	(20.0)
Retail	1,003	853	17.6
	20,403	**20,526**	**(0.6)**
Total sales volume of crude oil and refined products	**31,304**	**30,272**	**3.4**

Realized average sales prices	3 months of				
	2007		2006		Change, %
	($/barrel)	($/tonne)	($/barrel)	($/tonne)	
Average realized price international					
Oil (excluding CIS)	53.52	392.27	57.39	420.66	(6.7)
Oil (CIS)	35.10	257.30	33.39	244.74	5.1
Refined products					
Wholesale		485.45		496.30	(2.2)
Retail		968.70		919.34	5.4
Average realized price within Russia					
Oil	26.32	192.90	22.30	163.43	18.0
Refined products					
Wholesale		343.40		309.18	11.1
Retail		718.10		619.34	15.9

During the first quarter of 2007 our revenues increased by $709 million, or by 4.7%, compared to the same period of 2006.

The total volume of crude oil and refined products sold amounted to 31.3 million tonnes, which is nearly at the same level as in the first quarter of 2006. Our revenues from crude oil sales increased by $239 million, or by 6.2%. Our sales of refined products increased by $273 million, or by 2.7%.

Sales of crude oil and refined products on international markets, including the CIS, accounted for 84.3% of the total sales volume in the first quarter of 2007 (81.8% in the first quarter of 2006).

Sales of crude oil

The 6.2% increase in our total crude oil sales from the first quarter of 2006 to the first quarter of 2007 was attributable primarily to increases in our international crude oil sales revenues. Our international crude oil sales revenue (excluding CIS), which accounted for approximately 93.4% of our total crude oil sales revenue in the first quarter of 2007 and 92.6% in the same period of 2006, increased by 7.1%, primarily due to a 14.8% increase in sales volumes. At the same time, from the first quarter of 2006 to the first quarter of 2007, our average realized prices for our international sales outside of the CIS decreased by 6.7%, while our average realized prices for the sales in the CIS increased by 5.1%. Some shift in crude oil volumes between domestic and CIS sales had no material effect on our revenues.

Sales of refined products

Sales of refined products made up 66.7% of our total revenues (65.2% in terms of volumes sold) compared to 68.0% (67.8% – in terms of volumes) in the same period of 2006. The portion of our domestic refined product sales in the first quarter of 2007 was 14.4% of the total tonnes sold (in the first quarter of 2006 – 17.2%), but represented 12.3% of our total revenues (in the first quarter of 2006 – 12.5%). The decrease in our domestic refined products sales as a percentage of total refined products sales was due to the increase in volumes exported from Russia.

The average realized wholesale price of refined products outside Russia decreased by $10.85 per tonne, or by 2.2%, compared to the first quarter of 2006. Wholesale volumes of refined products sold outside Russia increased by 588 thousand tonnes, or by 4.3%, due to increased volumes of export from Russia. As a result, our revenue from the wholesale sales of refined products outside Russia increased by $138 million, or by 2.0%.

During the first quarter of 2007, retail sales of refined products outside Russia were approximately at the same level as in the first quarter of 2006. Average retail prices increased up to $968.70 per tonne, or by 5.4%. As a result, our revenue from retail sales increased by $93 million, or by 6.2%, compared to the first quarter of 2006. In the first quarter of 2007, revenue from retail sales was 18.8% (in the first quarter of 2006 – 18.2%) of total refined products sales outside Russia. Our international retail sales include supplies of refined products to third party retail networks within the bounds of long-term contracts with pricing similar to retail pricing.

The average domestic realized price on refined products in the first quarter of 2007 increased by $34.22 per tonne, or by 11.1%, compared to the same period of 2006. The wholesale sales of refined products within Russia in the first quarter of 2007 decreased by 874 thousand tonnes, or by 20.0%, compared to the first quarter of 2006. As a result, our revenue from the wholesale of refined products on the domestic market decreased by $150 million, or by 11.1%. Volumes of refined products, which were not utilized in the domestic wholesale market were directed to a retail segment or exported from Russia.

Retail sales within Russia in the first quarter of 2007 increased by 150 thousand tonnes, or by 17.6%, compared to the first quarter of 2006. Average retail prices increased up to $718.10 per tonne, or by 15.9%. As a result, our revenue from retail sales increased by $192 million in the first quarter of 2007, or by 36.4%, compared to the same period of 2006. Revenue from retail sales was 37.5% of total refined products sales in Russia in the first quarter of 2007 (in the first quarter of 2006 – 28.1%).

Sales of petrochemical products

Revenue from sales of petrochemical products increased in the first quarter of 2007 by $66 million, or by 15.1%, compared to the first quarter of 2006, due to an increase in prices for petrochemical products.

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 in the first quarter of 2007 by $131 million, or by 26.8%, generally as a result of the growth in gas and gas refined products sales. Sales of natural gas amounted to $100 million in the first quarter of 2007 ($53 million in the same period of 2006). Our major purchaser of natural gas produced in Russian Federation is OAO Gazprom. In the first quarter of 2007 we sold 2,018 million cubic meters to OAO Gazprom at an average realization price of $40 per 1,000 cubic meters (1,775 million cubic meters at $22 per 1,000 cubic meters in the first quarter of 2006).

Equity share in income of affiliates

Compared to the first quarter of 2006, our share in income of affiliates decreased by $14 million, or by 14.3%. The decrease is due to the changes in affiliates' structure.

Operating expenses

Operating expenses include the following types of costs:

	3 months of		
	2007	**2006**	**Change, %**
	(millions of US dollars)		
Hydrocarbon extraction expenses	651	508	28.1
Own refining expenses	192	176	9.1
Refining expenses at third parties refineries	66	40	65.0
Excise included in processing fee paid to third parties refineries*	48	–	–
Petrochemical expenses	64	61	4.9
Crude oil transportation to own refineries	189	171	10.5
Other operating expenses	217	171	26.9
	1,427	**1,127**	**26.6**
Change in operating expenses in crude oil and refined products inventory originated within the Group	16	(202)	–
Total operating expenses	**1,443**	**925**	**56.0**
Cost of purchased crude oil, gas and products	**5,050**	**5,344**	**(5.5)**

*As a result of recent amendments to the Russian tax legislation, effective since January 1, 2007, responsibility to pay excises on refined products (except for straight-run gasoline) was transferred from traders and retailers to refineries. Before 2007 substantial part of excises on realization of refined products produced at third parties refineries was paid by the marketing subsidiaries of the Group and included in "Excise and export tariff" of our results of operations. Currently such excises are included into processing fee.

Compared to the first quarter of 2006, operating expenses increased by $518 million, or by 56.0%, which is mainly explained by change in operating expenses in inventory balances, the growth of hydrocarbon extraction expenses and the increase in refining expenses at third parties refineries. Real appreciation of the ruble against the US dollar is a significant factor affecting our operating expenses in Russia. For the year ended March 31, 2007 the real ruble appreciation was 14.8%.

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

Expenses of the Company's oil and gas 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 2007 our extraction expenses rose by $143 million, or by 28.1%, compared to the first quarter of 2006. The increase resulted from growth of hydrocarbons production by our subsidiaries up to 196.1 million BOE, or by 8.4%, compared to the first quarter of 2006, the effect of the real ruble appreciation, increased expenses of artificial stimulation of reservoirs and expenses for power supply and materials. In the first quarter of 2007, extraction expenses included $12 million of expenses related to crude oil producing companies acquired after March 31, 2006. Our average hydrocarbon extraction cost per barrel of oil equivalent increased from $2.82 to $3.34, or by 18.4%, compared to the first quarter of 2006, but was on the same level as in the fourth quarter of 2006.

Own refining expenses at our refineries increased by $16 million, or by 9.1%, in the first quarter of 2007 compared to the first quarter of 2006.

Refining expenses of our domestic refineries increased by 12.8%, or by $16 million as a result of increased production volume and due to the effect of the real ruble appreciation.

Refining expenses of our international refineries in the first quarter of 2007 remained unchanged, compared to the same period of 2006, despite of the decreased production, due to significant share of fixed costs in our refining expenses.

Refining expenses at third parties refineries. Along with our own production of refined products we refined crude oil at third parties refineries both in Russia and overseas. Related expenses for the first quarter of 2007 increased by 65.0% compared to the same period of 2006. This resulted from an increase in refining volumes and costs in Russia.

Crude oil transportation to own refineries increased by $18 million, or by 10.5%, compared to the first quarter of 2006 due to an increase in transportation tariffs.

Other operating expenses include operating expenses of our gas processing plants, the costs of other services provided and goods not related to our core 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 increased by $46 million, or by 26.9%, compared to the same period of 2006. This was due to increased amount of other services provided by the Group.

Change in operating expenses in crude oil and refined products inventory originated within the Group included 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.

Cost of purchased crude oil, gas and products decreased by $294 million in the first quarter of 2007, or by 5.5%, compared to the same period of 2006, due to a decrease in international trading volumes and in crude oil and refined products prices.

Cost of purchased crude oil, gas and products included the result of hedging of international crude oil and refined products sales. In the first quarter of 2007 we recognized a $153 million loss on hedging compared to a loss of $75 million in the first quarter of 2006.

Transportation expenses

Our transportation expenses increased in the first quarter of 2007 by $208 million, or by 26.7%, compared to the first quarter of 2006. This was due to an increase in transportation tariffs, the increased volumes of refined products export from Russia, and overall increase in sales volumes.

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 2007 compared to the same period of the previous year as follows: crude oil sea shipping tariffs increased by 12.0%; crude oil pipeline tariffs increased by 14.6%; railway tariffs for refined products transportation increased by 22.1%.

Selling, general and administrative expenses

Selling, general and administrative 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. In the first quarter of 2007 our selling, general and administrative expenses decreased by $98 million, or by 12.9%, compared to the first quarter of 2006.

The decrease in these expenses was mainly caused by a decrease in costs related to our share-based compensation program for management in the first quarter of 2007. In the first quarter of 2007 such expenses amounted to $30 million compared to $203 million in the first quarter of 2006.

The increase in other components of selling, general and administrative expenses was primarily due to the real ruble appreciation.

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 $139 million, or by 34.1%, compared to the first quarter of 2006. The increase was a result of the Company's capital expenditures and the corresponding increase in depreciable assets. The increase included $21 million of depreciation, depletion and amortization expenses related to our acquisitions, made after March 31, 2006.

Exploration expenses

During the first quarter of 2007, the amount charged to exploration expense increased by $40 million, or by 114.3%, compared to the first quarter of 2006.

We completed the drilling and assessment of two exploratory wells in Saudi Arabia. One of the wells was dry, and its cost of $40 million was charged to expense in the first quarter of 2007. The second well discovered a natural gas reservoir. In the first quarter of 2007, dry hole costs in Russia amounted to $8 million, primarily related to Volga region ($6 million). Geological and geophysical costs, charged to exploration expense in the first quarter of 2007 were incurred primarily in Russia ($12 million in Western Siberia, $8 million in Volga region and $6 million in the Komi Republic and Northern Timan-Pechora).

In the first quarter of 2006, dry hole costs amounted to $10 million, and primarily related to our project in Egypt. Geological and geophysical costs related to projects in Russia (primarily Western Siberia and Northern Timan-Pechora, $8 million and $4 million, respectively) and Uzbekistan ($5 million).

Interest expense

Interest expense in the first quarter of 2007 increased by $15 million, or by 24.2%, compared to the first quarter of 2006. The growth of interest expense was primarily due to a general increase of our indebtedness. Moreover, in the second quarter of 2006, the Group and ConocoPhillips reached an agreement to amend the contractual interest rates related to the financing of our joint venture OOO Naryanmarneftegaz from 0.1% to 6.8-8.2% per annum, which also impacted interest expense.

Taxes other than income taxes

The taxes other than income taxes increased by 3.3% in the first quarter of 2007 compared to the same period of 2006. The decrease of crude oil extraction tax rate by 7.7% was offset by the effect of increased crude oil production in Russia.

	3 months of			
	2007		2006	
	In Russia	International	In Russia	International
	(millions of US dollars)			
Mineral extraction taxes	1,604	–	1,599	–
Social security taxes and contributions	116	12	86	11
Property tax	66	6	49	6
Other taxes	23	2	12	8
	1,809	**20**	**1,746**	**25**
Total		**1,829**		**1,771**

Excise and export tariffs

Our excise and export tariffs include taxes on sales of refined products and export tariffs on the export of crude oil and refined products. Excise and export tariffs increased by $583 million, or by 21.7%, compared to the first quarter of 2006. The increase in export tariff expenses resulted from an increase in export volumes and from an increase in export tariff rates. Because of the two-month lag between the determination of the crude oil export tariff rate and the period of its application we sold crude oil in the first quarter of 2007 at lower prices while we paid export tariffs at higher rates. This resulted in approximately $0.1 billion of negative effect on our income before income tax.

	3 months of			
	2007		2006	
	In Russia	**International**	**In Russia**	**International**
	(millions of US dollars)			
Excise tax and sales taxes on refined products	174	692	167	577
Export tariffs	2,397	5	1,938	3
	2,571	**697**	**2,105**	**580**
Total		**3,268**		**2,685**

Income taxes

Our total income tax expense decreased by $136 million, or by 20.2%, compared to the first quarter of 2006, due to a decrease of income before income tax by $526 million, or by 22.3%.

Our effective income tax rate in the first quarter of 2007 was 29.3% (in the first quarter of 2006 it was 28.5%), 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 net income to EBITDA (earnings before interest, income taxes, depreciation and amortization)

	3 months of	
	2007	**2006**
	(millions of US dollars)	
Net income	**1,299**	**1,689**
Add back:		
Income tax expense	538	674
Depreciation and amortization	547	408
Interest expense	77	62
Interest and dividend income	(29)	(27)
EBITDA	**2,432**	**2,806**

EBITDA is a non-US GAAP financial measure. EBITDA is defined as net income before interest, income taxes and depreciation and amortization. The Company believes that EBITDA provides useful information to investors because it is an indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions and other investments and our ability to incur and service debt. While depreciation and amortization are considered operating costs under US GAAP, these expenses primarily represent the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. Our EBITDA calculation is commonly used as a basis for some investors, analysts and credit rating agencies to evaluate and compare the periodic and future operating performance and value of companies within the oil and gas industry. EBITDA should not be considered in isolation as an alternative to net income, operating income or any other measure of performance under US GAAP. EBITDA does not include our need to replace our capital equipment over time.

Liquidity and capital resources

	3 months of		
	2007	2006	Change, %
	(million US dollars)		
Net cash provided by operating activities	2,020	1,276	58.3
Net cash used in investing activities	(2,184)	(1,169)	86.8
Net cash provided by (used in) financing activities	43	(101)	–
Net debt	5,699	3,322	71.6
Current ratio	2.02	2.18	(7.3)
Total debt to equity	18%	18%	–
Long-term debt to long term debt and equity	12%	12%	–

Operating activities

Our primary source of cash flow is funds generated from our operations. During the first quarter of 2007 cash generated by operating activities was $2,020 million, an increase of 58.3% compared to the first quarter of 2006. In the first quarter of 2007 our operating cash inflows were improved by a decrease of working capital by $237 million compared to January 1, 2007. This was mainly caused by:

- a net decrease by $404 million of VAT receivable balances
- a net decrease by $51 million of income tax receivable balances
- a net decrease by $107 million of accounts receivable related to taxes other than income taxes, excises and export tariffs.

At the same time, the positive effect from decreased working capital was partly offset by:

- a $33 million net increase in trade accounts receivable
- an increase of inventory by $277 million, resulting from increased volumes of crude oil and refined products held.

In the first quarter of 2006 our cash flows from operating activities were significantly affected by an increase of working capital by $671 million, primarily due to a $736 million increase in inventory.

Investing activities

An increase in cash used in investing activities is explained by the increase in capital expenditures by $814 million, or 75.0% compared to the same period of 2006 (for detailed analysis of the capital expenditures see the next page). Also during the first quarter of 2007 the Company paid $246 million on the acquisition of licenses for crude oil exploration and production on the two fields in the Komi Republic.

Financing activities

In the first quarter of 2007 net movements of short-term and long-term debt generated an inflow of $120 million, compared to an inflow of $24 million in the respective period of 2006. This inflow resulted from $156 million of loans received from ConocoPhillips as its part of financing our joint venture in the Timan-Pechora region (previously this loan was accounted for as equity contribution).

During the first quarter of 2007, as a result of settlement of a stock-based compensation plan employees purchased approximately 8.8 million shares held by the Group as a treasury stock at the grant price for $129 million and resold approximately 1.5 million shares back to the Group for $134 million.

Also during the first quarter of 2007, a Group company paid $78 million for the purchase of the Company's common stock under our capital management program.

These factors resulted in a net cash inflow from financing activities of $43 million in the first quarter of 2007 compared to an outflow of $101 million in the first quarter of 2006.

Analysis of capital expenditures

	3 months of		Change, %
	2007	**2006**	
	(millions of US dollars)		
Exploration and production			
Russia	1,565	728	115.0
International	151	111	36.0
Total exploration and production	1,716	839	104.5
Refining, marketing and distribution			
Russia	149	177	(15.8)
International	128	106	20.8
Total refining, marketing and distribution	277	283	(2.1)
Chemicals			
Russia	18	19	(5.3)
International	26	7	–
Total chemicals	44	26	69.2
Other	25	15	66.7
Total capital expenditures*	**2,062**	**1,163**	**77.3**
Acquisitions of subsidiaries			
Exploration and production			
Russia	5	–	–
International	–	–	–
Total exploration and production	5	–	–
Refining, marketing and distribution			
Russia	12	9	33.3
International	1	–	–
Total refining, marketing and distribution	13	9	44.4
Other	6	14	(57.1)
Less cash acquired	–	–	–
Total acquisitions of subsidiaries**	**24**	**23**	**4.3**

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

Capital expenditures, including non-cash transactions, during the first quarter of 2007 amounted to $2,062 million, $899 million more than in the same period of 2006. The growth was mainly caused by expenditures in our exploration and production segment, which increased by $877 million compared to the first quarter of 2006. The growth in exploration and production capital expenditures in new regions amounted to $285 million. The capital expenditures in traditional exploration regions of Western Siberia and European Russia increased by $314 million and $218 million, respectively. Growth of the capital expenditures in our overseas exploration projects (excluding Caspian region) amounted to $60 million in the first quarter of 2007.

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

	3 months of		Change, %
	2007	**2006**	
	(millions of US dollars)		
Northern Timan-Pechora	547	219	149.8
Yamal	8	58	(86.2)
Caspian region*	52	45	15.6
Total	**607**	**322**	**88.5**

* Russian and international projects.