

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

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

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

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

### Key financial and operational results

|  | 9 months of<br>2005 | 9 months of<br>2004 | %<br>change | 3 <sup>rd</sup> quarter<br>of 2005 | 3 <sup>rd</sup> quarter<br>of 2004 | %<br>change |
|--|---------------------|---------------------|-------------|------------------------------------|------------------------------------|-------------|
| Sales (including excise and export tariffs).....   | 40,238              | 24,217              | 66.2%       | 16,189                             | 9,740                              | 66.2%       |
| <b>Net Income</b> .....  | <b>4,801</b>        | 3,095               | 55.1%       | <b>2,211</b>                       | 1,399                              | 58.0%       |
| EBITDA.....  | 7,657               | 5,220               | 46.7%       | 3,359                              | 2,255                              | 49.0%       |
| Earnings per share of common stock<br>(US dollars)   |                     |                     |             |                                    |                                    |             |
| Basic earnings.....  | 5.90                | 3.79                | 55.7%       | 2.72                               | 1.71                               | 59.1%       |
| Diluted earnings.....  | 5.81                | 3.73                | 55.8%       | 2.67                               | 1.69                               | 58.0%       |
| Crude oil production by consolidated subsidiaries (thousands of tonnes) ....                   | 64,002              | 61,407              | 4.2%        | 21,651                             | 20,855                             | 3.8%        |
| Crude oil production by the Group including our share in affiliates (thousands of tonnes)..... | 66,906              | 64,081              | 4.4%        | 22,681                             | 21,774                             | 4.2%        |
| Commercial gas production by consolidated subsidiaries (million cubic metres).....             | 3,817               | 3,398               | 12.3%       | 1,199                              | 1,058                              | 13.3%       |
| Refined products produced by consolidated subsidiaries (thousands of tonnes).....              | 32,765              | 30,425              | 7.7%        | 11,746                             | 10,703                             | 9.7%        |

During the nine-month period ended September 30, 2005 net income was \$4,801 million, which is \$1,706 million more than in the same period of 2004.

The increase in net income resulted from favorable price conditions in the nine months of 2005 and improved cost control. However, an increased tax burden has restrained growth of our profitability. 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 marketing and trading of crude oil, natural gas and refined products, and refining and transport operations
- **Chemicals** – which includes processing and trading of petrochemical products

Other businesses include banking and finance, construction and other activities. Each of our three main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the “Domestic crude oil 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 that segment’s underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows, but we do present the financial data for each in Note 18 to our consolidated financial statements.

## Operating developments

### Strategic Partnership with ConocoPhillips

In September 2004 LUKOIL entered into a Shareholder agreement forming a broad-based strategic alliance with ConocoPhillips. In June 2005 LUKOIL and ConocoPhillips finalized the creation of a joint venture to develop resources in the northern Timan-Pechora area. The joint venture is governed by LUKOIL and ConocoPhillips in equal parts, but with effective ownership interests of 70% and 30%, respectively. The joint venture was formed by selling to ConocoPhillips an effective 30% interest in our wholly owned subsidiary OOO Narianmarneftegaz for \$512 million. It is expected that the joint venture’s crude oil production will reach approximately 200 thousand barrels per day by 2008. Crude oil production of OOO Narianmarneftegaz in the nine-month period ended September 30, 2005 was approximately 12 thousand barrels per day.

### Recent developments

In November 2005 a Group company acquired the remaining 50% of the share capital of ZAO SeverTEK for \$322 million from Neste Oil Corporation (including \$98 million repayment of ZAO SeverTEK 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.

During the period from October 14 to December 5, 2005, a Group company acquired 100% of the share capital of Nelson Resources Limited for \$1.9 billion. Nelson Resources Limited is an exploration and production company operating in Kazakhstan.

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 Western 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.

In July 2005 LUKOIL sold its 100% stake in ZAO Arktikneft, an oil production company, for approximately \$40 million, including \$20 million for settlement of Arktikneft’s debt to LUKOIL. ZAO Arktikneft produced 30.3 thousand tonnes of crude oil in the first half of 2005.

In June 2005 the Company sold its 38% interest in its construction affiliate ZAO Globalstroy-Engineering – formerly ZAO LUKOIL-Neftegazstroy for \$69 million.

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

In January 2005 a Group company acquired an additional 22% interest in LUKOIL Neftochim Bourgas AD for \$56 million (20.7% interest was acquired from a related party for \$52 million). The acquisition increased the Group's ownership stake in LUKOIL Neftochim Bourgas AD to 93.2%. In August 2005 a Group company acquired an additional 4% interest in LUKOIL Neftochim Bourgas AD for \$10 million, thereby increasing the Group's ownership stake in LUKOIL Neftochim Bourgas AD to 97.2%.

On January 26, 2004, a Group company entered into an agreement with ConocoPhillips to purchase 308 gas stations and contracts to supply petroleum products to an additional 471 gas stations in the Northeast of the United States of America for \$270 million. The transaction was finalized in May 2004.

## Main macroeconomic factors affecting our results of operations

### Change in the price of crude oil and refined products

The price at which we can sell crude oil and refined products is the primary driver of our revenues. During the nine-month period ended September 30, 2005 crude oil prices steadily increased due to growth of the world economy, driven mainly by the USA and China, and increased worldwide crude oil consumption accompanied by refining and distribution bottlenecks in some major consuming regions. In the third quarter 2005 crude oil prices reached their historical records in absolute terms as a result of a crude oil supply interruption in the USA caused by hurricanes Rita and Katrina. OPEC forecasts a 4.3% growth of the world economy in 2005 and estimates that the worldwide crude oil consumption will reach the level of 83.3 million barrels per day in 2005, or 1.4% more than in 2004 (data as of November, 2005). Based on OPEC's data, its actual daily production in September 2005 reached 30.4 million barrels a day, or 2.4 million barrels a day more than in the same period of the 2004, which is near OPEC's full capacity. The current market situation is also influenced by high political and natural risks, which could cause crude oil production to decrease. This situation can be viewed as an indicator that crude oil prices will remain steadily high in a medium-term perspective.

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

|   | 9 months of<br>2005 | 2004   | Change<br>% | 3 <sup>rd</sup> quarter of<br>2005 | 2004   | Change<br>% |
|---|---------------------|--------|-------------|------------------------------------|--------|-------------|
| (in US dollars per bbl, except for figures in percent)          |                     |        |             |                                    |        |             |
| Brent crude .....   | 53.47               | 36.35  | 47.1%       | 61.63                              | 41.54  | 48.4%       |
| Urals crude (CIF Mediterranean)* .....                          | 49.55               | 33.02  | 50.1%       | 57.39                              | 37.41  | 53.4%       |
| Urals crude (CIF Rotterdam)* .....                              | 49.10               | 32.89  | 49.3%       | 57.13                              | 37.23  | 53.5%       |
| (in US dollars per metric tonne, except for figures in percent) |                     |        |             |                                    |        |             |
| Fuel oil 3.5% (FOB Rotterdam).....                              | 221.94              | 152.25 | 45.8%       | 260.29                             | 161.47 | 61.2%       |
| Diesel fuel (FOB Rotterdam).....                                | 496.22              | 321.38 | 54.4%       | 569.76                             | 376.82 | 51.2%       |
| High-octane gasoline (FOB Rotterdam) ....                       | 532.27              | 393.03 | 35.4%       | 643.52                             | 435.97 | 47.6%       |

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

### Domestic crude oil prices

Substantially all crude oil produced in Russia is produced by vertically integrated oil companies such as ours, as a result most transactions are between affiliated entities within vertically integrated groups. Thus, there is no concept of a benchmark domestic market price for crude oil. Essentially, crude oil prices on traditional international markets will be higher than those in Russia due to incremental transportation cost incurred to deliver the crude oil from the Russian border to the markets, and export tariffs. However, the price of crude oil that is produced but not refined or exported by one of the vertically integrated oil companies is generally determined on a transaction-by-transaction basis against a background of world market prices, but with no direct reference or correlation. At any time there may exist significant price differences between regions for similar quality crude oil as a result of the competition and economic conditions in those regions.

### Domestic refined product prices

Domestic prices for refined products are determined to some extent by world market prices, but they are also directly affected by local demand and competition. In general, retail prices on refined products in Russia are comparable to those in the USA. For example, during the nine months of 2005 the average retail price on regular gasoline in the USA was about 59 cents per litre, an increase of 22% compared to the same period of 2004. In central regions of European Russia the average retail price on gasoline of the same quality (95 octane) during the nine-month period ended September 30, 2005 was 55 cents per litre, an increase of 24% compared to the nine months of 2004.

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

| (\$/tonne)                           | 9 months of |        | Change | 3 <sup>rd</sup> quarter of |        | Change% |
|--------------------------------------|-------------|--------|--------|----------------------------|--------|---------|
|                                      | 2005        | 2004   | %      | 2005                       | 2004   |         |
| Fuel oil.....                        | 110.48      | 73.03  | 51.3%  | 150.03                     | 83.78  | 79.1%   |
| Diesel fuel .....                    | 405.36      | 265.74 | 52.5%  | 445.92                     | 302.68 | 47.3%   |
| High-octane gasoline (Regular) ..... | 471.93      | 371.29 | 27.1%  | 520.37                     | 426.25 | 22.1%   |
| High-octane gasoline (Premium) ...   | 515.40      | 411.22 | 25.3%  | 566.71                     | 458.56 | 23.6%   |

Source: Kortes (excluding VAT).

### Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenues is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, the movements of ruble inflation and exchange rates can significantly affect the results of our operations. In particular, our operating margins are generally adversely affected by real appreciation of the ruble against the US dollar because this will generally cause our costs to increase in US dollar terms relative to our revenues.

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

|   | 9 months of |       | 3 <sup>rd</sup> quarter of |        |
|---|-------------|-------|----------------------------|--------|
|   | 2005        | 2004  | 2005                       | 2004   |
| Ruble inflation (CPI) .....   | 8.6%        | 8.1%  | 0.7%                       | 1.7%   |
| Nominal (devaluation)/appreciation of the exchange rate (ruble to US dollar)..... | (2.7)%      | 0.8%  | 0.6%                       | (0.7)% |
| Real appreciation of the exchange rate (ruble to US dollar).....                  | 5.7%        | 8.9%  | 1.3%                       | 1.0%   |
| Average exchange rate for the period (ruble to US dollar).....                    | 28.15       | 28.91 | 28.51                      | 29.17  |
| Exchange rate at the end of the period (ruble to US dollar).....                  | 28.50       | 29.22 | –                          | –      |

### Change in tax rates and export tariffs

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

|  |           | 9 months of |          | Change |
|--|-----------|-------------|----------|--------|
|  |           | 2005*       | 2004*    | %      |
| Export tariffs on crude oil.....   | \$/tonne  | 114.05      | 43.61    | 161.5% |
| Export tariffs on refined products   |           |             |          |        |
| Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils ..... | \$/tonne  | 81.12       | 33.73    | 140.5% |
| Liquid fuels (fuel oil) .....  | \$/tonne  | 47.75       | 33.73    | 41.6%  |
| Excise on refined products   |           |             |          |        |
| High-octane gasoline.....  | RUR/tonne | 3,629.00    | 3,360.00 | 8.0%   |
| Low-octane gasoline .....  | RUR/tonne | 2,657.00    | 2,460.00 | 8.0%   |
| Diesel fuel .....  | RUR/tonne | 1,080.00    | 1,000.00 | 8.0%   |
| Motor oils.....  | RUR/tonne | 2,951.00    | 2,732.00 | 8.0%   |
| Mineral extraction tax.....  | RUR/tonne | 1,820.22    | 1,009.50 | 80.3%  |

\* Average values.

|  |           | 3 <sup>rd</sup> quarter of |          | Change<br>% |
|--|-----------|----------------------------|----------|-------------|
|  |           | 2005*                      | 2004*    |             |
| Export tariffs on crude oil.....   | \$/tonne  | 138.72                     | 60.36    | 129.8%      |
| Export tariffs on refined products   |           |                            |          |             |
| Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils ..... | \$/tonne  | 105.05                     | 39.90    | 163.3%      |
| Liquid fuels (fuel oil) .....  | \$/tonne  | 56.53                      | 39.90    | 41.7%       |
| Excise on refined products   |           |                            |          |             |
| High-octane gasoline.....  | RUR/tonne | 3,629.00                   | 3,360.00 | 8.0%        |
| Low-octane gasoline .....  | RUR/tonne | 2,657.00                   | 2,460.00 | 8.0%        |
| Diesel fuel .....  | RUR/tonne | 1,080.00                   | 1,000.00 | 8.0%        |
| Motor oils.....  | RUR/tonne | 2,951.00                   | 2,732.00 | 8.0%        |
| Mineral extraction tax.....  | RUR/tonne | 2,203.50                   | 1,195.63 | 84.3%       |

\* Average values.

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

|                             | 9 months of |        | Change<br>% | 3 <sup>rd</sup> quarter of |        | Change<br>% |
|-----------------------------|-------------|--------|-------------|----------------------------|--------|-------------|
|                             | 2005 *      | 2004 * |             | 2005 *                     | 2004 * |             |
| (in US dollars per tonne)   |             |        |             |                            |        |             |
| Excise on refined products  |             |        |             |                            |        |             |
| High-octane gasoline.....   | 128.94      | 116.22 | 10.9%       | 127.28                     | 115.18 | 10.5%       |
| Low-octane gasoline .....   | 94.40       | 85.09  | 10.9%       | 93.19                      | 84.33  | 10.5%       |
| Diesel fuel .....           | 38.37       | 34.59  | 10.9%       | 37.88                      | 34.28  | 10.5%       |
| Motor oils.....             | 104.85      | 94.49  | 10.9%       | 103.50                     | 93.65  | 10.5%       |
| Mineral extraction tax..... | 64.67       | 34.92  | 85.2%       | 77.29                      | 40.99  | 88.6%       |

\* Average values.

During the nine-month period ended September 30, 2005 our tax burden rose significantly compared to the previous year. Average crude oil export tariffs increased by 161.5% compared to the nine months of 2004. Approximately 93% of the increase related to growth of crude oil prices, and the remaining 69% resulted from changes in the duty rate calculations effective June 2004 (see below). Export tariffs on gasoline, kerosene, jet fuel, diesel fuel and gasoils increased by 140.5%. Excise on refined products increased by approximately 8.0%.

The mineral extraction tax rate increased by 80.3% compared to the nine months of 2004. This resulted from an increase of the Urals crude price and a change in the tax calculation method effective from January 1, 2005.

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

In June 2004 the Russian government introduced a new method of crude oil export duty rate calculation with 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. If the Urals blend price is above \$25.00 per barrel, each \$1.00 dollar per barrel increase in the Urals blend price over this limit results in the increase of the crude oil export duty rate by \$0.65 per barrel exported.

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

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

## Operational highlights

### Oil production

In line with our long-term strategy we increased our total daily oil production by 4.2% (including the Company's share in equity associates) compared to the nine months of 2004 and produced 492.4 million barrels (66.9 million tonnes) during the nine-month period ended September 30, 2005.

|  | 9 months of<br>2005 | 2004  | Change,<br>% |
|--|---------------------|-------|--------------|
| Daily production of crude oil, including Company's share in affiliates (thousand barrels per day)..... | 1,804               | 1,732 | 4.2%         |
| Refinery throughput (thousand barrels per day) .....   | 937                 | 863   | 8.6%         |

|  | 3 <sup>rd</sup> quarter of<br>2005 | 2004  | Change,<br>% |
|--|------------------------------------|-------|--------------|
| Daily production of crude oil, including Company's share in affiliates (thousand barrels per day)..... | 1,811                              | 1,753 | 3.3%         |
| Refinery throughput (thousand barrels per day) .....   | 994                                | 898   | 10.7%        |

The following table represents our production in the nine months of 2005 and 2004 by major regions, excluding our share in equity associates.

| (thousands of tonnes)                           | 9 months<br>of<br>2005 | Change from 2004 |                        |                   | 9 months<br>of<br>2004 |
|---|------------------------|------------------|------------------------|-------------------|------------------------|
|   |                        | Total<br>%       | Change in<br>structure | Organic<br>growth |                        |
| Western Siberia.....                            | 42,768                 | 3.0%             | –                      | 1,229             | 41,539                 |
| Komi Republic.....                              | 7,421                  | 3.7%             | –                      | 268               | 7,153                  |
| Ural region.....                                | 7,664                  | 2.2%             | –                      | 168               | 7,496                  |
| Volga region .....                              | 2,248                  | 1.1%             | –                      | 25                | 2,223                  |
| Timan-Pechora (Nenetsky Autonomous District)    | 1,306                  | 22.6%            | 11                     | 230               | 1,065                  |
| Other in Russia .....                           | 1,321                  | 32.9%            | –                      | 327               | 994                    |
| <b>Crude oil production in Russia.....</b>      | <b>62,728</b>          | <b>3.7%</b>      | <b>11</b>              | <b>2,247</b>      | <b>60,470</b>          |
| <b>Crude oil produced internationally .....</b> | <b>1,274</b>           | <b>36.0%</b>     | <b>54</b>              | <b>283</b>        | <b>937</b>             |
| <b>Total crude oil produced .....</b>           | <b>64,002</b>          | <b>4.2%</b>      | <b>65</b>              | <b>2,530</b>      | <b>61,407</b>          |

The main oil production region of the Company is Western Siberia. In the oil fields of Western Siberia the Company produced 66.8% of its total production of crude oil in the nine-month period ended September 30, 2005 (67.6% in the nine months of 2004). The increase of production in Western Siberia was 3.0%. The organic growth of oil production in traditional production regions resulted from improvement and optimization of oil production methods. As a result our average well debits increased from 10.65 tonnes a day in the nine months of 2004 to 11.04 tonnes a day in the nine months of 2005, or by 3.7%. In addition to traditional regions we continued exploration and development of new promising production regions. Commencement of oil production in new oil fields in the Nenetsky Autonomous District led to an increase of oil production in this region more than 1.2 times compared to the nine months of 2004. In the third quarter of 2004 we started commercial production at Kravtsovskoye (D-6), a Baltic offshore field. In the nine-month period ended September 30, 2005 we produced 374 thousand tonnes of crude oil from this field, and we expect that annual crude oil production will reach 700 thousand tonnes by 2007. The structural growth in international production volumes in the nine-month period ended September 30, 2005 was caused by consolidation of the Company's share in the Meleiha Hydrocarbon License Agreement as a result of an increase in our share of LUKAgip N.V. at the end of 2004.

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.



|   | <b>9 months of</b>       |                         |                          |                         |
|---|--------------------------|-------------------------|--------------------------|-------------------------|
|   | <b>2005</b>              |                         | <b>2004</b>              |                         |
|   | (thousand of<br>barrels) | (thousand of<br>tonnes) | (thousand of<br>barrels) | (thousand of<br>tonnes) |
| Crude oil purchases in Russia.....        | 7,007                    | 956                     | 16,866                   | 2,301                   |
| Crude oil purchases internationally ..... | 58,831                   | 8,026                   | 51,677                   | 7,050                   |
| <b>Total crude oil purchased.....</b>     | <b>65,838</b>            | <b>8,982</b>            | <b>68,543</b>            | <b>9,351</b>            |

|   | <b>3<sup>rd</sup> quarter of</b> |                         |                          |                         |
|---|----------------------------------|-------------------------|--------------------------|-------------------------|
|   | <b>2005</b>                      |                         | <b>2004</b>              |                         |
|   | (thousand of<br>barrels)         | (thousand of<br>tonnes) | (thousand of<br>barrels) | (thousand of<br>tonnes) |
| Crude oil purchases in Russia.....        | 3,848                            | 525                     | 6,377                    | 870                     |
| Crude oil purchases internationally ..... | 21,609                           | 2,948                   | 18,039                   | 2,461                   |
| <b>Total crude oil purchased.....</b>     | <b>25,457</b>                    | <b>3,473</b>            | <b>24,416</b>            | <b>3,331</b>            |

The volume of crude oil purchased in Russia in the nine-month period ended September 30, 2005 was 1,345 thousand tonnes less than in the nine months of 2004 as a result of decreases in purchases from third parties, nevertheless purchases from our associates remained on the same level. The volume of crude oil purchased internationally during the nine months of 2005 increased by 976 thousand tonnes compared to the same period of 2004, because in 2005 we extended our marketing activity on international markets.

### **Gas production**

In the nine-month period ended September 30, 2005 we produced 4,007 million cubic metres of commercial gas (including our share in equity associates), an increase of 12.0% compared to the nine months of 2004. In April 2005 we started commercial production on the Nakhodkinskoe gas field. This is a first stage of development of the Bolshekhetskaya basin fields in the Yamalo-Nenetsky Autonomous District. We estimate production output from the field will reach 11 billion cubic metres during 2005-2006 and the field's planned production capacity of 10 billion cubic metres per year will be achieved in 2007. Development of the Bolshekhetskaya basin fields is a core element of our gas business strategy.

### **Refining and marketing**

We operate four refineries located in European Russia and three refineries located overseas – in Bulgaria, Ukraine and Romania. Our Romanian refinery, Petrotel-LUKOIL S.A., was undergoing significant upgrades until October 2004. In October 2004, we put Petrotel-LUKOIL back into operation. In August 2005 we commenced a wide-scale upgrade of Odessa refinery. The upgrade program is scheduled for three years and the total amount of investment is estimated to be around \$320 million.

In the nine-month period ended September 30, 2005 the production of refined products increased by 7.7% as compared to the same period of the previous year. Production of Russian refineries increased by 3.0%, but in the third quarter of 2005 we increased production by 9.2% compared to the same period of 2004 in order to supply an increased demand on refined products in Russia and on international markets. The overseas refineries increased production by 30.5% primarily due to recommencement of production by Petrotel-LUKOIL.

Along with own production of refined products we refine our crude oil on third parties' refineries. In Russia we processed 1,036 thousand tonnes of crude oil during the nine months of 2005 in order to supply our network in the Ural region. Outside of Russia we processed 893 thousand tonnes of crude oil in Belorussia and Serbia in this period.

In the nine-month period ended September 30, 2005 we continued to expand our marketing activities in Western Europe, South-East Asia, Northern and Central America. Our marketing activities mainly include wholesale and bunkering operations in Western Europe and South-East Asia as well as supply our retail networks in the USA, Baltic states and some other regions. The total volume of refined products purchased from third parties for wholesale was 15,591 thousand tonnes or \$6,186 million in the nine months of 2005 (9,872 thousand tonnes or \$2,637 million in the nine months of 2004). The total volume of refined products purchased from third parties to supply the retail network during the nine-month period

ended September 30, 2005 was 8,085 thousand tonnes or \$4,555 million (4,608 thousand tonnes or \$2,155 million in the nine months of 2004).

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

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

|   | <b>9 months of</b>                     |  |
|---|--|--|
|   | <b>2005</b><br>(thousand of<br>tonnes) | <b>2004</b><br>(thousand of<br>tonnes) |
| Refined products produced at the Group refineries in Russia.....          | 25,940                                 | 25,194                                 |
| Refined products produced at the Group refineries outside of Russia ..... | 6,825                                  | 5,231                                  |
| <b>Total refined products produced .....</b>                              | <b>32,765</b>                          | <b>30,425</b>                          |
| Refined products purchased in Russia .....                                | 995                                    | 1,536                                  |
| Refined products purchased internationally .....                          | 23,687                                 | 14,636                                 |
| <b>Total refined products purchased .....</b>                             | <b>24,682</b>                          | <b>16,172</b>                          |

|   | <b>3<sup>rd</sup> quarter of</b>       |  |
|---|--|--|
|   | <b>2005</b><br>(thousand of<br>tonnes) | <b>2004</b><br>(thousand of<br>tonnes) |
| Refined products produced at the Group refineries in Russia.....          | 9,498                                  | 8,699                                  |
| Refined products produced at the Group refineries outside of Russia ..... | 2,248                                  | 2,004                                  |
| <b>Total refined products produced .....</b>                              | <b>11,746</b>                          | <b>10,703</b>                          |
| Refined products purchased in Russia .....                                | 405                                    | 645                                    |
| Refined products purchased internationally .....                          | 8,775                                  | 5,145                                  |
| <b>Total refined products purchased .....</b>                             | <b>9,180</b>                           | <b>5,790</b>                           |

### **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 has extended the capacity of the Baltic Pipeline System. During the nine months of 2005 it rose to 57 million tonnes of crude oil per year. This allowed us to increase the volume of crude oil exported via the Primorsk terminal in the nine months of 2005 up to 7,025 thousand tonnes, or 756 thousand tonnes more than in the same period of 2004.

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

Additional access to international markets bypassing Transneft export routes can be obtained through rail transport, by tankers or by 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 nine-month period ended September 30, 2005 the Company exported 9.8% of crude oil produced, or 6,298 thousand tonnes, by means other than Transneft (5,012 thousand tonnes in the same period of 2004), including 3,199 thousand tonnes through our own export infrastructure (1,522 thousand tonnes in the same period of 2004). In the third quarter of 2005 we ceased the export of crude oil through the Vysotsk terminal due to increased capacity of the Baltic Pipeline System. Currently we use the terminal to export refined products. In the future the terminal will be used to export both crude oil and refined products depending on market conditions.

In the nine months of 2005 we exported 774 thousand tonnes of crude oil to China (in the nine months of 2004 we did not export crude oil to China). In the third quarter of 2005 we did not export crude oil into China.

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

|  | <b>9 months of</b>          |                            |                             |                            |
|--|-----------------------------|----------------------------|-----------------------------|----------------------------|
|  | <b>2005</b>                 | <b>2004</b>                |                             | <b>2004</b>                |
|  | (thousand<br>of<br>barrels) | (thousand<br>of<br>tonnes) | (thousand<br>of<br>barrels) | (thousand<br>of<br>tonnes) |
| Export of crude oil using Transneft export routes..... | 206,853                     | 28,220                     | 217,063                     | 29,613                     |
| Export of crude oil bypassing Transneft .....          | 46,164                      | 6,298                      | 36,738                      | 5,012                      |
| <b>Total crude oil export .....</b>                    | <b>253,017</b>              | <b>34,518</b>              | <b>253,801</b>              | <b>34,625</b>              |

|  | <b>3<sup>rd</sup> quarter of</b> |                            |                             |                            |
|--|----------------------------------|----------------------------|-----------------------------|----------------------------|
|  | <b>2005</b>                      | <b>2004</b>                |                             | <b>2004</b>                |
|  | (thousand<br>of<br>barrels)      | (thousand<br>of<br>tonnes) | (thousand<br>of<br>barrels) | (thousand<br>of<br>tonnes) |
| Export of crude oil using Transneft export routes..... | 70,881                           | 9,670                      | 73,102                      | 9,973                      |
| Export of crude oil bypassing Transneft .....          | 9,419                            | 1,285                      | 12,967                      | 1,769                      |
| <b>Total crude oil export .....</b>                    | <b>80,300</b>                    | <b>10,955</b>              | <b>86,069</b>               | <b>11,742</b>              |

In the nine-month period ended September 30, 2005 we exported 11.5 million tonnes of refined products, an increase of 6.5% compared to the nine months of 2004.

## Nine months ended September 30, 2005 compared to the nine months ended September 30, 2004

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

|  | 9 months of    |                | Change       |
|--|----------------|----------------|--------------|
|  | 2005           | 2004           | %            |
| <b>Revenues</b>  |                |                |              |
| Sales (including excise and export tariffs) .....                  | 40,238         | 24,217         | 66.2%        |
| Equity share in income of affiliates.....                          | 336            | 214            | 57.0%        |
| <b>Total revenues .....</b>  | <b>40,574</b>  | <b>24,431</b>  | <b>66.1%</b> |
| <b>Costs and other deductions</b>                                  |                |                |              |
| Operating expenses .....   | (2,376)        | (2,101)        | 13.1%        |
| Cost of purchased crude oil, petroleum and chemical products ..... | (14,379)       | (7,335)        | 96.0%        |
| Transportation expenses.....                                       | (2,522)        | (2,080)        | 21.3%        |
| Selling, general and administrative expenses .....                 | (1,820)        | (1,445)        | 26.0%        |
| Depreciation, depletion and amortization.....                      | (937)          | (806)          | 16.3%        |
| Taxes other than income taxes .....                                | (4,669)        | (2,515)        | 85.6%        |
| Excise and export tariffs.....                                     | (6,778)        | (3,412)        | 98.7%        |
| Exploration expenses .....   | (244)          | (125)          | 95.2%        |
| Gain (loss) on disposals and impairments of assets.....            | 83             | (168)          | –            |
| <b>Income from operating activities .....</b>                      | <b>6,932</b>   | <b>4,444</b>   | <b>56.0%</b> |
| Interest expense.....  | (179)          | (220)          | (18.6)%      |
| Interest and dividend income .....                                 | 63             | 145            | (56.6)%      |
| Currency translation (loss) gain .....                             | (96)           | 12             | –            |
| Other non-operating (expense) income .....                         | (20)           | 15             | –            |
| Minority interest.....   | (96)           | (57)           | 68.4%        |
| <b>Income before income taxes .....</b>                            | <b>6,604</b>   | <b>4,339</b>   | <b>52.2%</b> |
| Current income taxes .....   | (1,766)        | (1,266)        | 39.5%        |
| Deferred income taxes .....  | (37)           | 22             | –            |
| <b>Total income tax expense.....</b>                               | <b>(1,803)</b> | <b>(1,244)</b> | <b>44.9%</b> |
| <b>Net income .....</b>  | <b>4,801</b>   | <b>3,095</b>   | <b>55.1%</b> |
| Per share of common stock (in US dollars):                         |                |                |              |
| <b>Net income</b>  |                |                |              |
| Basic .....  | 5.90           | 3.79           | 55.7%        |
| Diluted .....  | 5.81           | 3.73           | 55.8%        |

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

## Sales revenues

| Sales breakdown   | 9 months of              |               |               |               |
|---|--------------------------|---------------|---------------|---------------|
|   | 2005                     |               |               | 2004          |
|   | (millions of US dollars) |               |               |               |
| Crude oil   |                          |               |               |               |
| Export and sales on international markets other than CIS..... | 11,842                   | 29.4%         | 7,643         | 31.6%         |
| Export and sales to CIS.....                                  | 460                      | 1.1%          | 475           | 2.0%          |
| Domestic sales .....  | 106                      | 0.3%          | 139           | 0.6%          |
|   | <b>12,408</b>            | <b>30.8%</b>  | <b>8,257</b>  | <b>34.2%</b>  |
| Refined products  |                          |               |               |               |
| Export and sales on international markets                     |                          |               |               |               |
| Wholesale.....  | 16,040                   | 40.0%         | 8,046         | 33.2%         |
| Retail.....   | 4,472                    | 11.1%         | 2,741         | 11.3%         |
| Domestic sales  |                          |               |               |               |
| Wholesale.....  | 3,428                    | 8.5%          | 2,362         | 9.8%          |
| Retail.....   | 1,396                    | 3.5%          | 890           | 3.7%          |
|   | <b>25,336</b>            | <b>63.1%</b>  | <b>14,039</b> | <b>58.0%</b>  |
| Petrochemicals  |                          |               |               |               |
| Export and sales on international markets.....                | 863                      | 2.1%          | 688           | 2.8%          |
| Domestic sales .....  | 342                      | 0.8%          | 240           | 1.0%          |
|   | <b>1,205</b>             | <b>2.9%</b>   | <b>928</b>    | <b>3.8%</b>   |
| Other .....   | <b>1,289</b>             | <b>3.2%</b>   | <b>993</b>    | <b>4.0%</b>   |
| <b>Total sales .....</b>                                      | <b>40,238</b>            | <b>100.0%</b> | <b>24,217</b> | <b>100.0%</b> |

| Sales volumes  | 9 months of            |                       |               |               |
|--|------------------------|-----------------------|---------------|---------------|
|  | 2005                   |                       |               | 2004          |
|  | (thousands of barrels) |                       |               |               |
| Crude oil  |                        |                       |               |               |
| Export and sales on international markets other than CIS.....    | 242,029                |                       | 234,780       |               |
| Export and sales to CIS.....                                     | 14,836                 |                       | 24,314        |               |
| Domestic sales .....   | 4,273                  |                       | 9,514         |               |
| Crude oil  |                        | (thousands of tonnes) |               |               |
| Export and sales on international markets other than CIS.....    | 33,019                 | 36.4%                 | 32,030        | 39.1%         |
| Export and sales to CIS.....                                     | 2,024                  | 2.2%                  | 3,317         | 4.1%          |
| Domestic sales .....   | 583                    | 0.6%                  | 1,298         | 1.6%          |
|  | <b>35,626</b>          | <b>39.2%</b>          | <b>36,645</b> | <b>44.8%</b>  |
| Refined products   |                        | (thousands of tonnes) |               |               |
| Export and sales on international markets                        |                        |                       |               |               |
| Wholesale.....   | 35,154                 | 38.6%                 | 26,660        | 32.6%         |
| Retail.....  | 5,214                  | 5.7%                  | 3,910         | 4.8%          |
| Domestic sales   |                        |                       |               |               |
| Wholesale.....   | 12,382                 | 13.6%                 | 12,510        | 15.3%         |
| Retail.....  | 2,595                  | 2.9%                  | 2,061         | 2.5%          |
|  | <b>55,345</b>          | <b>60.8%</b>          | <b>45,141</b> | <b>55.2%</b>  |
| <b>Total sales volume of crude oil and refined products.....</b> | <b>90,971</b>          | <b>100.0%</b>         | <b>81,786</b> | <b>100.0%</b> |

| Realized average sales prices        | 9 months of |            |             |            |
|--------------------------------------|-------------|------------|-------------|------------|
|                                      | 2005        |            |             | 2004       |
|                                      | (\$/barrel) | (\$/tonne) | (\$/barrel) | (\$/tonne) |
| Average realized price international |             |            |             |            |
| Oil (excluding CIS) .....            | 48.93       | 358.63     | 32.55       | 238.61     |
| Oil (CIS) .....                      | 31.02       | 227.35     | 19.55       | 143.29     |
| Refined products                     |             |            |             |            |
| Wholesale.....                       |             | 456.29     |             | 301.83     |
| Retail.....                          |             | 857.68     |             | 700.98     |
| Average realized price within Russia |             |            |             |            |
| Oil .....                            | 24.73       | 181.29     | 14.64       | 107.31     |
| Refined products                     |             |            |             |            |
| Wholesale.....                       |             | 276.85     |             | 188.80     |
| Retail.....                          |             | 537.87     |             | 431.73     |

During the nine-month period ended September 30, 2005 our revenues increased by \$16,021 million, or 66.2%, compared to the same period of 2004.

The total volume of crude oil and refined products sold amounted to 91.0 million tonnes, which is 11.2% more than in the nine months of 2004. Our revenues from crude oil sales increased by \$4,151 million, or 50.3%. Our sales of refined products increased by \$11,297 million, or 80.5%.

Sales of crude oil and refined products on the international markets, including the CIS, accounted for 82.9% of total sales volume in the nine-month period ended September 30, 2005 compared to 80.6% in the nine months of 2004.

***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 “Oil production” on page 8)
- increase in marketing activities (see page 9)

*Sales of crude oil*

During the nine-month period ended September 30, 2005 the Company decreased its sales of crude oil on the domestic market compared to the same period of 2004 by 715 thousand tonnes, or 55.1%, due to increased volume of refining in Russia.

In order to obtain benefits from increased refined products prices in Russia and on international markets and due to 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 in the third quarter of 2005 by 968 thousand tonnes compared to the second quarter of 2005. As a result our export of crude oil from Russia in the nine months of 2005 slightly decreased by 107 thousand tonnes, or 0.3%, compared to the respective period of 2004.

*Sales of refined products*

Sales of refined products made up 63.1% of our total revenues (60.8% in terms of volumes sold) compared to 58.0% (55.2% – in terms of volumes) in the nine months of 2004. The portion of our domestic refined product sales in the nine-month period ended September 30, 2005 was 16.5% of the total tonnes sold (the nine months of 2004: 17.8%), but represented 12.0% of our total revenues (the nine months of 2004: 13.5%).

The average realized wholesale price on refined products outside of Russia increased by \$154.46 per tonne, or 51.2%, compared to the nine months of 2004. Volumes of refined products sold outside of Russia increased by 8,494 thousand tonnes, or 31.9% (see also “Refining and marketing” on page 9). As a result, our revenue from wholesale of refined products outside of Russia increased by \$7,994 million, or 99.4%.

In the nine-month period ended September 30, 2005 retail sales of refined products outside of Russia increased by 1,304 thousand tonnes, or by 33.4%, compared to the same period of 2004. The increase was a result of continuing development of the existing retail chains outside of Russia and structural changes in the retail network we operate. In particular, in May 2004 we acquired an additional retail network in the USA, and in March 2005 we acquired a retail network in Finland. Average retail prices increased up to \$857.68 per tonne, or by 22.4%. As a result, our revenue from retail sales increased by \$1,731 million, or 63.2%. In the nine months of 2005 revenue from retail sales was 21.8% of total refined products sales outside of Russia. Our international retail sales include supplies of refined products to third parties’ retail networks within the bounds of long-term contracts with pricing similar to retail pricing.

Wholesale of refined products within Russia in the nine-month period ended September 30, 2005 slightly decreased compared to the same period of 2004. The average domestic realized price on refined products increased by \$88.05 per tonne, or 46.6%. As a result, our revenue from wholesale of refined products on the domestic market increased by \$1,066 million, or 45.1%.

Retail sales within Russia in the nine-month period ended September 30, 2005 increased by 534 thousand tonnes, or 25.9%, compared to the same period of 2004. Average retail prices increased up to \$537.87 per tonne, or by 24.6%. As a result, our revenue from retail sales increased by \$506 million, or 56.9%. Revenue from retail sales was 28.9% of total refined products sales in Russia in the nine-month period ended September 30, 2005.

### *Sales of petrochemical products*

Revenue from sales of petrochemical products increased by \$277 million, or 29.8%, during the nine-month period ended September 30, 2005. This was mainly due to an increase in average realized prices.

### *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 \$296 million, or 29.8%, as a result of sales of other products produced by the Company, and also increased activity in providing other services to third parties.

### *Equity share in income of affiliates*

Our share in the income of affiliates in the nine-month period ended September 30, 2005 increased by \$122 million, or 57.0%, compared to the nine months of 2004 due to a general increase in profitability of our affiliates and, in particular, an increase in the net income of ZAO Turgai-Petroleum. ZAO Turgai-Petroleum, our 50% interest affiliate company, is a partner in the Turgai-Petroleum joint venture developing the Kumkol oil field in Kazakhstan. The Group's share in the net income of ZAO Turgai-Petroleum in the nine-month period ended September 30, 2005 was \$168 million, which represents an increase of \$74 million as compared to the same period of the previous year.

## **Operating expenses**

Operating expenses include the following types of costs:

|   | <b>9 months of</b>       |              |
|---|--------------------------|--------------|
|   | <b>2005</b>              | <b>2004</b>  |
|   | (millions of US dollars) |              |
| Crude oil extraction expenses .....                                       | 1,275                    | 1,145        |
| Refining expenses .....   | 481                      | 372          |
| Petrochemical expenses .....  | 178                      | 146          |
| Other operating expenses .....  | 442                      | 438          |
| <b>Total operating expenses .....</b>                                     | <b>2,376</b>             | <b>2,101</b> |
| <b>Cost of purchased crude oil, petroleum and chemical products .....</b> | <b>14,379</b>            | <b>7,335</b> |

Compared to the nine months of 2004, operating expenses increased by \$275 million, or 13.1%. Real appreciation of the ruble against the US dollar is still a significant factor affecting our operating expenses in Russia. During the twelve-month period ended September 30, 2005 the real ruble appreciation was 15.0%.

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

Expenses of the Company's 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 nine-month period ended September 30, 2005 our extraction expenses rose by \$130 million, or 11.4%, compared to the same period of 2004. The increase resulted from growth of crude oil produced by our subsidiaries up to 64 million tonnes, or by 4.2%, compared to the nine months of 2004, and increased expenses on repairs and overhaul in our production subsidiaries and increased expenses of artificial stimulation of reservoirs in 2005. Moreover, extraction costs were affected by real ruble appreciation. However, the impact of these factors was mitigated by an increase of average well debits from 10.65 tonnes a day in the nine months of 2004 to 11.04 tonnes a day in the nine months of 2005 and improved cost control. As a result our average extraction cost per barrel increased from \$2.54 to \$2.72 per barrel, or by 7.1% (average extraction cost calculated using an average tonnes to barrels conversion rate of 7.33).

**Refining expenses** at our refineries increased by \$109 million, or 29.3%, in the nine-month period ended September 30, 2005 compared to the nine months of 2004.

Refining expenses of our domestic refineries increased by 18.6%, or \$52 million, primarily as a result of real ruble appreciation. Moreover, in late 2004 we began changing product mix in order to produce higher quality and more profitable products (in particular, Euro 4 quality standard diesel fuel), which led to an increase of our refinery expenses.

Refining expenses of our international refineries increased by 62.0%, or \$57 million, as a result of an overall increase in volumes produced and the recommencement of operations of our Romanian refinery Petrotel-LUKOIL after modernization.

**Operating expenses of petrochemical companies** increased by \$32 million, or 21.9%, compared to the nine months of 2004, as result of an increase in volumes produced on petrochemical plants in Russia.

**Other operating expenses** include natural gas extraction expenses and operating expenses of our gas processing plants, and the costs of other services provided and goods not related to primary activities (such as electricity, heat, etc.) sold by our production and marketing companies, and operating expenses of other non-core businesses of the Group. Other operating expenses also include transportation costs associated with the delivery of crude oil from the Group's exploration and production entities to the Group's refineries, as well as the amount of the change in crude oil and refined products inventory originated within the Group. Other operating expenses increased by \$4 million compared to the nine months of 2004.

**Cost of purchased crude oil, petroleum and chemical products** increased by \$7,044 million in the nine-month period ended September 30, 2005, or 96.0%, compared to the same period of the previous year due to a significant increase in volumes of sales of purchased crude oil and refined products in the nine-month period ended September 30, 2005 by 8,037 thousand tonnes, or 31.5%, compared to the same period of 2004 and growth of market prices on crude oil and petroleum products.

### **Transportation expenses**

The increase in the total volume of sales together with the increase in transportation tariffs led to growth of our transportation expenses in the nine-month period ended September 30, 2005 by \$442 million, or 21.3%, compared to the nine months of 2004.

According to the Federal Statistics Service of the Russian Federation, during the twelve months ended September 30, 2005 transportation tariffs increased as follows: transportation of oil by pipeline transport – 30.7% (including certain specific tariffs established for individual parts of the Transneft pipeline which did not have a material impact on transportation expenses of the Group), transportation of refined products by pipeline transport – 30.1%, railway transport – 13.3%. Sea shipping tariffs decreased by 9.3% (weighted average by volumes transported to different locations).

### **Selling, general and administrative expenses**

Our selling, general and administrative expenses increased by \$375 million, or 26.0%, compared to the nine months of 2004. The above-mentioned expenses include general business expenses, payroll costs (excluding extraction entities' and refineries' production staff costs), insurance costs (except for property insurance related to oil and gas, and refinery equipment), costs of maintenance of social infrastructure, movement in bad debt provision and other expenses.

The increase in selling, general and administrative expenses was a result of general expansion of our operations. Also, the expenses were affected by an increase in expenses related to a share-based compensation program for management in the nine-month period ended September 30, 2005, which was \$219 million compared to \$55 million in the same period of 2004. At the same time we partially mitigated an effect of real ruble appreciation, which was 15.0% during the twelve months ended September 30, 2005.

Selling, general and administrative expenses for the nine months ended September 30, 2005 also included \$41 million of expenses related to our Finnish subsidiaries acquired in March 2005 (see page 3).

### **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 \$131 million, or 16.3%, compared to the nine months of 2004. The increase was a result of the Company's capital expenditures and corresponding growth of depreciable assets. This increase was partly compensated by upward revisions of the Company's proved reserves and, consequently, an increase in estimated useful economic life of fixed assets.



## Taxes other than income taxes

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

|   | 9 months of              |               |              |               |
|---|--------------------------|---------------|--------------|---------------|
|   | 2005                     |               | 2004         |               |
|   | In Russia                | International | In Russia    | International |
|   | (millions of US dollars) |               |              |               |
| Mineral extraction tax .....                  | 4,041                    | –             | 2,130        | –             |
| Social security taxes and contributions ..... | 233                      | 28            | 242          | 17            |
| Property tax .....                            | 152                      | 16            | 59           | 14            |
| Other taxes .....                             | 173                      | 26            | 31           | 22            |
| <b>Total .....</b>                            | <b>4,599</b>             | <b>70</b>     | <b>2,462</b> | <b>53</b>     |
|   |                          | <b>4,669</b>  |              | <b>2,515</b>  |

The increase in taxes other than income taxes resulted primarily from a \$1,911 million increase in mineral extraction tax, which is linked to international crude oil prices (see “Change in tax rates and export tariffs” on page 5). Property tax in Russia increased in the nine months of 2005 primarily due to recalculation of domestic property tax related to 2002 and 2003. In the nine-month period ended September 30, 2005 the Group also accrued a provision in relation to the results of tax audits of the Group companies for periods prior to the 2004 financial year. The amount of provision related to taxes other than income taxes was approximately \$150 million.

## Excise and export tariffs

Our excise and export tariffs include duties on sales of refined products and export tariffs on export of crude oil and refined products. Excise and export tariffs increased by \$3,366 million, or 98.7%, compared to the nine months of 2004. The increase in export tariff expenses resulted from an increase in export tariff rates (see “Change in tax rates and export tariffs” on page 5). The increase in international excise taxes on refined products resulted from an increase in volumes of products sold across our international group, primarily in the USA, and due to commencement of our operations in Finland.

|   | 9 months of              |               |              |               |
|---|--------------------------|---------------|--------------|---------------|
|   | 2005                     |               | 2004         |               |
|   | In Russia                | International | In Russia    | International |
|   | (millions of US dollars) |               |              |               |
| Excise tax and sales taxes on refined products..... | 475                      | 1,991         | 391          | 1,259         |
| Export tariffs .....                                | 4,308                    | 4             | 1,752        | 10            |
| <b>Total .....</b>                                  | <b>4,783</b>             | <b>1,995</b>  | <b>2,143</b> | <b>1,269</b>  |
|   |                          | <b>6,778</b>  |              | <b>3,412</b>  |

## Exploration expenses

The costs we incur in our exploratory drilling efforts are capitalized to the extent that our exploration efforts are successful and otherwise are charged to expenses of the current period. During the nine-month period ended September 30, 2005 the amount charged to exploration expense increased in comparison with the same period of the previous year by \$119 million, or by 95.2%. This is attributable to the fact that during the nine-month period ended September 30, 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 \$105 million were charged to expense. Notwithstanding the fact that the initial exploratory wells were not successful, the Group continues to perform further geological studies and is using the results of the first exploratory drilling in its analysis to assess potential placement of hydrocarbon deposits and to determine drilling programs for the second exploratory wells in both fields. The Group expects to complete this assessment in the first quarter of 2006.

## Gain (loss) on disposals and impairments of assets

Gain on disposals of assets in the nine-month period ended September 30, 2005 amounted to \$83 million compared to \$168 million loss in the nine months of 2004.

In the nine-month period ended September 30, 2005 we recognized an \$135 million gain on the sale our 30% interest in OOO Narianmarneftegaz to ConocoPhillips, a gain of \$4 million on the sale of our 38% interest in ZAO Globalstroy-Engineering and a gain of \$25 million on the sale of the entire interest in ZAO Arktikneft.

In the nine months of 2004 we recognized an impairment loss in relation to our decision to sell our ownership interests in OAO Bank Petrocommerce in the amount of \$35 million and an impairment loss of \$70 million in relation to our decision to sell our ownership interest in OOO LUKOIL-Burenie.

### **Interest expense**

Interest expense in the nine-month period ended September 30, 2005 decreased by \$41 million compared to the same period of 2004 primarily due to the sale of our ownership interest in OAO Bank Petrocommerce in the third quarter of 2004.

### **Income taxes**

Our total income tax expense increased by \$559 million, or 44.9%, compared to the same period of 2004, due to an increase of income before income tax by \$2,265 million, or 52.2%.

Our effective tax rate in the nine-month period ended September 30, 2005 was 27.3% (in the nine months of 2004 it was 28.7%), which is higher than the maximum statutory rate for the Russian Federation (24%). This is attributable to the fact that some costs incurred during the period are not tax deductible or only deductible to a certain limit.

## Liquidity and capital resources

|   | 9 months of          |         |
|---|----------------------|---------|
|   | 2005                 | 2004    |
|   | (million US dollars) |         |
| Net cash provided by operating activities .....   | 4,122                | 2,870   |
| Net cash used in investing activities.....        | (2,632)              | (2,679) |
| Net cash used in financing activities .....       | (948)                | (74)    |
| Net debt.....                                     | 1,721                | 2,361   |
| Current ratio.....                                | 1.95                 | 1.76    |
| Total debt to equity .....                        | 14%                  | 20%     |
| Long term debt to long term debt and equity ..... | 9%                   | 11%     |

Our primary source of cash flow is funds generated from our operations. During the nine-month period ended September 30, 2005 cash generated by operating activities was \$4,122 million, an increase of \$1,252 million compared to the nine months of 2004. In the nine-month period ended September 30, 2005 cash inflow from operating activity was impacted by the following factors:

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

Moreover, in the nine-month period ended September 30, 2005 our operating cash inflows were significantly affected by an increase of working capital (excluding effect of acquisitions) by \$1,456 million compared to January 1, 2005. This was mainly caused by:

- increase in trade accounts and notes receivable by \$1,144 million, which is resulted from an increase in the price of crude oil and refined products and expansion of marketing activities
- increase of inventory by \$1,049 million, which is resulted from increased volumes of crude oil and refined products in stock and increased purchase prices.

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

- an increase in accounts payable related to mineral extraction tax by \$282 million due to rise of the tax rate
- increase in trade accounts and notes payable by \$432 million, which is resulted from an increase in volumes of purchased crude oil and refined products and growth of related prices.

During the nine-month period ended September 30, 2005 the Company spent \$3,223 million on capital investments and acquisitions of interests in other companies, which was \$686 million more than in the nine months of 2004. Capital expenditures, including non-cash transactions during the nine-month period ended September 30, 2005 amounted to \$2,918 million, which was \$617 million more than in the same period of the previous year. The growth in capital expenditures in new regions amounted to \$262 million. Also during the nine months of 2005 we paid \$423 million (an increase of \$128 million compared to the same period of 2004) mainly for acquisition of Oy Teboil Ab and Suomen Petrooli Oy, equity interest in OOO Geoilbent and increase of our share in LUKOIL Neftochim Burgas.

Cash flows from investing activities include \$565 million of cash received from the sale of interests in OOO Narianmarneftegaz, ZAO Globalstroy-Engineering and ZAO Arktikneft.

In the nine-month period ended September 30, 2005 cash outflows related to financing activities were \$948 million, compared to an outflow of \$74 million in the same period of the previous year. The main reasons were an increase of dividends paid by \$387 million and an overall decrease of our indebtedness.

## Analysis of capital expenditures

|  | 9 months of              |              | 3 <sup>rd</sup> quarter of |            |
|--|--------------------------|--------------|----------------------------|------------|
|  | 2005                     | 2004         | 2005                       | 2004       |
|  | (millions of US dollars) |              | (millions of US dollars)   |            |
| Exploration and production                       |                          |              |                            |            |
| Russia .....                                     | 1,785                    | 1,374        | 586                        | 425        |
| International.....                               | 277                      | 87           | 90                         | 15         |
| Total exploration and production.....            | 2,062                    | 1,461        | 676                        | 440        |
| Refining, marketing and distribution             |                          |              |                            |            |
| Russia .....                                     | 435                      | 548          | 116                        | 198        |
| International.....                               | 335                      | 245          | 124                        | 43         |
| Total refining, marketing and distribution ..... | 770                      | 793          | 240                        | 241        |
| Chemicals  |                          |              |                            |            |
| Russia .....                                     | 40                       | 16           | 15                         | 4          |
| International.....                               | 9                        | 14           | 4                          | 9          |
| Total chemicals.....                             | 49                       | 30           | 19                         | 13         |
| Other.....                                       | 37                       | 17           | –                          | 11         |
| <b>Total capital expenditures*</b> .....         | <b>2,918</b>             | <b>2,301</b> | <b>935</b>                 | <b>705</b> |
| <b>Acquisitions of subsidiaries**</b>            |                          |              |                            |            |
| Exploration and production                       |                          |              |                            |            |
| Russia .....                                     | 199                      | –            | –                          | –          |
| International.....                               | –                        | –            | –                          | –          |
| Total exploration and production.....            | 199                      | –            | –                          | –          |
| Refining, marketing and distribution             |                          |              |                            |            |
| Russia .....                                     | 22                       | 6            | 21                         | 1          |
| International.....                               | 229                      | 289          | 10                         | –          |
| Total refining, marketing and distribution ..... | 251                      | 295          | 31                         | 1          |
| Chemicals  |                          |              |                            |            |
| Russia .....                                     | –                        | –            | –                          | –          |
| International.....                               | –                        | –            | –                          | –          |
| Total chemicals.....                             | –                        | –            | –                          | –          |
| Other.....                                       | –                        | –            | –                          | –          |
| <b>Less cash acquired</b> .....                  | <b>(10)</b>              | <b>–</b>     | <b>–</b>                   | <b>–</b>   |
| <b>Total acquisitions of subsidiaries</b> .....  | <b>440</b>               | <b>295</b>   | <b>31</b>                  | <b>1</b>   |

\* Including non-cash transactions.

\*\* Including advances related to acquisitions

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

### Exploration and production

|                              | 9 months of              |            | 3 <sup>rd</sup> quarter of |            |
|------------------------------|--------------------------|------------|----------------------------|------------|
|                              | 2005                     | 2004       | 2005                       | 2004       |
|                              | (millions of US dollars) |            | (millions of US dollars)   |            |
| Northern Timan-Pechora ..... | 468                      | 259        | 175                        | 76         |
| Yamal .....                  | 182                      | 286        | 19                         | 81         |
| Caspian region .....         | 186                      | 29         | 45                         | 2          |
| <b>Total</b> .....           | <b>836</b>               | <b>574</b> | <b>239</b>                 | <b>159</b> |

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

|   | 9 months of  |              |
|---|--------------|--------------|
|   | 2005         | 2004         |
| <b>Income before income taxes</b> ..... | <b>6,604</b> | <b>4,339</b> |
| Add back:                               |              |              |
| Depreciation and amortization .....     | 937          | 806          |
| Interest expense .....                  | 179          | 220          |
| Interest and dividend income.....       | (63)         | (145)        |
| <b>EBITDA</b> .....                     | <b>7,657</b> | <b>5,220</b> |

## Three months ended September 30, 2005 compared to three months ended September 30, 2004

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

|  | 3 <sup>rd</sup> quarter of |              | Change       |
|--|----------------------------|--------------|--------------|
|  | 2005                       | 2004         | %            |
| <b>Revenues</b>  |                            |              |              |
| Sales (including excise and export tariffs) .....                  | 16,189                     | 9,740        | 66.2%        |
| Equity share in income of affiliates.....                          | 135                        | 82           | 64.6%        |
| <b>Total revenues .....</b>  | <b>16,324</b>              | <b>9,822</b> | <b>66.2%</b> |
| <b>Costs and other deductions</b>                                  |                            |              |              |
| Operating expenses .....   | (877)                      | (767)        | 14.3%        |
| Cost of purchased crude oil, petroleum and chemical products ..... | (6,057)                    | (3,007)      | 101.4%       |
| Transportation expenses.....                                       | (828)                      | (697)        | 18.8%        |
| Selling, general and administrative expenses.....                  | (686)                      | (523)        | 31.2%        |
| Depreciation, depletion and amortization.....                      | (336)                      | (292)        | 15.1%        |
| Taxes other than income taxes .....                                | (1,775)                    | (957)        | 85.5%        |
| Excise and export tariffs.....                                     | (2,642)                    | (1,465)      | 80.3%        |
| Exploration expenses .....   | (61)                       | (38)         | 60.5%        |
| Gain (loss) on disposals and impairments of assets.....            | 30                         | (97)         | –            |
| <b>Income from operating activities .....</b>                      | <b>3,092</b>               | <b>1,979</b> | <b>56.2%</b> |
| Interest expense.....  | (62)                       | (77)         | (19.5)%      |
| Interest and dividend income .....                                 | 26                         | 46           | (43.5)%      |
| Currency translation loss.....                                     | (11)                       | (7)          | 57.1%        |
| Other non-operating (loss) gain.....                               | (14)                       | 11           | –            |
| Minority interest.....   | (44)                       | (20)         | 120.0%       |
| <b>Income before income taxes .....</b>                            | <b>2,987</b>               | <b>1,932</b> | <b>54.6%</b> |
| Current income taxes .....   | (678)                      | (554)        | 22.4%        |
| Deferred income taxes .....  | (98)                       | 21           | –            |
| <b>Total income tax expense.....</b>                               | <b>(776)</b>               | <b>(533)</b> | <b>45.6%</b> |
| <b>Net income .....</b>  | <b>2,211</b>               | <b>1,399</b> | <b>58.0%</b> |
| Per share of common stock (in US dollars):                         |                            |              |              |
| <b>Net income</b>  |                            |              |              |
| Basic .....  | 2.72                       | 1.71         | 59.1%        |
| Diluted .....  | 2.67                       | 1.69         | 58.0%        |

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

## Sales revenues

| Sales breakdown   | 3 <sup>rd</sup> quarter of |               |              |               |
|---|----------------------------|---------------|--------------|---------------|
|   | 2005                       |               | 2004         |               |
|   | (millions of US dollars)   |               |              |               |
| Crude oil   |                            |               |              |               |
| Export and sales on international markets other than CIS..... | 4,432                      | 27.4%         | 3,073        | 31.6%         |
| Export and sales to CIS.....                                  | 269                        | 1.7%          | 177          | 1.8%          |
| Domestic sales .....  | 48                         | 0.3%          | 38           | 0.4%          |
|   | <b>4,749</b>               | <b>29.4%</b>  | <b>3,288</b> | <b>33.8%</b>  |
| Refined products  |                            |               |              |               |
| Export and sales on international markets                     |                            |               |              |               |
| Wholesale.....  | 6,863                      | 42.4%         | 3,211        | 32.9%         |
| Retail.....   | 1,867                      | 11.5%         | 1,253        | 12.9%         |
| Domestic sales  |                            |               |              |               |
| Wholesale.....  | 1,398                      | 8.6%          | 947          | 9.7%          |
| Retail.....   | 563                        | 3.5%          | 375          | 3.9%          |
|   | <b>10,691</b>              | <b>66.0%</b>  | <b>5,786</b> | <b>59.4%</b>  |
| Petrochemicals  |                            |               |              |               |
| Export and sales on international markets.....                | 213                        | 1.3%          | 237          | 2.4%          |
| Domestic sales .....  | 113                        | 0.7%          | 86           | 0.9%          |
|   | <b>326</b>                 | <b>2.0%</b>   | <b>323</b>   | <b>3.3%</b>   |
| Other .....   | <b>423</b>                 | <b>2.6%</b>   | <b>343</b>   | <b>3.5%</b>   |
| <b>Total sales .....</b>                                      | <b>16,189</b>              | <b>100.0%</b> | <b>9,740</b> | <b>100.0%</b> |

## Sales volumes

| Sales volumes  | 3 <sup>rd</sup> quarter of |                       |               |               |
|--|----------------------------|-----------------------|---------------|---------------|
|  | 2005                       |                       | 2004          |               |
|  | (thousands of barrels)     |                       |               |               |
| Crude oil  |                            |                       |               |               |
| Export and sales on international markets other than CIS.....    | 77,368                     |                       | 81,583        |               |
| Export and sales to CIS.....                                     | 7,082                      |                       | 7,411         |               |
| Domestic sales .....   | 1,612                      |                       | 1,964         |               |
|  |                            |                       |               |               |
| Crude oil  |                            | (thousands of tonnes) |               |               |
| Export and sales on international markets other than CIS.....    | 10,555                     | 32.4%                 | 11,130        | 38.9%         |
| Export and sales to CIS.....                                     | 966                        | 3.0%                  | 1,011         | 3.5%          |
| Domestic sales .....   | 220                        | 0.7%                  | 268           | 0.9%          |
|  | <b>11,741</b>              | <b>36.1%</b>          | <b>12,409</b> | <b>43.3%</b>  |
| Refined products   |                            | (thousands of tonnes) |               |               |
| Export and sales on international markets                        |                            |                       |               |               |
| Wholesale.....   | 13,744                     | 42.2%                 | 9,860         | 34.5%         |
| Retail.....  | 1,930                      | 5.9%                  | 1,709         | 6.0%          |
| Domestic sales   |                            |                       |               |               |
| Wholesale.....   | 4,164                      | 12.8%                 | 3,851         | 13.4%         |
| Retail.....  | 993                        | 3.0%                  | 791           | 2.8%          |
|  | <b>20,831</b>              | <b>63.9%</b>          | <b>16,211</b> | <b>56.7%</b>  |
| <b>Total sales volume of crude oil and refined products.....</b> | <b>32,572</b>              | <b>100.0%</b>         | <b>28,620</b> | <b>100.0%</b> |

**Realized average sales prices**

|                                      | 3 <sup>rd</sup> quarter of |            |             |            |
|--------------------------------------|----------------------------|------------|-------------|------------|
|                                      | 2005                       |            | 2004        |            |
|                                      | (\$/barrel)                | (\$/tonne) | (\$/barrel) | (\$/tonne) |
| Average realized price international |                            |            |             |            |
| Oil (excluding CIS) .....            | 57.28                      | 419.88     | 37.67       | 276.13     |
| Oil (CIS) .....                      | 37.92                      | 277.95     | 23.86       | 174.86     |
| Refined products                     |                            |            |             |            |
| Wholesale.....                       |                            | 499.39     |             | 325.75     |
| Retail.....                          |                            | 967.20     |             | 732.96     |
| Average realized price within Russia |                            |            |             |            |
| Oil .....                            | 29.39                      | 215.45     | 19.50       | 142.94     |
| Refined products                     |                            |            |             |            |
| Wholesale.....                       |                            | 335.74     |             | 245.61     |
| Retail.....                          |                            | 566.48     |             | 474.61     |

During the third quarter of 2005 our revenues increased by \$6,449 million, or 66.2%, compared to the same period of 2004.

The total volume of crude oil and refined products sold amounted to 32.6 million tonnes, which is 13.8% more than that sold in the third quarter of 2004. Our revenues from crude oil sales increased by \$1,461 million, or 44.4%. Our sales of refined products increased by \$4,905 million, or 84.8%.

Sales of crude oil and refined products on the international markets, including the CIS, accounted for 83.5% of total sales volume in the third quarter of 2005 compared to 82.9% in the third quarter of 2004.

***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 “Oil production” on page 8)
- increase in marketing activities (see page 9)

*Sales of crude oil*

During the third quarter of 2005 the Company decreased its sales of crude oil on the domestic market compared to the same period of the previous year by 48 thousand tonnes, or 17.9%.

In order to obtain benefits from increased refined products prices in Russia and on international markets and due to 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 in the third quarter of 2005 by 787 thousand tonnes compared to the third quarter of 2004.

*Sales of refined products*

Sales of refined products made up 66.0% of our total revenues (63.9% in terms of volumes sold) compared to 59.4% (56.7% – in terms of volumes) in the third quarter of 2004. The portion of our domestic refined product sales in the third quarter of 2005 was 15.8% of total tonnes sold (the third quarter of 2004: 16.2%), but represented 12.1% of our total sales revenue (the third quarter of 2004: 13.6%).

The average realized wholesale price on refined products outside of Russia increased by \$173.64 per tonne, or 53.3%, compared to the third quarter of 2004. Volumes of refined products sold outside of Russia increased by 3,884 thousand tonnes, or 39.4% (see also “Refining and marketing” on page 9). As a result, our revenue from wholesale of refined products outside of Russia increased by \$3,652 million, or 113.7%.

In the third quarter of 2005 retail sales of refined products outside of Russia increased by 221 thousand tonnes, or by 12.9%, compared to the same period of 2004. The increase was a result of continuing development of the existing retail chains outside of Russia and structural changes in the retail network we operate. In particular, we acquired a retail network in Finland. Average retail prices increased up to \$967.20 per tonne, or by 32.0%. As a result, our revenue from retail sales increased by \$614 million, or 49.0%. In the third quarter of 2005 revenue from retail sales was 21.4% 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 third quarter of 2005 increased by 313 thousand tonnes, or 8.1%, as compared to the same period of 2004. The average domestic realized price on refined



products increased by \$90.13 per tonne, or 36.7%. As a result, our revenue from wholesale of refined products on the domestic market increased by \$451 million, or 47.6%.

Retail sales within Russia in the third quarter of 2005 increased by 202 thousand tonnes, or 25.5%, compared to the same period of 2004. Average retail prices increased up to \$566.48 per tonne, or by 19.4%. As a result, our revenue from retail sales increased by \$188 million, or 50.1%. Revenue from retail sales was 28.7% of total refined products sales in Russia in the third quarter of 2005.

#### *Sales of petrochemical products*

Revenues from sales of petrochemical products in the third quarter of 2005 remained on the same level compared to the same period of 2004. This was mainly resulted from a decrease of production in LUKOR, our Ukrainian petrochemical plant, due to a planned overhaul. Decrease of production was compensated by an increase in average realized prices.

#### *Sales of other products*

Other sales increased by \$80 million, or 23.3%, as a result of sales of other products produced by the Company, and also increased activity in providing other services to third parties.

#### *Equity share in income of affiliates*

Our share in the income of affiliates in the third quarter of 2005 increased by \$53 million, or 64.6%, compared to the third quarter of 2004 due to a general increase in profitability of our affiliates.

### **Operating expenses**

Operating expenses include the following types of costs:

|   | <b>3<sup>rd</sup> quarter of</b> |              |
|---|----------------------------------|--------------|
|   | <b>2005</b>                      | <b>2004</b>  |
|   | (millions of US dollars)         |              |
| Crude oil extraction expenses .....                                       | 440                              | 393          |
| Refining expenses .....   | 166                              | 128          |
| Petrochemical expenses .....  | 68                               | 48           |
| Other operating expenses .....  | 203                              | 198          |
| <b>Total operating expenses .....</b>                                     | <b>877</b>                       | <b>767</b>   |
| <b>Cost of purchased crude oil, petroleum and chemical products .....</b> | <b>6,057</b>                     | <b>3,007</b> |

Compared to the third quarter of 2004, operating expenses increased by \$110 million, or 14.3%. Real appreciation of the ruble against the US dollar is still a significant factor affecting our operating expenses in Russia. During the twelve-month period ended September 30, 2005 the real ruble appreciation was 15.0%.

In the third quarter of 2005 our **crude oil extraction expenses** rose by \$47 million, or 12.0%, compared to the same period of 2004. The increase resulted from growth of crude oil produced by our subsidiaries up to 21.7 million tonnes, or by 3.8%, compared to the third quarter of 2004, and additional expenses on repairs and overhaul in our production subsidiaries and increased expenses of artificial stimulation of reservoirs in the third quarter of 2005. Moreover, extraction costs were affected by real ruble appreciation. However, the impact of these factors was mitigated by an increase of average well debits from 10.81 tonnes a day in the third quarter of 2004 to 11.01 tonnes a day in the same period of 2005 and improved cost control. As a result our average extraction cost per barrel increased from \$2.57 to \$2.77 per barrel, or by 7.8% (average extraction cost calculated using an average tonnes to barrels conversion rate of 7.33).

**Refining expenses** at our refineries increased by \$38 million, or 29.7%, in the third quarter of 2005 compared to the third quarter of 2004.

Refining expenses of our domestic refineries increased by 14.3%, or \$14 million, primarily as a result of real ruble appreciation. Moreover in late 2004 we began changing product mix in order to produce higher quality and more profitable products (in particular, Euro 4 quality standard diesel oil) which led to an increase of our refinery expenses.

Refining expenses of our international refineries increased by 80.0%, or \$24 million, as a result of the recommencement of operations of our Romanian refinery Petrotel-LUKOIL after modernization.

**Operating expenses of petrochemical companies** increased by \$20 million compared to the third quarter of 2004.

**Other operating expenses** increased by \$5 million compared to the third quarter of 2004.

**Cost of purchased crude oil, petroleum and chemical products** increased by \$3,050 million in the third quarter of 2005, or 101.4%, compared to the same period of the previous year due to a significant increase in volumes of crude oil and refined products purchased for resale in the third quarter of 2005 by 3,404 thousand tonnes, or by 37.3%, and growth of market prices on crude oil and petroleum products.

### Transportation expenses

The increase in the total volume of sales together with the increase in transportation tariffs led to growth of our transportation expenses in the third quarter of 2005 by \$131 million, or 18.8%, compared to the third quarter of 2004.

### Selling, general and administrative expenses

Our selling, general and administrative expenses increased by \$163 million, or 31.2%, compared to the third quarter of 2004 as a result of general expansion of our operations. Also, in the third quarter of 2005 the Company accrued \$131 million of compensation to management in relation to its share-based compensation program, compared to \$24 million in the same period of 2004. At the same time we partially mitigated an effect of real ruble appreciation, which was 15.0% during the twelve months ended September 30, 2005.

Also, selling, general and administrative expenses for the three months ended September 30, 2005 included \$18 million of expenses related to our Finnish subsidiaries acquired in March 2005 (see page 3).

### Depreciation, depletion and amortization

Depreciation, depletion and amortization expenses increased by \$44 million, or 15.1%, compared to the third quarter of 2004. The increase was a result of the Company's capital expenditure program and corresponding growth of depreciable assets. This increase was partly compensated by upward revisions of the Company's proved reserves and, consequently, an increase in estimated useful economic life of fixed assets.

### Taxes other than income taxes

The increase in taxes other than income taxes resulted primarily from a \$785 million increase in mineral extraction tax, which is linked to international crude oil prices (see "Change in tax rates and export tariffs" on page 6).

|   | 3 <sup>rd</sup> quarter of |               |            |               |
|---|----------------------------|---------------|------------|---------------|
|   | 2005                       |               | 2004       |               |
|   | In Russia                  | International | In Russia  | International |
|   | (millions of US dollars)   |               |            |               |
| Mineral extraction tax .....                  | 1,640                      | –             | 855        | –             |
| Social security taxes and contributions ..... | 73                         | 11            | 81         | 4             |
| Property tax .....                            | 33                         | 5             | (2)        | 5             |
| Other taxes .....                             | 2                          | 11            | 5          | 9             |
|   | <b>1,748</b>               | <b>27</b>     | <b>939</b> | <b>18</b>     |
| <b>Total .....</b>                            |                            | <b>1,775</b>  |            | <b>957</b>    |

### Excise and export tariffs

Excise and export tariffs increased by \$1,177 million, or 80.3%, compared to the third quarter of 2004. The increase in export tariff expenses resulted from an increase in export tariff rates (see “Change in tax rates and export tariffs” on page 6) despite a decrease of our crude oil export from Russia. The increase in international excise taxes on refined products resulted from an increase in volumes of products sold across our international group, primarily in the USA, and due to commencement of our operations in Finland.

|   | 3 <sup>rd</sup> quarter of |               |            |               |
|---|----------------------------|---------------|------------|---------------|
|   | 2005                       |               | 2004       |               |
|   | In Russia                  | International | In Russia  | International |
|   | (millions of US dollars)   |               |            |               |
| Excise tax and sales taxes on refined products..... | 168                        | 756           | 142        | 503           |
| Export tariffs .....                                | 1,716                      | 2             | 816        | 4             |
| <b>Total .....</b>                                  | <b>1,884</b>               | <b>758</b>    | <b>958</b> | <b>507</b>    |

### Exploration expenses

During the third quarter of 2005 the amount charged to exploration expense increased in comparison with the same period of the previous year by \$23 million.

### Gain (loss) on disposals and impairments of assets

Gain on disposals of assets in the third quarter of 2005 was \$30 million compared to \$97 million loss in the third quarter of 2004. In the third quarter of 2005 we recognized a gain of \$25 million on the sale of our entire interest in ZAO Arktikneft.

In the third quarter of 2004 we recognized an impairment loss of \$70 million in relation to our decision to sell our ownership interest in OOO LUKOIL-Burenie.

### Interest expense

Interest expense in the third quarter of 2005 decreased by \$15 million compared to the same period of 2004.

### Income taxes

Our total income tax expense increased by \$243 million, or 45.6%, compared to the same period of 2004, due to an increase of income before income tax by \$1,055 million, or 54.6%.

Our effective tax rate in the third quarter of 2005 was 26.0% (in the third quarter of 2004 it was 27.6%), 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, taxes, depreciation and amortization)

|  | 3 <sup>rd</sup> quarter of |              |
|--|----------------------------|--------------|
|  | 2005                       | 2004         |
| <b>Income before income taxes.....</b> | <b>2,987</b>               | <b>1,932</b> |
| Add back:                              |                            |              |
| Depreciation and amortization .....    | 336                        | 292          |
| Interest expense .....                 | 62                         | 77           |
| Interest and dividend income.....      | (26)                       | (46)         |
| <b>EBITDA .....</b>                    | <b>3,359</b>               | <b>2,255</b> |