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 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 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 half of		Change	2nd quarter of		Change
	2006	2005		2006	2005	
Sales (including excise and export tariffs)	33,210	24,049	38.1%	18,267	13,492	35.4%
Net Income	4,010	2,590	54.8%	2,321	1,410	64.6%
EBITDA	6,464	4,298	50.4%	3,658	2,339	56.4%
Earnings per share of common stock (US dollars)						
Basic earnings	4.85	3.18	52.5%	2.80	1.73	61.8%
Diluted earnings	4.83	3.14	53.8%	2.80	1.71	63.7%
Crude oil production by our subsidiaries (thousands of tonnes)	44,888	42,351	6.0%	22,779	21,347	6.7%
Crude oil production by the Group including our share in equity affiliates (thousands of tonnes)	46,688	44,225	5.6%	23,709	22,243	6.6%
Refined products produced by our subsidiaries (thousands of tonnes)	21,789	21,018	3.7%	10,510	10,985	(4.3)%

During the first half of 2006 our net income was $4,010 million, which is $1,420 million more than in the same period of 2005.

The improvement of our performance resulted from favorable price conditions and increased refining margins, production and refining volumes. However, the growth of our net income was bounded by growth of taxes linked to international crude oil prices. 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 22 to our consolidated financial statements.

Recent developments

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 refuel 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 $853 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 subsidiaries operate oil and gas fields in the West Siberian region of the Russian Federation.

At the end of May 2006 the Group sold its 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 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% interests 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 half of 2006 the Brent crude oil price fluctuated between $56 and $75 per barrel. Movements of crude oil prices were driven by various factors, but political instability in major oil producing regions dominated among them. In the second quarter of 2006 crude oil prices were influenced by instability in the Middle East and West Africa and a decline in US petrol inventories due to seasonal increase of demand. Moreover, based on OPEC's data, its actual daily production in the first half of 2006 was 29.6 million barrels a day, or 0.3% less than in the first half of 2005. This, along with macroeconomic factors, supported a growing price trend. According to the International Energy Agency (IEA) in the first half of 2006 the world demand for crude oil and, subsequently, refined products amounted to 84.1 million barrels per day, which is 0.7% more than in the first half 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 half of 2006 and 2005 based on Northern Europe averages.

	1st half of		**Change**	**2nd quarter of**		**Change**
	2006	**2005**		**2006**	**2005**	
	(in US dollars per bbl, except for figures in percent)					
Brent crude	65.66	49.25	33.3%	69.53	50.84	36.8%
Urals crude (CIF Mediterranean)*	61.52	45.51	35.2%	64.80	47.74	35.7%
Urals crude (CIF Rotterdam)*	61.42	44.95	36.6%	64.69	47.30	36.8%
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam)	298.17	201.84	47.7%	308.98	227.82	35.6%
Diesel fuel (FOB Rotterdam)	580.86	457.67	26.9%	619.65	482.07	28.5%
High-octane gasoline (FOB Rotterdam)	637.66	473.95	34.5%	711.62	510.21	39.5%

* 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. 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 half of 2006	1st half of 2005	Change	2nd quarter of 2006	2nd quarter of 2005	Change
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil	178.33	90.33	97.4%	187.61	115.39	62.6%
Diesel fuel	469.34	384.72	22.0%	490.88	403.98	21.5%
High-octane gasoline (Regular)	528.70	447.28	18.2%	546.65	486.92	12.3%
High-octane gasoline (Premium)	576.59	489.30	17.8%	590.18	531.77	11.0%

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 change in the ruble-dollar exchange rate, and the level of real ruble appreciation.

	1st half of 2006	1st half of 2005	2nd quarter of 2006	2nd quarter of 2005
Ruble inflation (CPI)	6.2%	7.8%	1.2%	2.5%
Change of the ruble-dollar exchange rate	5.9%	(3.3)%	2.5%	(3.0)%
Real appreciation/(devaluation) of the ruble against the US dollar	12.9%	4.4%	3.8%	(0.5)%
Average exchange rate for the period (ruble to US dollar)	27.68	27.96	27.20	28.08
Exchange rate at the end of the period (ruble to US dollar)	27.08	28.67	–	–

Tax burden

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

		1st half of* 2006	1st half of* 2005	Change
Export tariffs on crude oil	\$/tonne	179.11	101.51	76.4%
Export tariffs on refined products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	\$/tonne	130.87	68.96	89.8%
Liquid fuels (fuel oil)	\$/tonne	70.49	43.29	62.8%
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	2,313.27	1,625.40	42.3%
Natural gas	RUR/1,000 m^3	147.00	135.00	8.9%

* Average values.

		2nd quarter of*		Change
		2006	2005	
Export tariffs on crude oil	$/tonne	190.82	113.68	67.9%
Export tariffs on refined products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	131.78	79.06	66.7%
Liquid fuels (fuel oil)	$/tonne	70.99	42.54	66.9%
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	2,421.71	1,734.64	39.6%
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 half of*		Change	2nd quarter of*		Change
		2006	2005		2006	2005	
Excise on refined products							
High-octane gasoline	USD/tonne	131.11	129.79	1.0%	133.42	129.24	3.2%
Low-octane gasoline	USD/tonne	95.99	95.03	1.0%	97.68	94.62	3.2%
Diesel fuel	USD/tonne	39.02	38.63	1.0%	39.71	38.46	3.2%
Motor oils	USD/tonne	106.61	105.55	1.0%	108.49	105.09	3.2%
Mineral extraction tax							
Crude oil	USD/tonne	83.57	58.13	43.8%	89.03	61.77	44.1%
Natural gas	USD/1,000 m^3	5.31	4.83	9.9%	5.40	4.81	12.3%

* Average values.

During the first half of 2006 the tax rates specific to the oil industry in Russia rose significantly compared to the respective period of the previous year. These increases primarily resulted from growth of the Urals crude oil price. The methods to determine the rates for such taxes are presented below. 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). This method of the crude oil extraction tax will be applied until December 31, 2006.

Effective from January 1, 2007 the crude oil extraction tax rate will be diversified depending on the development stage and exhaustion of a particular oil field. The tax rate will be zero for extra-heavy crude oil and for crude oil produced in the certain regions of the Eastern Siberia, depending on the period and volume of production. For crude oil produced in the other regions the tax rate calculation described above will be multiplied by a coefficient characterizing an exhaustion of a particular oil field. The coefficient will be equal to 1.0 for the oil fields with exhaustion below 80%. Each 1% increase of exhaustion of a particular oil field above 80% will result in a decrease of the coefficient by 0.035. The minimum value of the coefficient will be 0.3. The exhaustion level assessment will be based on statutory crude oil production and reserves information.

If in 2007 the Urals blend price and our crude oil production stay on the same level as in the first half of 2006, our annual crude oil extraction tax expense will decrease approximately by $0.4 billion as a result of application of the new methodology.

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.

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

Hydrocarbon production

	1st half of 2006	1st half of 2005	Change
Daily production of hydrocarbons, including Company's share in equity affiliates (thousand BOE per day)*	2,118	1,889	12.1%
- crude oil	1,903	1,800	5.7%
- natural and petroleum gas	215	89	141.6%
Hydrocarbon extraction expenses (US dollar per BOE)	2.90	2.60	11.5%

	2nd quarter of 2006	2nd quarter of 2005	Change
Daily production of hydrocarbons, including Company's share in equity affiliates (thousand BOE per day)*	2,149	1,892	13.6%
- crude oil	1,923	1,800	6.8%
- natural and petroleum gas	226	92	145.7%
Hydrocarbon extraction expenses (US dollar per BOE)	2.98	2.68	11.2%

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

Crude oil production. In the first half of 2006 we increased our total daily crude oil production by 5.7% compared to the first half of 2005 (including the Company's share in equity affiliates) and produced 344.4 million barrels, or 46.7 million tonnes.

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

(thousands of tonnes)	1st half of 2006	Change to 2005 Total	Change to 2005 Change in structure	Change to 2005 Organic growth	1st half of 2005
Western Siberia	28,672	1.5%	296	136	28,240
Komi Republic	5,794	18.1%	748	142	4,904
Ural region	5,326	5.1%	–	257	5,069
Volga region	1,492	0.1%	–	2	1,490
Timano-Pechora (Nenetsky Autonomous District)	884	1.0%	(30)	39	875
Other in Russia	1,009	19.1%	(16)	178	847
Crude oil production in Russia	43,177	4.2%	998	754	41,425
Crude oil produced internationally	1,711	84.8%	908	(123)	926
Total crude oil produced by consolidated subsidiaries	**44,888**	**6.0%**	**1,906**	**631**	**42,351**
Our share in crude oil production of equity affiliates:					
in Russia	791	(11.8)%	(135)	29	897
outside of Russia	1,009	3.3%	–	32	977
Total crude oil production	**46,688**	**5.6%**	**1,771**	**692**	**44,225**

The main oil production region of the Company is Western Siberia. In the oil fields of Western Siberia the Company produced 63.9% of its crude oil in the first half of 2006 (66.7% in the first half 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 10.97 tonnes a day in the first half of 2005 to 11.23 tonnes a day in the first half of 2006. The slowdown in organic growth of crude oil production in Western Siberia was compensated by an increase of production due to structural changes, namely our acquisition of the remaining interest in ZAO SeverTEK and increase of our share in ZAO Tursunt in late 2005, which are exploration and production companies operating within the Komi Republic and the West Siberian region of the Russian Federation, respectively. Before 2005, the crude oil production of these companies was accounted for using equity method. Also, in June 2006 we acquired KMOC, whose subsidiaries produced 123 thousand tonnes of crude oil in June 2006. 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 half of				
	2006		**2005**		**Change**
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	
Crude oil purchases in Russia	6,824	931	3,159	431	116.0 %
Crude oil purchases internationally	17,812	2,430	37,222	5,078	(52.1)%
Total crude oil purchased	**24,636**	**3,361**	**40,381**	**5,509**	**(39.0)%**

	2nd quarter of				
	2006		**2005**		**Change**
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	
Crude oil purchases in Russia	3,921	535	1,759	240	122.9 %
Crude oil purchases internationally	7,374	1,006	22,203	3,029	(66.8)%
Total crude oil purchased	**11,295**	**1,541**	**23,962**	**3,269**	**(52.9)%**

The volume of crude oil purchased in Russia in the first half of 2006 was 500 thousand tonnes more than in the same period of 2005 as a result of an increase in purchases from our equity affiliates. This trend reflects structural changes in the Group: crude oil purchases in the first half of 2006 include results of transactions with OOO Geoilbent, our equity affiliate acquired in July 2005. The volume of crude oil purchased internationally during the first half of 2006 decreased by 2,648 thousand tonnes compared to the first half of 2005, which was caused by growth of the refined products' share in our marketing activity.

Gas production. In the first half of 2006 we produced 6,627 million cubic meters of commercial gas (including our share in equity affiliates), an increase of 141.6% compared to the first half of 2005. This increase was mainly caused by production from the Nakhodkinskoe gas field, which totaled 3,970 million cubic meters of natural gas in the first half 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.

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 half of 2006 increased by 3.7% as compared to the first half of 2005. Russian refineries increased production by 8.0%. The production of overseas refineries decreased by 11.8% as a result of suspension of production in the Odessa refinery.

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 half of 2006 we produced 2,952 thousand tonnes of Euro 4 and Euro 5 diesel fuel at our Russian refineries (in the first half of 2005 – 1,424 thousand tonnes).

Along with our own production of refined products we refine our crude oil at third parties' refineries. In Russia we processed 1,495 thousand tonnes of crude oil during the first half of 2006 in order to supply our network in the Ural region (in the first half of 2005 – 498 thousand tonnes). To supply our retail networks in Eastern Europe we processed 918 thousand tonnes of crude oil in Belorussia and Serbia in the first half of 2006 (in the respective period of 2005 – 569 thousand tonnes).

In the first half 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 18,351 thousand tonnes or $10,119 million in the first half of 2006 (14,902 thousand tonnes or $6,225 million in the same period of 2005). The increase was a result of the expansion of our marketing activities and continuing development of our retail chains outside of Russia. 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 refinery throughput, refined products produced and purchased.

	1st half of 2006	1st half of 2005	Change
	(thousand barrels per day)		
Own refinery throughput	939	908	3.4 %

	1st half of 2006	1st half of 2005	Change
	(thousand of tonnes)		
Refined products produced at the Group refineries in Russia	17,750	16,441	8.0 %
Refined products produced at the Group refineries outside of Russia	4,039	4,577	(11.8)%
Total refined products produced at the Group refineries	**21,789**	**21,018**	**3.7%**
Refined products purchased in Russia	704	590	19.3 %
Refined products purchased internationally	18,382	14,912	23.3 %
Total refined products purchased	**19,086**	**15,502**	**23.1%**

	2nd quarter of 2006	2005	Change
	(thousand barrels per day)		
Own refinery throughput	900	954	(5.7)%

	2nd quarter of 2006	2005	Change
	(thousand of tonnes)		
Refined products produced at the Group refineries in Russia	8,596	8,414	2.2 %
Refined products produced at the Group refineries outside of Russia	1,914	2,571	(25.6)%
Total refined products produced at the Group refineries	**10,510**	**10,985**	**4.3%**
Refined products purchased in Russia	408	286	42.7 %
Refined products purchased internationally	9,129	8,087	12.9 %
Total refined products purchased	**9,537**	**8,373**	**13.9%**

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 half of 2006 up to 6,234 thousand tonnes, or 1,407 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 half of 2006 the Company exported 2.7% of crude oil produced, or 1,230 thousand tonnes, by means other than Transneft (5,013 thousand tonnes in the first half of 2005), including 1,198 thousand tonnes through our own export infrastructure (2,582 thousand tonnes in the first half 2005). The decrease in crude oil exported through our own terminals occurred because we ceased exporting crude oil through the Vysotsk terminal in the third quarter of 2005 due to increased capacity of the Baltic Pipeline System. Currently we use the terminal to export refined products: in the first half of 2006 we exported 3,698 thousand tonnes of refined products (in the first half of 2005 – 1,374 thousand tonnes). In September 2006 we completed the construction of the Vysotsk terminal and extended its capacity up to 11.6 million tonnes per year and total reservoir volume up to 460 thousand cubic meters. In the future the terminal will be used to export both crude oil and refined products depending on market conditions. Its capacity can be extended up to 13.5 million tonnes per year.

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

	1st half of 2006		2005		Change
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	
Export of crude oil using Transneft export routs	155,139	21,165	135,972	18,550	14.1 %
Export of crude oil bypassing Transneft	9,016	1,230	36,745	5,013	(75.5)%
Total crude oil export	**164,155**	**22,395**	**172,717**	**23,563**	**(5.0)%**

	2nd quarter of				Change
	2006		2005		
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)	
Export of crude oil using Transneft export routs	81,209	11,079	70,310	9,592	15.5 %
Export of crude oil bypassing Transneft	4,596	627	17,086	2,331	(73.1)%
Total crude oil export	**85,805**	**11,706**	**87,396**	**11,923**	**(1.8)%**

In the first half of 2006 we exported 9.3 million tonnes of refined products, an increase of 36% compared to the same period of 2005.

Six months ended June 30, 2006 compared to six months ended June 30, 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 changes compared to the first half of 2005.

	1st half of 2006	1st half of 2005	Change, %
Revenues			
Sales (including excise and export tariffs)	33,210	24,049	38.1
Equity share in income of affiliates	210	201	4.5
Total revenues	**33,420**	**24,250**	**37.8**
Costs and other deductions			
Operating expenses	(2,204)	(1,499)	47.0
Cost of purchased crude oil, petroleum and chemical products	(11,706)	(8,322)	40.7
Transportation expenses	(1,767)	(1,694)	4.3
Selling, general and administrative expenses	(1,498)	(1,134)	32.1
Depreciation, depletion and amortization	(857)	(601)	42.6
Taxes other than income taxes	(3,833)	(2,894)	32.4
Excise and export tariffs	(5,954)	(4,136)	44.0
Exploration expense	(63)	(183)	(65.6)
(Loss) gain on disposals and impairments of assets	(22)	53	–
Income from operating activities	**5,516**	**3,840**	**43.6**
Interest expense	(141)	(117)	20.5
Interest and dividend income	52	37	40.5
Currency translation gain (loss)	148	(85)	–
Other non-operating expense	(39)	(6)	–
Minority interest	(18)	(52)	(65.4)
Income before income taxes	**5,518**	**3,617**	**52.6**
Current income taxes	(1,584)	(1,088)	45.6
Deferred income taxes	76	61	24.6
Total income tax expense	**(1,508)**	**(1,027)**	**46.8**
Net income	**4,010**	**2,590**	**54.8**
Per share of common stock (in US dollars):			
Net income			
Basic	4.85	3.18	52.5
Diluted	4.83	3.14	53.8

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

Sales revenues

Sales breakdown	**1st half of 2006**		**2005**	
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS	8,180	24.6%	7,410	30.8%
Export and sales to CIS	463	1.4%	191	0.8%
Domestic sales	202	0.6%	58	0.2%
	8,845	**26.6%**	**7,659**	**31.8%**
Refined products				
Export and sales on international markets				
Wholesale	15,148	45.6%	9,177	38.2%
Retail	3,447	10.4%	2,605	10.8%
Domestic sales				
Wholesale	2,709	8.2%	2,030	8.4%
Retail	1,168	3.5%	833	3.5%
	22,472	**67.7%**	**14,645**	**60.9%**
Petrochemicals				
Export and sales on international markets	594	1.8%	650	2.7%
Domestic sales	261	0.8%	229	1.0%
	855	**2.6%**	**879**	**3.7%**
Other	**1,038**	**3.1%**	**866**	**3.6%**
Total sales	**33,210**	**100.0%**	**24,049**	**100.0%**

Sales volumes	**1st half of 2006**		**2005**	
Crude oil	(thousands of barrels)			
Export and sales on international markets other than CIS	134,190		164,661	
Export and sales to CIS	12,959		7,754	
Domestic sales	7,029		2,661	
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than CIS	18,307	29.5%	22,464	38.5%
Export and sales to CIS	1,768	2.8%	1,058	1.8%
Domestic sales	959	1.5%	363	0.6%
	21,034	**33.8%**	**23,885**	**40.9%**
Refined products	(thousands of tonnes)			
Export and sales on international markets				
Wholesale	28,118	45.1%	21,410	36.7%
Retail	3,468	5.6%	3,284	5.6%
Domestic sales				
Wholesale	7,849	12.6%	8,218	14.1%
Retail	1,825	2.9%	1,602	2.7%
	41,260	**66.2%**	**34,514**	**59.1%**
Total sales volume of crude oil and refined products	**62,294**	**100.0%**	**58,399**	**100.0%**

Realized average sales prices	1st half of			
	2006		2005	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	60.96	446.82	45.00	329.86
Oil (CIS)	35.71	261.76	24.70	181.05
Refined products				
Wholesale		538.73		428.63
Retail		993.90		793.30
Average realized price within Russia				
Oil	28.68	210.19	21.91	160.59
Refined products				
Wholesale		345.20		247.01
Retail		639.84		520.14

During the first half of 2006 our revenues increased by $9,161 million, or 38.1%, compared to the first half of 2005.

The total volume of crude oil and refined products sold amounted to 62.3 million tonnes, which is 6.7% more than in the first half of 2005. Our revenues from crude oil sales increased by $1,186 million, or 15.5%. Our sales of refined products increased by $7,827 million, or 53.4%.

Sales of crude oil and refined products on the international markets, including the CIS, accounted for 83.0% of total sales volume in the first half of 2006 compared to 82.6% in the first half 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 "Hydrocarbon production" on page 8)
- increase in marketing activities (see page 10)
- increase in crude oil refining, resulting from an increase of refining margin

Sales of crude oil

During the first half of 2006 we increased our sales of crude oil on the domestic market compared to the first half of 2005 by 596 thousand tonnes, or 164.2%.

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 1,168 thousand tonnes, or 5.0%, compared to the first half of 2005.

Sales of refined products

Sales of refined products made up 67.7% of our total revenues (66.2% in terms of volumes sold) compared to 60.9% (59.1% – in terms of volumes) in the first half of 2005. The portion of our domestic refined product sales in the first half of 2006 was 15.5% of the total tonnes sold (in the first half of 2005 – 16.8%), but represented 11.7% of our total revenues (in the first half of 2005 – 11.9%). 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 $110.10 per tonne, or 25.7%, compared to the first half of 2005. Volumes of refined products sold outside of Russia increased by 6,708 thousand tonnes, or 31.3%, due to increased volumes of marketed refined products. As a result, our revenue from wholesale of refined products outside of Russia increased by $5,971 million, or 65.1%.

In the first half of 2006 retail sales of refined products outside of Russia increased by 184 thousand tonnes, or by 5.6%, compared to the first half of 2005. Average retail prices increased up to $993.90 per tonne, or by 25.3%. As a result, our revenue from retail sales increased by $842 million, or 32.3%. In the first half of 2006 revenue from retail sales was 18.5% (in the first half of 2005 – 22.1%) 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 half of 2006 decreased by 369 thousand tones, or 4.5%, compared to the respective period of 2005. The average domestic realized price on refined products increased by $98.19 per tonne, or 39.8%. As a result, our revenue from wholesale of refined products on the domestic market increased by $679 million, or 33.4%.

Retail sales within Russia in the first half of 2006 increased by 223 thousand tonnes, or 13.9%, compared to the first half of 2005. Average retail prices increased up to $639.84 per tonne, or by 23.0%. As a result, our revenue from retail sales increased by $335 million, or 40.2%. Revenue from retail sales was 30.1% of total refined products sales in Russia in the first half of 2006 (in the first half of 2005 – 29.1%).

Sales of petrochemical products

Revenue from sales of petrochemical products decreased by $24 million, or 2.7%, compared to the same period of 2005, due to decreased production volumes caused by maintenance activities performed at our Russian petrochemical plants in the second quarter of 2006. Moreover, in the first half of 2006 we decreased the volume of petrochemical products marketed outside of Russia.

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 $172 million, or 19.9%, generally as a result growth of sales of gas and gas refined products.

Equity share in income of affiliates

Compared to the first half of 2005, our share in the income of affiliates increased by $9 million, or 4.5%. Our largest affiliate is ZAO Turgai-Petroleum, a 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 half of 2006 was $107 million, which represents a decrease of $6 million as compared to the same period of 2005. This decrease of the net income of ZAO Turgai-Petroleum was compensated in the first half of 2006 by growth of profitability of our Russian crude oil production affiliates.

Operating expenses

Operating expenses include the following types of costs:

	1st half of	
	2006	**2005**
	(millions of US dollars)	
Hydrocarbon extraction expenses	1,066	841
Refining expenses	343	315
Petrochemical expenses	129	110
Other operating expenses	779	704
Change in operating expenses in crude oil and refined products inventory originated within the Group	(113)	(471)
Total operating expenses	**2,204**	**1,499**
Cost of purchased crude oil, petroleum and chemical products	**11,706**	**8,322**

Compared to the first half of 2005, operating expenses increased by $705 million, or 47.0%, which is mainly explained by the movements of operating expenses in crude oil and refined products inventory, originated within the Group, and the growth of hydrocarbon 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 June 30, 2006 the real ruble appreciation was 15.7%.

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 crude 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 half of 2006 our extraction expenses rose by $225 million, or 26.8%, compared to the same period of 2005. The increase resulted from growth of crude oil produced by our subsidiaries up to 44.9 million tonnes, or by 6.0%, compared to the first half of 2005, effects of the real ruble appreciation, and increased expenses of artificial stimulation of reservoirs. In the first half of 2006 extraction expenses include $46 million of expenses related to Nelson, ZAO SeverTEK and ZAO Tursunt, which were acquired in the late 2005. Our average hydrocarbon extraction cost per barrel of oil equivalent increased from $2.60 to $2.90 per BOE, or by 11.5%, compared to the first half of 2005.

Refining expenses at our refineries increased by $28 million, or 8.9%, in the first half of 2006 compared to the first half of 2005.

Refining expenses of our domestic refineries increased by 11.4%, or $25 million as a result of increased production volume and due to effect of the real ruble appreciation.

Refining expenses of our international refineries remained at the same level as in the first half of 2005. A reduction of refining expenses in the Odessa refinery, due to its wide-scale upgrade, offset growth of refining expenses at our plant in Bulgaria, which were caused by increased production volumes.

Operating expenses of petrochemical companies increased by $19 million, or by 17.3%, compared to the first half of 2005 mainly as a result of increased cost of raw materials and power supply and maintenance activities performed at our Russian petrochemical plants in the second quarter of 2006.

Other operating expenses include operating expenses of our gas processing plants, 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 $75 million compared to the first half of 2005. This was due to increased volumes of our crude oil refined at third parties' refineries and other services provided.

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 year 2005 as not material, no reclassifications were made to comparatives.

Cost of purchased crude oil, petroleum and chemical products increased by $3,384 million in the first half of 2006, or 40.7%, compared to the same period of the previous year due to a significant increase in volumes of refined products trading 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 half of 2006 by $73 million, or 4.3%, compared to the first half of 2005. At the same time, growth of transportation tariffs in the Russian Federation was partly compensated by optimization of our crude oil export delivery routes.

According to the Federal Statistics Service of the Russian Federation, during the twelve months period ended June 30, 2006 transportation tariffs increased as follows: transportation of oil by pipeline transport – 10.4%, transportation of refined products by pipeline transport – 4.8%, 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 half of 2006 compared to the same period of the previous year as follows: crude oil sea shipping tariffs decreased by 25.8%; crude oil pipeline tariffs increased by 21.9%; railway tariffs for refined products transportation increased by 25.9%.

Selling, general and administrative expenses

In the first half of 2006 our selling, general and administrative expenses increased by $364 million, or 32.1%, compared to the first half 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 the real ruble appreciation and general expansion of our operations 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 half of 2006, which was $269 million compared to $88 million in the first half of 2005.

Selling, general and administrative expenses for the first half of 2006 also included $73 million of expenses related to our subsidiaries, acquired after June 30, 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 $256 million, or 42.6%, compared to the first half of 2005. The increase was a result of the Company's capital expenditures and corresponding growth of depreciable assets. The increase also included $90 million of depreciation, depletion and amortization expenses related to Nelson, acquired in October-December 2005.

Taxes other than income taxes

The increase in taxes other than income taxes resulted primarily from a $1,091 million increase in mineral extraction tax, which is linked to international crude oil prices (see "Tax burden" on page 5). Other taxes for the first half of 2005 include a $150 million provision accrued in relation to the results of tax audits of the Group companies for periods prior to the 2004 financial year.

	1st half of			
	2006		2005	
	In Russia	International	In Russia	International
	(millions of US dollars)			
Mineral extraction tax	3,492	–	2,401	–
Social security taxes and contributions	174	21	160	17
Property tax	102	11	119	11
Other taxes	18	15	171	15
	3,786	**47**	**2,851**	**43**
Total		**3,833**		**2,894**

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 $1,818 million, or 44.0%, compared to the first half of 2005. The increase in export tariff expenses resulted from a growth in export tariff rates (see "Tax burden" on page 5).

	1st half of			
	2006		2005	
	In Russia	International	In Russia	International
	(millions of US dollars)			
Excise tax and sales taxes on refined products	329	1,267	307	1,235
Export tariffs	4,352	6	2,592	2
	4,681	**1,273**	**2,899**	**1,237**
Total		**5,954**		**4,136**

Exploration expenses

During the first half of 2006 the amount charged to exploration expense decreased by $120 million, or 65.6% compared to the first half of 2005. This is attributable to the fact that during the first half of 2005 the Group completed drilling the first exploratory wells of the Yalama (D-222) and Tyub-Karagan exploration projects. Both exploratory wells were dry and their costs in the amount of $102 million were charged to expense.

(Loss) gain on disposals and impairments of assets

Loss on disposals of assets in the first half of 2006 amounted to $22 million compared to a $53 million gain in the first half of 2005.

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

At the same time, in the first half of 2005 we recognized a gain of $87 million on the sale of our 30% interest in OOO Narianmarneftegaz to ConocoPhillips, and a gain of $4 million on the sale of our 38% interest in ZAO Globalstroy-Engineering.

Interest expense

Interest expense in the first half of 2006 increased by $24 million, or by 20.5% compared to the first half of 2005. The growth of interest expense was primarily due to the debt service related to the loan of $1,934 million, which the Group obtained to finance the acquisition of Nelson.

Income taxes

Our total income tax expense increased by $481 million, or 46.8%, compared to the first half of 2005, due to an increase of income before income tax by $1,901 million, or 52.6%.

Our effective income tax rate in the first half of 2006 was 27.3% (in the first half of 2005 it was 28.4%), 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 half of	
	2006	**2005**
Income before income taxes	**5,518**	**3,617**
Add back:		
Depreciation and amortization	857	601
Interest expense	141	117
Interest and dividend income	(52)	(37)
EBITDA	**6,464**	**4,298**

Liquidity and capital resources

	1st half of 2006	2005
	(million US dollars)	
Net cash provided by operating activities	3,780	2,420
Net cash used in investing activities	(3,157)	(1,818)
Net cash used in financing activities	(40)	(313)
Net debt	3,560	2,025
Current ratio	1.80	1.70
Total debt to equity	20%	16%
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 half of 2006 cash generated by operating activities was $3,780 million, an increase of $1,360 million compared to the first half of 2005. In the first half of 2006 cash inflow from operating activities 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 half of 2006 our operating cash inflows were significantly affected by an increase of working capital by $912 million compared to January 1, 2006. This was mainly caused by:

- an increase in trade accounts and notes receivable by $837 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 $897 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 $291 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 $438 million.

During the first half of 2006 the Company spent $3,429 million on capital investments and acquisitions of interests in other companies, which was $1,127 million more than in the first half of 2005. In the first half of 2006 we paid $901 million for acquisitions of interests in other companies, which represented an increase of $493 million compared to the first half of 2005. We paid $853 million for the acquisition of KMOC. In the respective period of 2005 we spent $396 million for the acquisitions of shares in Oy Teboil Ab and Suomen Petrooli Oy, additional share in LUKOIL Neftochim Burgas AD and prepayment for a 66% equity interest in OOO Geoilbent.

The outflow from financing activities in the first half of 2006 resulted from $382 million payments for the purchase of the Company's stock under our capital management program. At the same time, in the first half of 2006 net movements of short term and long term debt generated an inflow of $263 million, compared to an outflow of $338 million in the respective period of 2005. This resulted in a net cash outflow from financing activities of $40 million compared to outflow of $313 million in the first half of 2005.

Analysis of capital expenditures

	1st half of		2nd quarter of	
	2006	**2005**	**2006**	**2005**
	(millions of US dollars)			
Exploration and production				
Russia	1,691	1,199	963	628
International	229	187	118	104
Total exploration and production	1,920	1,386	1,081	732
Refining, marketing and distribution				
Russia	392	319	215	162
International	227	211	121	108
Total refining, marketing and distribution	619	530	336	270
Chemicals				
Russia	55	25	36	20
International	20	5	13	–
Total chemicals	75	30	49	20
Other	33	37	18	23
Total capital expenditures*	**2,647**	**1,983**	**1,484**	**1,045**
Acquisitions of subsidiaries**				
Exploration and production				
Russia	1,170	199	1,170	199
International	–	–	–	–
Total exploration and production	1,170	199	1,170	199
Refining, marketing and distribution				
Russia	53	1	44	–
International	–	219	–	–
Total refining, marketing and distribution	53	220	44	–
Chemicals				
Russia	–	–	–	–
International	–	–	–	–
Total chemicals	–	–	–	–
Other	18	–	4	–
Less cash acquired	**(26)**	**(10)**	**(26)**	**–**
Total acquisitions of subsidiaries	**1,215**	**409**	**1,192**	**199**

* 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 half of 2006 amounted to $2,647 million, $664 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 $534 million compared to the first half of 2005. The growth in exploration and production capital expenditures in new regions amounted to $163 million. The capital expenditures in traditional exploration regions of the Western Siberia increased by $154 million.

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

	1st half of		2nd quarter of	
	2006	**2005**	**2006**	**2005**
	(millions of US dollars)			
Northern Timan-Pechora	590	293	371	152
Yamal	88	163	30	77
Caspian region	82	141	37	80
Total	**760**	**597**	**438**	**309**

Three months ended June 30, 2006 compared to three months ended June 30, 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 compared to the second quarter of 2005.

	2nd quarter of 2006	2nd quarter of 2005	Change, %
Revenues			
Sales (including excise and export tariffs)	18,267	13,492	35.4
Equity share in income of affiliates	112	142	(21.1)
Total revenues	**18,379**	**13,634**	**34.8**
Costs and other deductions			
Operating expenses	(1,304)	(717)	81.9
Cost of purchased crude oil, petroleum and chemical products	(6,406)	(4,942)	29.6
Transportation expenses	(919)	(857)	7.2
Selling, general and administrative expenses	(737)	(622)	18.5
Depreciation, depletion and amortization	(449)	(317)	41.6
Taxes other than income taxes	(2,062)	(1,597)	29.1
Excise and export tariffs	(3,269)	(2,361)	38.5
Exploration expense	(28)	(147)	(81.0)
(Loss) gain on disposals and impairments of assets	(30)	70	–
Income from operating activities	**3,175**	**2,144**	**48.1**
Interest expense	(79)	(62)	27.4
Interest and dividend income	25	19	31.6
Currency translation gain (loss)	56	(73)	–
Other non-operating expense	(14)	(19)	(26.3)
Minority interest	(8)	(30)	(73.3)
Income before income taxes	**3,155**	**1,979**	**59.4**
Current income taxes	(815)	(598)	36.3
Deferred income taxes	(19)	29	–
Total income tax expense	**(834)**	**(569)**	**46.6**
Net income	**2,321**	**1,410**	**64.6**
Per share of common stock (in US dollars):			
Net income			
Basic	2.80	1.73	61.8
Diluted	2.80	1.71	63.7

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

Sales revenues

Sales breakdown	2nd quarter of 2006		2005	
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS	4,614	25.3%	3,996	29.6%
Export and sales to CIS	226	1.2%	140	1.0%
Domestic sales	153	0.8%	49	0.4%
	4,993	**27.3%**	**4,185**	**31.0%**
Refined products				
Export and sales on international markets				
Wholesale	8,368	45.9%	5,289	39.1%
Retail	1,941	10.6%	1,581	11.7%
Domestic sales				
Wholesale	1,357	7.4%	1,088	8.1%
Retail	640	3.5%	466	3.5%
	12,306	**67.4%**	**8,424**	**62.4%**
Petrochemicals				
Export and sales on international markets	296	1.6%	319	2.4%
Domestic sales	122	0.7%	116	0.9%
	418	**2.3%**	**435**	**3.3%**
Other	**550**	**3.0%**	**448**	**3.3%**
Total sales	**18,267**	**100.0%**	**13,492**	**100.0%**

Sales volumes	2nd quarter of 2006		2005	
Crude oil	(thousands of barrels)			
Export and sales on international markets other than CIS	72,046		83,452	
Export and sales to CIS	5,871		5,049	
Domestic sales	4,823		1,935	
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than CIS	9,829	30.7%	11,385	37.2%
Export and sales to CIS	801	2.5%	689	2.3%
Domestic sales	658	2.1%	264	0.9%
	11,288	**35.3%**	**12,338**	**40.4%**
Refined products	(thousands of tonnes)			
Export and sales on international markets				
Wholesale	14,456	45.1%	11,654	38.1%
Retail	1,830	5.7%	1,870	6.1%
Domestic sales				
Wholesale	3,476	10.9%	3,821	12.5%
Retail	972	3.0%	888	2.9%
	20,734	**64.7%**	**18,233**	**59.6%**
Total sales volume of crude oil and refined products	**32,022**	**100.0%**	**30,571**	**100.0%**

Realized average sales prices	2nd quarter of			
	2006		2005	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	64.04	469.39	47.88	350.98
Oil (CIS)	38.51	282.28	27.87	204.26
Refined products				
Wholesale		578.82		453.76
Retail		1,060.60		845.73
Average realized price within Russia				
Oil	31.60	231.60	25.40	186.19
Refined products				
Wholesale		390.51		284.79
Retail		657.83		524.81

During the second quarter of 2006 our revenues increased by $4,775 million, or 35.4%, compared to the second quarter of 2005.

The total volume of crude oil and refined products sold amounted to 32.0 million tonnes, which is 4.7% more than in the second quarter of 2005. Our revenues from crude oil sales increased by $808 million, or 19.3%. Our sales of refined products increased by $3,882 million, or 46.1%.

Sales of crude oil and refined products on the international markets, including the CIS, accounted for 84.0% of total sales volume in the second quarter of 2006 compared to 83.7% in the second 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 “Hydrocarbon production” on page 8)
- increase in marketing activities (see page 10)
- increase in crude oil refining, resulting from an increase of refining margin

Sales of crude oil

During the second quarter of 2006 we increased our sales of crude oil on the domestic market compared to the second quarter of 2005 by 394 thousand tonnes, or 149.2%.

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 217 thousand tonnes, or 1.8%, compared to the second quarter of 2005.

Sales of refined products

Sales of refined products made up 67.4% of our total revenues (64.7% in terms of volumes sold) compared to 62.4% (59.6% – in terms of volumes) in the second quarter of 2005. The portion of our domestic refined product sales in the second quarter of 2006 was 13.9% of the total tonnes sold (in the second quarter of 2005 – 15.4%), but represented 10.9% of our total revenues (in the second quarter of 2005 – 11.6%). 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 $125.06 per tonne, or 27.6%, compared to the second quarter of 2005. Volumes of refined products sold outside of Russia increased by 2,802 thousand tonnes, or 24.0%. As a result, our revenue from wholesale of refined products outside of Russia increased by $3,079 million, or 58.2%.

In the second quarter of 2006 retail sales of refined products remained on the same level compared to the second quarter of 2005. Average retail prices increased up to $1,060.60 per tonne, or by 25.4%. As a result, our revenue from retail sales increased by $360 million, or 22.8%. In the second quarter of 2006 revenue from retail sales was 18.8% (in the second quarter of 2005 – 23.0%) 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 second quarter of 2006 decreased by 345 thousand tonnes, or 9.0% compared to the respective period of 2005. The average domestic realized price on refined products increased by $105.71 per tonne, or 37.1%. As a result, our revenue from wholesale of refined products on the domestic market increased by $269 million, or 24.7%.

Retail sales within Russia in the second quarter of 2006 increased by 84 thousand tonnes, or 9.5%, compared to the second quarter of 2005. Average retail prices increased up to $657.83 per tonne, or by 25.3%. As a result, our revenue from retail sales increased by $174 million, or 37.3%. Revenue from retail sales was 32.0% of total refined products sales in Russia in the second quarter of 2006 (in the second quarter of 2005 – 30.0%).

Sales of petrochemical products

Revenue from sales of petrochemical products decreased by $17 million, or 3.9%, compared to the second quarter of 2005, due to decreased production volumes caused by maintenance activities performed at our Russian petrochemical plants in the second quarter of 2006. Moreover, in the second quarter of 2006 we decreased volume of petrochemical products marketed outside of Russia.

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 $102 million, or 22.8%, as a result of sales of other products produced by the Company, primarily gas and gas refined products.

Equity share in income of affiliates

Our share in the income of affiliates decreased by $30 million, or 21.1%, in the second quarter of 2006 compared to the second quarter of 2005. The decrease is explained by a decrease in the net income of ZAO Turgai-Petroleum, 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 second quarter of 2006 was $67 million, which represents a decrease of $35 million as compared to the respective period of 2005.

Operating expenses

Operating expenses include the following types of costs:

	2nd quarter of	
	2006	**2005**
	(millions of US dollars)	
Hydrocarbon extraction expenses	558	440
Refining expenses	167	166
Petrochemical expenses	68	53
Other operating expenses	422	377
Change in operating expenses in crude oil and refined products inventory originated within the Group	89	(319)
Total operating expenses	**1,304**	**717**
Cost of purchased crude oil, petroleum and chemical products	**6,406**	**4,942**

Compared to the second quarter of 2005, operating expenses increased by $587 million, or 81.9%, which is mainly explained by the movements of operational expenses in crude oil and refined products inventory, originated within the Group, and the growth of hydrocarbon 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 June 30, 2006 the real ruble appreciation was 15.7%.

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 crude 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 second quarter of 2006 our extraction expenses rose by $118 million, or 26.8%, compared to the same period of 2005. The increase resulted from growth of crude oil produced by our subsidiaries up to 22.8 million tonnes, or by 6.7%, compared to the second quarter of 2005, increased expenses of artificial stimulation of reservoirs, and effects of the real ruble appreciation. Our average extraction cost per barrel of oil equivalent increased from $2.68 to $2.98 per BOE, or by 11.2%, compared to the second quarter of 2005.

Refining expenses at our refineries in the second quarter of 2006 remained at the same level as in the second quarter of 2005.

Refining expenses of our domestic refineries increased by 5.3%, or $6 million as a result of increased production volume and due to effect of the real ruble appreciation.

Refining expenses of our international refineries decreased by 9.4%, or $5 million, primarily as a result of the suspension of activities at the Odessa Refinery due to its wide-scale upgrade.

Operating expenses of petrochemical companies increased by $15 million, or by 28.3%, compared to the second quarter of 2005 mainly as a result of increased cost of raw materials and power supply and maintenance activities performed at our Russian petrochemical plants in the second quarter of 2006.

Other operating expenses include operating expenses of our gas processing plants, 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 $45 million compared to the second quarter of 2005. This was primarily due to increased volumes of our crude oil refined at third parties' refineries.

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 second 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 $1,464 million in the second quarter of 2006, or 29.6%, compared to the same period of the previous year due to a significant increase in volumes of refined products trading 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 second quarter of 2006 by $62 million, or 7.2%, compared to the second 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 delivery routes.

Selling, general and administrative expenses

Our selling, general and administrative expenses increased by $115 million, or 18.5%, compared to the second 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 the real ruble appreciation and 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 second quarter of 2006, which was $66 million compared to $55 million in the second quarter of 2005.

Selling, general and administrative expenses for the first quarter of 2006 also included $31 million of expenses related to Nelson, which we acquired in October-December, 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 $132 million, or 41.6%, compared to the second quarter of 2005. The increase was a result of the Company's capital expenditures and corresponding growth of depreciable assets. The increase also included $46 million of depreciation, depletion and amortization expenses related to Nelson, acquired in October-December 2005.

Taxes other than income taxes

The increase in taxes other than income taxes resulted primarily from a $609 million increase in mineral extraction tax, which is linked to international crude oil prices (see "Tax burden" on page 5). Other taxes for the second quarter of 2005 include a $150 million provision accrued in relation to the results of tax audits of the Group companies for periods prior to the 2004 financial year.

	2nd quarter of			
	2006		2005	
	In Russia	International	In Russia	International
	(millions of US dollars)			
Mineral extraction tax	1,893	–	1,284	–
Social security taxes and contributions	88	10	86	9
Property tax	53	5	39	6
Other taxes	6	7	164	9
	2,040	**22**	**1,573**	**24**
Total		**2,062**		**1,597**

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 $908 million, or 38.5%, compared to the second quarter of 2005. The increase in export tariff expenses resulted from a growth in export tariff rates (see "Tax burden" on page 5).

	2nd quarter of			
	2006		2005	
	In Russia	International	In Russia	International
	(millions of US dollars)			
Excise tax and sales taxes on refined products	162	690	163	728
Export tariffs	2,414	3	1,469	1
	2,576	**693**	**1,632**	**729**
Total		**3,269**		**2,361**

Exploration expenses

During the second quarter of 2006 the amount charged to exploration expense decreased by $119 million, or 81.0% compared to the second quarter of 2005. During the second quarter of 2005 the Group completed drilling the first exploratory wells of the Yalama (D-222) and Tyub-Karagan exploration projects. Both exploratory wells were dry and their costs in amount of $102 million were charged to expense.

(Loss) gain on disposals and impairments of assets

Loss on disposals of assets in the second quarter of 2006 amounted to $30 million compared to a $70 million gain in the second quarter of 2005.

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

At the same time, in the second quarter of 2005 we recognized a gain of $87 million on the sale of 30% of our shares in OOO Narianmarneftegaz to ConocoPhillips and a gain of $4 million in relation to sale of its 38% interest in ZAO Globalstroy-Engineering.

Interest expense

Interest expense in the second quarter of 2006 increased by $17 million, or 27.4%, compared to the second quarter of 2005. The additional accrued interest expense related to the loan of $1,934 million, which the Group obtained to finance the acquisition of Nelson.

Income taxes

Our total income tax expense increased by $265 million, or 46.6%, compared to the second quarter of 2005, due to an increase of income before income tax by $1,176 million, or 59.4%.

Our effective income tax rate in the second quarter of 2006 was 26.4% (in the second quarter of 2005 it was 28.8%), 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)

	2nd quarter of	
	2006	**2005**
Income before income taxes	**3,155**	**1,979**
Add back:		
Depreciation and amortization	449	317
Interest expense	79	62
Interest and dividend income	(25)	(19)
EBITDA	**3,658**	**2,339**