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

The following report represents management's discussion and analysis of the financial condition and results of operations of OAO LUKOIL as of September 30, 2008, and for the three and nine month periods ended September 30, 2008 and 2007, and significant trends that may affect its future performance. It should be read in conjunction with our interim US GAAP consolidated financial statements and notes thereto.

References to "LUKOIL," "the Company," "the Group," "we" or "us" are references to OAO LUKOIL and its subsidiaries and equity affiliates. All dollar amounts are in millions of US dollars, unless otherwise indicated. Tonnes of crude oil produced are translated into barrels using conversion rates characterizing the density of oil from each of our oilfields. Tonnes of crude oil purchased as well as other operational indicators expressed in barrels were translated into barrels using an average conversion rate of 7.33 barrels per tonne. Translations of cubic meters to cubic feet were made at the rate of 35.31 cubic feet per cubic meter. Translations of barrels of crude oil into barrels of oil equivalent ("BOE") were made at the rate of 1 barrel per BOE and of cubic feet into BOE at the rate of 6 thousand cubic feet per BOE.

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

Key financial and operational results

	9 months of		Change,	3rd quarter of		Change,
	2008	2007	%	2008	2007	%
Sales (millions of US dollars)	89,265	57,096	56.3	32,375	21,315	51.9
Net income (millions of US dollars)	10,765	6,298	70.9	3,472	2,482	39.9
EBITDA (millions of US dollars)	16,652	10,370	60.6	5,570	4,021	38.5
Basic earnings per share of common stock (US dollars)	12.85	7.60	69.1	4.09	3.01	36.2
Diluted earnings per share of common stock (US dollars)	12.85	7.59	69.2	4.09	3.00	36.2
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	599,877	595,553	0.7	203,760	195,689	4.1
Crude oil production by the Group including our share in equity affiliates (thousands of tonnes)	71,185	72,695	(2.1)	24,179	24,167	–
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	12,784	9,948	28.5	4,382	2,918	50.2
Refined products produced by our subsidiaries (thousands of tonnes)	39,416	36,128	9.1	13,957	12,656	10.3

During the nine month period ended September 30, 2008, our net income was $10,765 million, which is $4,467 million, or 70.9% more than in the same period of 2007.

The main factors for improvement of our performance in the nine months of 2008 were an increase in average international crude oil and refined products prices and increased volumes of crude oil refining. On the other side, we were affected by growing tax expenses, operating expenses, and transportation tariffs. These and other drivers impacting the results of our operations are considered below in detail.

Segment information

Our operations are divided into three main business segments:

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

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

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

Other businesses include a power generation business, banking, finance and other activities. Each of our three main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the "Domestic crude oil and refined products prices" section on page 8, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of refining crude oil and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However, we present the financial data for each in Note 22 "Segment information" to our interim consolidated financial statements.

Executive overview

Changes in the Group structure, acquisition and disposition of assets

In July 2008, a Group company signed an agreement to acquire a 100% interest in the Akpet group for $555 million. The transaction was finalized in November 2008. The amended agreement provides for three payments on purchase consideration: the first payment in amount of $250 million was paid at the date of finalization; second and third deferred payments should be paid by the end of April 2009 and October 2009, respectively. The Akpet group operates 693 petrol filling stations on the basis of dealer agreements and owns eight refined product terminals, five LNG storage tanks, three jet fuel terminals and a lubricant production plant in Turkey.

In June 2008, a Group company signed an agreement with ERG S.p.A. to establish a joint venture to operate the ISAB refinery complex in Priolo, Italy. On December 1, 2008, the Group completed the acquisition of a 49% stake in the joint venture for €1,347 million (approximately $1,743 million as of December 1, 2008), which is subject to finalization of working capital and other adjustments. The seller has a put option, the effect of which would be to increase the Group's stake in the joint venture. The agreement states that each partner will be responsible for procuring crude oil and marketing refined products in line with its equity stake in the joint venture. On December 1, 2008, the Group company paid €600 million (approximately $776 million). The remaining amount will be paid by three deferred payments by the end of September 2009. The ISAB refinery complex has the flexibility to process Urals blend crude oil, and the Group intends to fully integrate its share of the ISAB refinery complex capacity into its crude oil supply and refining products marketing operations. The ISAB refinery complex has an annual refining capacity of 16 million tonnes. The ISAB refinery complex also includes three jetties and storage tanks totaling 3,700 thousand cubic meters.

In April 2008, the Company entered into an agreement to sell 49.99% of the share capital of OAO Archangelskgeoldobycha ("AGD") to De Beers and Archangel Diamond ("ADC") for $100 million, which is subject to the finalization of a working capital adjustment and additional components of contingent purchase consideration.

On December 8, 2008, ADC gave the Company a notice that may result in termination of the agreement by ADC. The Company is currently evaluating the effect of this notice.

In December 2005, the Company made a decision to sell ten tankers. A Group company finalized the sale of eight tankers in May 2006, for a price that approximated their carrying value of $190 million. The sale of the remaining two tankers was finalized in April 2008, for a price that approximated their carrying value of $70 million.

In March 2008, a Group company entered into an agreement to acquire 75 petrol stations and storage facilities in Bulgaria for approximately $367 million. The transaction was finalized in the second quarter of 2008.

In March 2008, a Group company acquired 100% of the share capital of the SNG Holdings Ltd. group for $578 million. The purchase agreement provides for an additional two components of contingent purchase consideration.

- The first contingent payment, of $100 million, was based on an agreed level of proved and probable hydrocarbon reserves as verified by an independent petroleum engineer. This condition was met and the amount was paid in June 2008.
- The second contingent payment, of $100 million, is payable both upon approval of the agreed development program by the Uzbekistan authorities and if an agreed minimum production volume of crude oil is achieved by March 2009.

The SNG Holdings Ltd. group holds a 100% interest in a production sharing agreement in oil and gas condensate fields located in the South-Western Gissar and Ustyurt regions of Uzbekistan. The purpose of the acquisition was to increase the Group's presence in the Uzbekistan oil and gas sector.

In March 2008, a Group company entered into an agreement with a related party, whose management and directors include members of the Group's management and Board of Directors, to acquire a 64.31% interest in OAO UGK TGK-8 ("TGK-8") for approximately $2,117 million. The purchase consideration partly consists of 23.55 million shares of common stock of the Company (at a market value of approximately $1,620 million). The transaction was finalized in May 2008. By the end of September 2008, a Group company acquired an additional interest in TGK-8 for $1,070 million. These acquisitions increased the Group's ownership to 95.43%. TGK-8 is one of the major gas consumers in the Southern Federal District with an annual consumption of 6 billion cubic meters per year. Its power plants are located in Astrakhan, Volgograd and Rostov regions, Krasnodar and Stavropol Districts, and the Republic of Dagestan of the Russian Federation with total productive capacity of 3.6 GW. By purchasing TGK-8 LUKOIL expects significant synergies through natural gas supplies from the Company's gas fields located in the Northern Caspian and in Astrakhan region, which will allow the Company to reach efficient gas price. This acquisition is made in accordance with the Company's plans to develop its electric power business.

During 2007, the Group acquired 7.65% of the share capital of OAO LUKOIL-Nizhegorodnefteorgsintez from minority shareholders for $154 million, increasing the Group's ownership to 96.91%. During the first half of 2008, the Group acquired the remaining 3.09% of the share capital of OAO LUKOIL-Nizhegorodnefteorgsintez from minority shareholders for $64 million, increasing the Group's share in OAO LUKOIL-Nizhegorodnefteorgsintez to 100%. OAO LUKOIL-Nizhegorodnefteorgsintez is a refinery plant located in European Russia.

In December 2007, a Group company acquired a distribution network of 55 petrol stations and storage facilities in the Rostov region, for $56 million. The acquisition of this distribution network will enable the Company to double petroleum products marketing output in the region. We expect our refined products sales in this region to increase up to 200 thousand tonnes per year, which represents 12% of the local retail market as a result of this acquisition.

In June 2007, the Group finalized the acquisition of a 100% interest in companies owning 376 petrol stations in Europe, including 156 in Belgium and Luxembourg, 49 in Finland, 44 in the Czech Republic, 30 in Hungary, 83 in Poland and 14 in Slovakia, for $444 million from ConocoPhillips, its related party. The stations located in Finland were re-branded as Teboil stations in 2007. The remaining petrol stations in other European countries will be re-branded as LUKOIL stations by the end of 2008.

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

In January 2007, a Group company acquired the remaining 34% of the share capital of OOO Geoilbent for $300 million. The acquisition increased the Group's ownership to 100%. Prior to this acquisition the Group accounted for its investment using the equity method of accounting due to the fact that the minority shareholder held substantive participating rights. OOO Geoilbent was an exploration and production company operating in the West Siberian region of the Russian Federation.

Operational highlights

Hydrocarbon production

	9 months of	
	2008	**2007**
Daily production of hydrocarbons, including the Company's share in equity affiliates (thousand BOE per day)	2,189	2,181
- crude oil	1,915	1,967
- natural and petroleum gas*	274	214
Hydrocarbon extraction expenses (US dollar per BOE)	4.16	3.55

	3rd quarter of	
	2008	**2007**
Daily production of hydrocarbons, including the Company's share in equity affiliates (thousand BOE per day)	2,215	2,127
- crude oil	1,935	1,940
- natural and petroleum gas*	280	187
Hydrocarbon extraction expenses (US dollar per BOE)	4.29	3.68

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

Crude oil production. In the nine months of 2008, our total daily crude oil production decreased by 2.6% compared to the same period of 2007. We produced (including the Company's share in equity affiliates) 524.6 million barrels, or 71.2 million tonnes.

The following table represents our production in the nine months of 2008 and 2007 by major regions.

(thousands of tonnes)	**9 months of 2008**	**Change to 2007**			**9 months of 2007**
		Total, %	**Change in structure**	**Organic change**	
Western Siberia	42,443	(5.9)	105	(2,770)	45,108
Komi Republic	9,735	4.9	–	457	9,278
Ural region	8,591	2.9	–	245	8,346
Volga region	2,278	1.1	–	25	2,253
Northern Timan-Pechora	2,373	49.2	–	782	1,591
Other in Russia	1,634	3.4	–	54	1,580
Crude oil production in Russia	67,054	(1.6)	105	(1,207)	68,156
Crude oil produced internationally	2,344	(11.2)	(360)	64	2,640
Total crude oil produced by consolidated subsidiaries	**69,398**	**(2.0)**	**(255)**	**(1,143)**	**70,796**
Our share in crude oil production of equity affiliates:					
in Russia	224	(23.5)	(69)	–	293
outside Russia	1,563	(2.7)	–	(43)	1,606
Total crude oil production	**71,185**	**(2.1)**	**(324)**	**(1,186)**	**72,695**

The main oil producing region of the Company is Western Siberia. In the oil fields of Western Siberia the Company produced 61.2% of its crude oil in the nine months of 2008 (63.7% in the same period of 2007). In the nine months of 2008, the Western Siberian producing assets continue to mature resulting in a production decline and water cut increase. A significant impact on our production in the period was caused by a lack of sufficient power generating capacities to meet the growing demand for extra power from a wide range of oil producers in Western Siberia as they face the need to scale up pumping operations supporting crude oil production operations. In order to compensate for the decrease in crude oil production the Company is opening up oil fields in the Timan-Pechora and Caspian regions. In August 2008, we began commercial production on the first stage of the Yuzhnoye Khylchuyu oil field, located in the Timan-Pechora region. We produced 732 thousand tonnes from this field to September 30, 2008. This allowed us to stabilize our crude oil production in the third quarter of 2008, compared to prior year. Moreover, compared to the second quarter of 2008, we increased our crude oil production by 3.4%. In 2009, we expect to reach annual production of 7.5 million tonnes on Yuzhnoye Khylchuyu oil field. This oil field is developed within our strategic partnership with ConocoPhillips.

The structural decrease in overseas crude oil production reflects the changes in ownership of Caspian, where the Group reduced its interest from 100% to 50% at the end of April 2007.

In addition to our production, we purchase crude oil in Russia and on international markets. In Russia we primarily purchase crude oil from affiliated producing companies and other producers, including vertically integrated oil companies that lack refining capacity or are unable to export their crude oil. Then we either refine or export this purchased crude oil. Crude oil purchased on international markets is used for trading activities, for supplying our overseas refineries or for processing at third party refineries.

	9 months of			
	2008		2007	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	1,136	155	279	38
Crude oil purchases internationally	49,639	6,772	26,571	3,625
Total crude oil purchases	**50,775**	**6,927**	**26,850**	**3,663**

	3rd quarter of			
	2008		2007	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	674	92	66	9
Crude oil purchases internationally	21,939	2,993	8,474	1,156
Total crude oil purchases	**22,613**	**3,085**	**8,540**	**1,165**

The increase in volumes of crude oil purchased internationally resulted from increased refining and trading. During the nine months of 2008, we purchased 3,211 thousand tonnes in order to process at our and at third party refineries compared to 1,363 thousand tonnes in the same period of 2007.

Gas production. In the nine months of 2008, we produced 12,784 million cubic meters of gas available for sale (including our share in equity affiliates), an increase of 28.5%, compared to the same period of 2007.

Our major gas production field is the Nakhodkinskoe gas field, where we produced 6,407 million cubic meters of natural gas in the nine months of 2008, compared to 5,610 million cubic meters in the same period of 2007. In mid-2007, we began production from the Shakh-Deniz field in Azerbaijan where our share in gas production totaled 388 million cubic meters in the nine months of 2008. In the end of 2007, we began production from the Khauzak gas field in Uzbekistan, where we produced 1,621 million cubic meters of natural gas in the nine months of 2008.

Refining, marketing and trading

We operate four refineries located in European Russia and three refineries located overseas – in Bulgaria, Ukraine and Romania. In August 2005, we closed the Odessa refinery to commence a wide-scale upgrade. In April 2008, we put it back into operation after the completion of the upgrade. Annual capacity of the Odessa refinery amounts to 2.8 million tonnes per year.

Compared to the nine months of 2007, production at our refineries increased by 9.1%. Russian refineries increased production by 6.1%. In the second quarter of 2008, the production of our Ukhta refinery was lower than the average quarterly level by approximately 0.4 million tonnes due to a planned overhaul. In the nine months of 2007, our refinery throughput in Russia was lower than planned by approximately 0.2 million tonnes due to a fire at the Volgograd refinery in March 2007. We recovered crude oil throughput at the refinery by the end of April 2007. The production of our overseas refineries increased by 23.4% in the nine months of 2008, compared to the same period of 2007, primarily due to putting into operation the Odessa refinery.

The Group is constantly improving the refined products mix at our refineries in order to produce more profitable products of higher quality. At our Russian refineries we produced 5,452 and 5,169 thousand tonnes of Euro 4 and Euro 5 diesel fuel in the nine months of 2008 and 2007, respectively. In the nine months of 2008 and 2007, our production of Euro 3 gasoline amounted to 3,022 and 670 thousand tonnes, respectively.

Along with our own production of refined products we refined crude oil at third party refineries. In Russia we refined crude oil at third party refineries primarily to supply our network in the Ural region and for export sales. To supply our retail networks in Eastern Europe we refined crude oil at third party refineries in Belarus and Serbia. In early 2007, we decreased processing of our crude oil at Belarussian refineries due to a reduction in profitability of these operations resulting from changes in legislation. However, the growth in refining margins at the end of 2007 and beginning of 2008 resulted in increased volumes of refining in Belarus. Refined products processed in Belarus are used for supplying our local retail network and for wholesale export.

Our marketing and trading activities mainly include wholesale and bunkering operations in Western Europe, South-East Asia, Central America and retail operations in the USA, Central and Eastern Europe, the Baltic States and other regions. The total volume of refined products purchased from third parties for wholesale and retail network supply was 28,525 thousand tonnes, or $24,983 million, in the nine months of 2008 (compared to 28,700 thousand tonnes, or $16,577 million in the same period of 2007).

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

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

	9 months of		3rd quarter of	
	2008	**2007**	**2008**	**2007**
	(thousand barrels per day)			
Own refinery throughput*	1,119	1,034	1,178	1,071
Refinery throughput at third party refineries	109	90	107	91
Total refinery throughput	**1,228**	**1,124**	**1,285**	**1,162**
	(thousand of tonnes)			
Refined products produced at the Group refineries in Russia*	31,730	29,901	10,983	10,401
Refined products produced at the Group refineries outside Russia	7,686	6,227	2,974	2,255
Total refined products produced at the Group refineries	**39,416**	**36,128**	**13,957**	**12,656**
Refined products produced at the third party refineries in Russia	2,187	2,462	679	828
Refined products produced at the third party refineries outside Russia	1,589	625	558	221
Total refined products produced at the third party refineries	**3,776**	**3,087**	**1,237**	**1,049**
Refined products purchased in Russia	1,223	1,198	400	523
Refined products purchased internationally	28,569	28,732	8,291	9,890
Total refined products purchased	**29,792**	**29,930**	**8,691**	**10,413**

* Excluding mini refineries.

Exports of crude oil and refined products from Russia

In the nine months of 2008, our export of crude oil from Russia was 10.7% less than in the same period of 2007. In the nine months of 2008, we exported 43.0% of our total domestic crude oil production (47.3% in the same period of 2007). The decrease of export was due to growth of crude oil refining volumes in Russia and a decrease in crude oil production.

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

	9 months of			
	2008		2007	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Exports of crude oil using Transneft export routes ...	196,525	26,811	222,788	30,394
Exports of crude oil bypassing Transneft..................	14,594	1,991	13,502	1,842
Total crude oil exports..	**211,119**	**28,802**	**236,290**	**32,236**

	3rd quarter of			
	2008		2007	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Exports of crude oil using Transneft export routes ...	61,990	8,457	70,529	9,622
Exports of crude oil bypassing Transneft..................	8,415	1,148	5,952	812
Total crude oil exports..	**70,405**	**9,605**	**76,481**	**10,434**

In the nine months of 2008, the crude oil exported through our own export infrastructure was 1,693 thousand tonnes.

In June 2008, we finalized construction of the offshore ice-resistant terminal in Varandey. This has an annual capacity of 12 million tonnes. The Varandey oil export terminal will be used to export crude oil produced by the Group in Timan-Pechora, including our joint-venture with ConocoPhillips.

In the nine months of 2008, we exported from Russia 19.3 million tonnes of refined products, an increase of 2.5% compared to the same period of 2007. We export from Russia primarily diesel fuel, fuel oil and gasoil. These products account for approximately 93% of our refined products export volumes.

Main macroeconomic factors affecting our results of operations

Changes in the price of crude oil and refined products

The price at which we sell crude oil and refined products is the primary driver of our revenues. During the nine months of 2008, the Brent crude oil price fluctuated between $86 and $144 per barrel and reached its peak of $144.2 at the beginning of July.

In the first half of 2008, the price growth was driven by an escalation in geopolitical tensions which was strengthened by financial market speculation. The continued US dollar fluctuations and supply concerns due to a storm threat in the Gulf of Mexico also boosted prices. In the third quarter of 2008, the spread of crude oil price was significant: the price reached both its peak and bottom values since the beginning of the year. At the end of September, the crude oil market suffered the most significant price fluctuations ever. The financial crisis sent the crude oil price to a nine month minimum. However this decline was followed by price growth, driven by a decrease in US petrol stocks, interruptions of crude oil supplies from Nigeria and an increase in refining margins. Nevertheless, the downward trend is becoming more and more settled due to a decrease in the US crude oil demand and pessimism in respect of a quick recovery of the developed economies. Crude oil prices are now close to the level at which development of many oilfields becomes unprofitable. If the trend lasts, a concern over a shortage of hydrocarbon supply may appear.

Substantially all the crude oil we export is Urals blend. The following table shows the average crude oil and refined product prices for the respective periods of 2008 and 2007.

	9 months of		Change,	3rd quarter of		Change,
	2008	2007	%	2008	2007	%
	(in US dollars per barrel, except for figures in percent)					
Brent crude	111.11	67.12	65.5	115.09	74.74	54.0
Urals crude (CIF Mediterranean)*	108.06	63.96	68.9	113.55	72.21	57.2
Urals crude (CIF Rotterdam)*	108.18	63.82	69.5	113.32	71.98	57.4
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam)	529.65	306.29	72.9	606.45	356.93	69.9
Diesel fuel (FOB Rotterdam)	1,017.77	586.60	73.5	1,054.59	648.85	62.5
High-octane gasoline (FOB Rotterdam)	962.16	666.87	44.3	995.67	709.64	40.3

Source: Platts.

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

Domestic crude oil and refined products prices

Substantially all crude oil produced in Russia is produced by vertically integrated oil companies such as ours. As a result, most transactions are between affiliated entities within vertically integrated groups. Thus, there is no concept of a benchmark domestic market price for crude oil. The price of crude oil that is produced but not refined or exported by one of the vertically integrated oil companies is generally determined on a transaction-by-transaction basis against a background of world market prices, but with no direct reference or correlation. At any time there may exist significant price differences between regions for similar quality crude oil as a result of the competition and economic conditions in those regions. At the same time it should be noted that in 2007 and the nine months of 2008, our domestic crude oil sales prices were nearly at the level of our export net back price.

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

The table below represents average domestic wholesale prices of refined products for the respective periods of 2008 and 2007.

	9 months of 2008	9 months of 2007	Change, %	3rd quarter of 2008	3rd quarter of 2007	Change, %
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil	291.31	161.35	80.5	305.46	206.48	47.9
Diesel fuel	767.82	470.85	63.1	811.99	491.73	65.1
High-octane gasoline (Regular)	812.35	596.06	36.3	845.80	662.23	27.7
High-octane gasoline (Premium)	870.11	676.25	28.7	893.08	736.82	21.2

Source: Kortes (excluding VAT).

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenues is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, ruble inflation and movements of exchange rates can significantly affect the results of our operations. In particular, the real appreciation of the ruble against the US dollar generally causes our costs to increase in US dollar terms. However, an increase of the ruble denominated revenue in Russia in US dollar terms reduces this adverse effect. The devaluation of the purchasing power of the US dollar in the Russian Federation calculated on the basis of the ruble-dollar exchange rates and the level of inflation in Russia was 23.0% in the nine months of 2008, compared to the same period of 2007. However, in the third quarter, the appreciation of the purchasing power of the US dollar in Russia was 0.4% compared to the second quarter of 2008.

The following table gives data on inflation in Russia and the change in the ruble-dollar exchange rate.

	9 months of 2008	9 months of 2007	3rd quarter of 2008	3rd quarter of 2007
Ruble inflation (CPI), %	10.7	7.6	1.7	1.8
Change of the ruble-dollar exchange rate, %	(2.9)	5.2	(7.6)	3.4
Average exchange rate for the period (ruble to US dollar)	24.05	25.89	24.25	25.51
Exchange rate at the end of the period (ruble to US dollar)	25.25	24.95	–	–

Tax burden

The following table represents average enacted rates for taxes specific to the oil industry in Russia for the respective periods of 2008 and 2007.

		9 months of 2008*	9 months of 2007*	Change, %
Export tariffs on crude oil	\$/tonne	379.00	189.15	100.4
Export tariffs on refined products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	\$/tonne	267.64	139.77	91.5
Liquid fuels (fuel oil)	\$/tonne	144.20	75.26	91.6
Excise on refined products				
Straight-run gasoline	RUR/tonne	2,657.00	2,657.00	–
High-octane gasoline	RUR/tonne	3,629.00	3,629.00	–
Low-octane gasoline	RUR/tonne	2,657.00	2,657.00	–
Diesel fuel	RUR/tonne	1,080.00	1,080.00	–
Motor oils	RUR/tonne	2,951.00	2,951.00	–
Mineral extraction tax				
Crude oil	RUR/tonne	3,806.10	2,282.30	66.8
Natural gas	RUR/1,000 m^3	147.00	147.00	–

* Average values.

		3rd quarter of 2008*	2007*	Change, %
Export tariffs on crude oil	$/tonne	462.95	216.05	114.3
Export tariffs on refined products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	324.19	157.91	105.3
Liquid fuels (fuel oil)	$/tonne	174.64	85.04	105.4
Excise on refined products				
Straight-run gasoline	RUR/tonne	2,657.00	2,657.00	–
High-octane gasoline	RUR/tonne	3,629.00	3,629.00	–
Low-octane gasoline	RUR/tonne	2,657.00	2,657.00	–
Diesel fuel	RUR/tonne	1,080.00	1,080.00	–
Motor oils	RUR/tonne	2,951.00	2,951.00	–
Mineral extraction tax				
Crude oil	RUR/tonne	4,012.22	2,597.68	54.5
Natural gas	RUR/1,000 m^3	147.00	147.00	–

* Average values.

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

		9 months of 2008*	2007*	Change, %
Excise on refined products				
Straight-run gasoline	$/tonne	110.50	102.63	7.7
High-octane gasoline	$/tonne	150.92	140.17	7.7
Low-octane gasoline	$/tonne	110.50	102.63	7.7
Diesel fuel	$/tonne	44.91	41.71	7.7
Motor oils	$/tonne	122.73	113.98	7.7
Mineral extraction tax				
Crude oil	$/tonne	158.29	88.15	79.6
Natural gas	$/1,000 m^3	6.11	5.68	7.7

* Average values.

		3rd quarter of 2008*	2007*	Change, %
Excise on refined products				
Straight-run gasoline	$/tonne	109.58	104.16	5.2
High-octane gasoline	$/tonne	149.67	142.26	5.2
Low-octane gasoline	$/tonne	109.58	104.16	5.2
Diesel fuel	$/tonne	44.54	42.34	5.2
Motor oils	$/tonne	121.71	115.68	5.2
Mineral extraction tax				
Crude oil	$/tonne	165.48	101.83	62.5
Natural gas	$/1,000 m^3	6.06	5.76	5.2

* Average values.

These rates of taxes specific to the oil industry in Russia are linked to international crude oil prices and are changed in line with them. The methods to determine the rates for such taxes are presented below.

Crude oil extraction tax rate. The base rate is 419 rubles per metric tonne extracted and it is adjusted depending on the international market price of Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals blend international market price for a tax period is less than or equal to $9.00 per barrel. Each $1.00 per barrel increase in the international Urals blend price over the threshold ($9.00 per barrel) results in an increase of the tax rate by $1.61 per tonne extracted (or $0.22 per barrel extracted using a conversion factor of 7.33).

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

Effective from January 1, 2009, the tax rate calculation will be changed. The threshold crude oil price up to which the tax rate is zero will be raised from $9.00 to $15.00 per barrel. This will lead to a $1.3 per barrel decrease in crude oil extraction tax expenses in Russia. Also, the list of regions where, depending on the period and volume of production, zero crude oil extraction tax rate applies will be extended. In particular, it now includes Caspian offshore and the Nenetsky Autonomous District, where the Group explores and produces hydrocarbons.

Natural gas extraction tax rate. The mineral extraction tax on natural gas production is calculated using a flat rate. The current rate of 147 rubles per thousand cubic meters of natural gas extracted is effective since January 1, 2006.

Crude oil export duty rate is calculated on a 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 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 $15.00 results in an increase of the crude oil export duty rate by $0.35 per barrel exported. If the Urals blend price is 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 $20.00 results in an increase of the crude oil export duty rate by $0.45 per barrel exported. Each $1.00 per barrel increase in the Urals blend price over $25.00 per barrel results in an increase of the crude oil export duty rate by $0.65 per barrel exported.

Prior to October 1, 2008, the Russian government set export tariff rates for two-month periods. The rates in a specific two-month period were based on Urals blend international market prices in the preceding two months. Thus, the calculation method that the Russian government employed to determine export tariff rates resulted in a two-month gap between movements in crude oil prices and the revision of the export duty rate based on those crude oil prices.

This method of calculation was amended in September 2008. The Russian government set the specific crude oil export duty rate for October and November 2008 at $372.20 and $287.30 per tonne respectively, in order to compensate oil companies for the negative effect of decrease of crude oil prices. Beginning from December 2008, the crude oil export duty rate will be revised monthly on the basis of the immediately preceding one-month period of crude oil price monitoring.

Export duty rates on refined products are set by the Russian government. The rate of export duty depends on internal demand for refined products and international crude oil market conditions.

Crude oil and refined products exported to CIS countries, other than Ukraine, are not subject to export duties. Crude oil exported from Russia to Belarus is subject to export duties with an application of a coefficient 0.335 in 2008 (0.293 in 2007) to the regular export duty rate set by the Government of the Russian Federation for calculation of export duty on crude oil exports from Russia to Belarus.

Income tax. Operations in the Russian Federation are currently subject to Federal income tax rate of 6.5% and a regional income tax rate that varies from 13.5% to 17.5% at the discretion of the individual regional administration. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate. Starting on January 1, 2009, the Federal income tax rate will be decreased to 2.5%.

Transportation of crude oil and refined products in Russia

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

Transportation of crude oil produced in Russia to refineries and export destinations is performed primarily through the trunk oil pipeline system of state-owned Transneft. Access to the Transneft crude oil export pipeline network is allocated quarterly, based on recent volumes produced and delivered through the pipeline and proposed export destinations. The crude oil transported by Transneft is Urals blend – a mix of crude oils of various qualities. Therefore Russian companies that produce crude oil of a higher quality, can not obtain benefits from selling it using Transneft's pipeline. Alternative access to international markets bypassing Transneft export routes can be obtained through railroad transport, by tankers, and by the own export infrastructure of oil producing companies. Our own export infrastructure includes the Vysotsk terminal in the Leningrad region, the Varandey terminal in the Nenetsky Autonomous District and the Svetly terminal in the Kaliningrad region. We use the Varandey terminal to export crude oil produced by our joint venture with ConocoPhillips located in Northern Timan-Pechora. The Svetly terminal exports crude oil primarily produced by OOO LUKOIL-Kaliningradmorneft, our subsidiary operating in the Kaliningrad region, and refined products. We use the Vysotsk terminal to export refined products. In the future we expect to use the terminal to export both crude oil and refined products, depending on market conditions. Currently it has capacity of 12 million tonnes per year and it can be expanded up to 15 million tonnes per year.

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

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

Nine months ended September 30, 2008, compared to nine months ended September 30, 2007

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

	9 months of	
	2008	**2007**
	(millions of US dollars)	
Revenues		
Sales (including excise and export tariffs)	89,265	57,096
Equity share in income of affiliates	462	251
Total revenues	**89,727**	**57,347**
Costs and other deductions		
Operating expenses	(5,882)	(4,469)
Cost of purchased crude oil, gas and products	(31,956)	(19,504)
Transportation expenses	(4,048)	(3,251)
Selling, general and administrative expenses	(2,832)	(2,259)
Depreciation, depletion and amortization	(2,098)	(1,675)
Taxes other than income taxes	(11,124)	(6,529)
Excise and export tariffs	(16,342)	(10,623)
Exploration expense	(273)	(176)
Loss on disposals and impairments of assets	(210)	(33)
Income from operating activities	**14,962**	**8,828**
Interest expense	(259)	(240)
Interest and dividend income	113	82
Currency translation (loss) gain	(216)	122
Other non-operating expense	(115)	(137)
Minority interest	(77)	(118)
Income before income taxes	**14,408**	**8,537**
Current income taxes	(3,899)	(2,364)
Deferred income taxes	256	125
Total income tax expense	**(3,643)**	**(2,239)**
Net income	**10,765**	**6,298**
Basic earnings per share of common stock (in US dollars)	12.85	7.60
Diluted earnings per share of common stock (in US dollars)	12.85	7.59

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

Sales revenues

Sales breakdown	9 months of 2008	9 months of 2007
	(millions of US dollars)	
Crude oil		
Export and sales on international markets other than CIS	19,065	13,207
Export and sales to CIS	1,288	653
Domestic sales	559	315
	20,912	**14,175**
Refined products		
Export and sales on international markets		
Wholesale	42,326	26,032
Retail	9,656	6,432
Domestic sales		
Wholesale	6,700	4,153
Retail	4,439	2,584
	63,121	**39,201**
Petrochemicals		
Export and sales on international markets	1,089	1,126
Domestic sales	730	502
	1,819	**1,628**
Gas and gas products		
Export and sales on international markets	689	383
Domestic sales	808	573
	1,497	**956**
Other products and services	**1,916**	**1,136**
Total sales	**89,265**	**57,096**

Sales volumes	9 months of 2008	9 months of 2007
Crude oil	(thousands of barrels)	
Export and sales on international markets other than CIS	178,962	208,832
Export and sales to CIS	19,608	15,430
Domestic sales	12,095	9,045
Crude oil	(thousands of tonnes)	
Export and sales on international markets other than CIS	24,415	28,490
Export and sales to CIS	2,675	2,105
Domestic sales	1,650	1,234
	28,740	**31,829**
Refined products	(thousands of tonnes)	
Export and sales on international markets		
Wholesale	49,948	47,410
Retail	6,180	5,791
Domestic sales		
Wholesale	10,185	10,314
Retail	4,390	3,452
	70,703	**66,967**
Total sales volume of crude oil and refined products	**99,443**	**98,796**

Realized average sales prices

	9 months of			
	2008		2007	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	106.53	780.86	63.24	463.57
Oil (CIS)	65.70	481.55	42.32	310.19
Refined products				
Wholesale		847.41		549.08
Retail		1,562.61		1,110.80
Average realized price within Russia				
Oil	46.23	338.86	34.82	255.20
Refined products				
Wholesale		657.86		402.72
Retail		1,011.05		748.53

During the nine months of 2008, our revenues increased by $32,169 million, or by 56.3%, compared to the same period of 2007.

The total volume of crude oil and refined products sold was 99.4 million tonnes, which represents a slight increase compared to the respective period of 2007. At the same time our revenues from crude oil sales increased by $6,737 million, or by 47.5%. Our revenue from sales of refined products increased by $23,920 million, or by 61.0%.

Sales of crude oil and refined products on international markets, including the CIS, accounted for 83.7% of the total sales volume in the nine months of 2008 (in the same period of 2007 – 84.8%).

The increase in sales was principally due to the following:

- increase in hydrocarbon prices
- increase in crude oil refining, resulting from high refining margins

Sales of crude oil

The 47.5% increase in our total crude oil sales revenue was attributable to the increase in crude oil sales prices. The international crude oil prices (excluding CIS) increased by 68.4%, compared to the nine months of 2007. The decrease in the total volume of international crude oil sales (other than in CIS) by 14.3% resulted from a decrease in our crude oil export from Russia and an increase in our international refining.

Sales of refined products

During the nine months of 2008, our revenue from the wholesale of refined products outside Russia increased by $16,294 million, or by 62.6%, compared to the same period of 2007, mainly due to an increase in the average realized price.

In the nine months of 2008, our revenue from international retail sales increased by $3,224 million, or by 50.1%, compared to the same period of 2007, mainly due to an increase in average retail prices by 40.7%. The increase of retail sales volumes outside Russia amounted to 389 thousand tonnes, or 6.7%. This increase is attributable to additional sales volumes generated by the petrol stations acquired from ConocoPhillips in the second quarter of 2007. Our international retail sales include supplies of refined products to third party retail networks under long-term contracts with pricing similar to retail pricing.

In the nine months of 2008, our revenue from the wholesale of refined products on the domestic market increased by $2,547 million, compared to the same period of the previous year, due to an increase in the average realized price of 63.4%.

In the nine months of 2008, our revenue from retail sales in Russia increased by $1,855 million, or by 71.8%, compared to the same period of 2007, due to an increase both in sales volumes and prices. Revenue from retail sales was 39.9% of total refined products sales in Russia in the nine months of 2008 (in the same period of 2007 – 38.4%).

Sales of petrochemical products

In spite of a decrease in sales volumes, our revenue from sales of petrochemical products increased in the nine months of 2008 by $191 million, or by 11.7%, compared to the same period of 2007. This increase resulted from an increase in prices of 22.7%. The sales volumes decreased by 8.9%.

Sales of gas and gas products

In the nine months of 2008, sales of gas and gas refined products amounted to $1,497 million, which is 56.6% more than in the same period of 2007. This was due to an increase in gas products and natural gas sales revenues. Gas products sales revenue increased by $294 million, or by 44.0%, compared to the nine months of 2007, mainly as a result of an increase in prices for gas products both in Russia and abroad. Natural gas sales revenue amounted to $516 million (an increase of 90.0%, compared to the nine months of 2007). This increase was a result of the commencement of natural gas production in Uzbekistan and Azerbaijan, and an increase in average realized prices in Russia.

Our major purchaser of natural gas produced in the Russian Federation is OAO Gazprom. In the nine months of 2008, we sold 6,063 million cubic meters of natural gas to OAO Gazprom (5,336 million cubic meters in the same period of the previous year), and the average realized price increased by 7.7% to $44 per 1,000 cubic meters.

Sales of other products

Other sales include sales through our retail network, other services provided and goods not related to our primary activities (such as electricity, heat, transportation, etc.) sold by our production and marketing companies and revenue of our electric power generating companies.

In the nine months of 2008, other sales increased by $780 million, or by 68.7%.

During the nine months of 2008, sales of goods and other products from our retail outlets amounted to $479 million, an increase of $169 million above the level of the respective period of 2007. This was mainly attributable to additional sales generated by the petrol stations acquired from ConocoPhillips in the second quarter of 2007 and an overall increase in non-petroleum sales by our international and Russian retail outlets.

The Group develops its electric power business. Related sales increased compared to the nine months of 2007 by $311 million mainly as a result of the acquisition of TGK-8.

Equity share in income of affiliates

The Group has investments in equity method affiliates and corporate joint ventures. These companies are primarily engaged in crude oil exploration, production, marketing and distribution operations in the Russian Federation and crude oil production and marketing in Kazakhstan. Our largest affiliate is ZAO Turgai-Petroleum, a 50% interest affiliate company developing the Kumkol oil field in Kazakhstan.

Compared to the nine months of 2007, our share in income of affiliates increased by $211 million, or by 84.1%, primarily due to the increase in net income of our exploration and production affiliates, Turgai-Petroleum and LUKARCO B.V., and a general increase in profitability of our affiliates because of an increase in crude oil and refined products prices.

Operating expenses

Operating expenses include the following:

	9 months of	
	2008	**2007**
	(millions of US dollars)	
Hydrocarbon extraction expenses	2,421	2,049
Own refining expenses	849	631
Refining expenses at third party refineries	297	169
Excise included in the processing fee paid to third party refineries*	90	141
Petrochemical expenses	187	198
Crude oil transportation to refineries	823	607
Other operating expenses	1,344	877
	6,011	**4,672**
Change in operating expenses in crude oil and refined products inventory originating within the Group**	(129)	(203)
Total operating expenses	**5,882**	**4,469**
Cost of purchased crude oil, gas and products	**31,956**	**19,504**

*As a result of amendments to the Russian tax legislation, effective from January 1, 2007, the responsibility to pay excises on refined products (except for straight-run gasoline) was transferred from traders and retailers to refineries. Therefore excises are included in processing fees.

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

Compared to the nine months of 2007, operating expenses increased by $1,413 million, or by 31.6%, which is mainly explained by the growth of other operating expenses, hydrocarbon extraction expenses and processing and refining costs. Real appreciation of the ruble against the US dollar is a significant factor affecting our operating expenses in Russia. The devaluation of the purchasing power of the US dollar in the Russian Federation in the nine months of 2008 was 23.0%, compared to the same period of 2007.

Hydrocarbon extraction expenses

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

In the nine months of 2008, our extraction expenses increased by $372 million, or by 18.2%, compared to the same period of 2007. The increase resulted from the effect of the real ruble appreciation against the US dollar, increased expenses for energy supply, materials, artificial stimulation of reservoirs and labor. Our average hydrocarbon extraction cost per barrel of oil equivalent increased from $3.55 to $4.16, or by 17.2%, compared to the nine months of 2007.

Own refining expenses

In the nine months of 2008, refining expenses increased by $218 million, or by 34.5%, compared to the same period of 2007.

Refining expenses at our domestic refineries increased by 29.8%, or by $139 million, mainly as a result of increased expenses for power supply, real ruble appreciation against the US dollar and increased production volumes.

Refining expenses at our international refineries increased by 48.2%, or by $79 million. This resulted mainly from increased expenses for power supply, the effect of appreciation of the exchange rates of the Romanian and Bulgarian currencies to the US dollar, and an increase in production volumes mainly as a result of commencement of operations of Odessa refinery after a wide-scale upgrade.

Refining expenses at third party refineries

Along with our own production of refined products we refined crude oil at third party refineries both in Russia and overseas.

In the nine months of 2008, refining expenses at third party refineries increased by 75.7%, compared to the same period of 2007, as a result of increased refining costs in Russia that are linked to crude oil prices. Also, we increased refining volumes in Belarus.

Petrochemical operating expenses

In the nine months of 2008, operating expenses of our petrochemical companies decreased by $11 million, or by 5.6%, compared to the same period of 2007.

Crude oil transportation to refineries

Crude oil transportation to refineries increased in the nine months of 2008 by $216 million, or by 35.6%, compared to the same period of 2007, due to an increase in transportation tariffs and volumes transported.

Other operating expenses

Other operating expenses include expenses of the Group's upstream and downstream enterprises that do not relate to their core activities, namely sales of electricity, heat, transportation services, other goods, etc., operating expenses of our gas processing plants, the costs of other services provided and goods sold by our marketing companies, and operating expenses of our power generating companies and of other non-core businesses of the Group.

In the nine months of 2008, our other operating expenses increased by $467 million, or by 53.2%, compared to the same period of 2007. This was due to a general increase in other sales including growth of transportation and other services provided by the Group in the international segment. One fourth of the increase of other operating expenses was attributable to changes in Group structure, mainly the acquisition of TGK-8 in May 2008.

Cost of purchased crude oil, gas and products

Cost of purchased crude oil, gas and products increased by $12,452 million in the nine months of 2008, or by 63.8%, compared to the same period of 2007, due to increases in international crude oil and refined products prices and an increase in volumes of crude oil purchases.

Cost of purchased crude oil, gas and products included the result of hedging of international crude oil and refined products sales. In the nine months of 2008, we recognized a $96 million expense on hedging, compared to an expense of $334 million in the same period of 2007.

Cost of purchased crude oil, gas and products for the nine months of 2008 included purchases of natural gas and fuel oil to supply TGK-8.

Transportation expenses

Our transportation expenses increased in the nine months of 2008 by $797 million, or by 24.5%, compared to the same period of 2007. This was due to an increase in transportation tariffs and an overall increase in refined products sales volumes in Russia and internationally.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations, weighted by volumes transported, changed in the nine months of 2008, compared to the same period of the previous year, as follows: crude oil and refined products freight rates increased by 19.1% and 19.2%, respectively; crude oil pipeline tariffs increased by 21.0%; railway tariffs for refined products transportation increased by 17.8%.

Selling, general and administrative expenses

Selling, general and administrative expenses include general business expenses, payroll costs (excluding extraction entities' and refineries' production staff costs), insurance costs (except for property insurance related to extraction and refinery equipment), costs of maintenance of social infrastructure, movement in bad debt provision and other expenses.

In the nine months of 2008, our selling, general and administrative expenses increased by $573 million, or by 25.4%, compared to the same period of 2007.

The growth was mainly due to real ruble appreciation, expansion of our activities both in Russia and internationally, and an overall increase in selling expenses.

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 $423 million, or by 25.3%, compared to the nine months of 2007. The increase was a result of the Company's capital expenditures and acquisitions and the corresponding increase in depreciable assets.

Exploration expenses

During the nine months of 2008, exploration expense increased by $97 million, or by 55.1%, compared to the same period of 2007. Dry hole costs increased by $94 million to $168 million.

In the nine months of 2008, we charged to expense the costs of three dry wells in Saudi Arabia totaling $113 million. Also, we expensed dry hole costs related to our projects in Kazakhstan and Columbia in amount of $20 million and $27 million, respectively.

In the nine months of 2007, we completed the assessment of two exploratory wells drilled in Saudi Arabia. One of the wells was dry, and its cost of $54 million was charged to expense in the nine months of 2007. The second well discovered a natural gas reservoir. During the nine months of 2007, the dry hole costs in Russia amounted to $20 million and primarily related to Volga and Timan-Pechora regions.

Loss on disposals and impairments of assets

Loss on disposals and impairments of assets for the nine months of 2008 amounted to $210 million, compared to $33 million in the respective period of 2007.

In the nine months of 2008, the loss included $156 million related to impairment of certain oil and gas assets located in the Timan-Pechora region. The impairment resulted from a decrease in crude oil reserves due to revision of geological models.

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

Taxes other than income taxes

	9 months of	
	2008	**2007**
	(millions of US dollars)	
In Russia		
Mineral extraction taxes	10,242	5,833
Social security taxes and contributions	366	304
Property tax	276	201
Other taxes	108	109
Total in Russia	**10,992**	**6,447**
International		
Social security taxes and contributions	59	42
Property tax	24	22
Other taxes	49	18
Total internationally	**132**	**82**
Total	**11,124**	**6,529**

In the nine months of 2008, taxes other than income taxes increased by 70.4%, or by $4,595 million, compared to the same period of 2007, mainly due to an increase in mineral extraction tax resulting from an increase in the crude oil extraction tax rate.

Excise and export tariffs

Our excise and export tariffs include taxes on sales of refined products and export tariffs on the export of crude oil and refined products.

	9 months of	
	2008	**2007**
	(millions of US dollars)	
In Russia		
Excise tax	745	524
Crude oil export tariffs	9,356	5,712
Refined products export tariffs	3,040	1,839
Total in Russia	**13,141**	**8,075**
International		
Excise tax and sales taxes on refined products	2,963	2,532
Crude oil export tariffs	60	–
Refined products export tariffs	178	16
Total internationally	**3,201**	**2,548**
Total	**16,342**	**10,623**

In spite of a decrease in crude oil export volumes, excise and export tariffs increased by $5,719 million, or by 53.8%, compared to the nine months of 2007, due to the increase in tariff rates.

The growth in international excises was mainly due to the effect of the acquisition of the European petrol stations from ConocoPhillips in the second quarter of 2007, increase in volumes sold and the appreciation of the Euro against the US dollar, as the excise rates in most European countries we operate in are either denominated in Euro or tied to it.

Income taxes

Our total income tax expense increased by $1,404 million, or by 62.7%, compared to the nine months of 2007, due to an increase of income before income tax of $5,871 million, or 68.8%.

Our effective income tax rate in the nine months of 2008 was 25.3%, compared to 26.2% in the same period of 2007. As a result of recent amendments to Russian tax legislation related to taxation of dividend payments, we recovered the deferred tax liability on undistributed retained earnings of our subsidiaries where our share was less than 100% as of January 1, 2008. This factor led to a decrease in our effective income tax rate.

The Group’s effective income tax rate for the periods presented differs from the statutory income tax rate primarily due to domestic and foreign rate differences and the incurrence of costs that are either not tax deductible or only deductible to a certain limit.

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

	9 months of	
	2008	**2007**
	(millions of US dollars)	
Net income	**10,765**	**6,298**
Add back:		
Income tax expense	3,643	2,239
Depreciation and amortization	2,098	1,675
Interest expense	259	240
Interest and dividend income	(113)	(82)
EBITDA	**16,652**	**10,370**

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

Three months ended September 30, 2008, compared to three months ended September 30, 2007

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

	3rd quarter of	
	2008	**2007**
	(millions of US dollars)	
Revenues		
Sales (including excise and export tariffs)	32,375	21,315
Equity share in income of affiliates	180	100
Total revenues	**32,555**	**21,415**
Costs and other deductions		
Operating expenses	(2,204)	(1,555)
Cost of purchased crude oil, gas and products	(10,837)	(7,384)
Transportation expenses	(1,494)	(1,116)
Selling, general and administrative expenses	(1,042)	(796)
Depreciation, depletion and amortization	(771)	(570)
Taxes other than income taxes	(4,372)	(2,486)
Excise and export tariffs	(6,566)	(3,954)
Exploration expense	(188)	(51)
(Loss) gain on disposals and impairments of assets	(19)	1
Income from operating activities	**5,062**	**3,504**
Interest expense	(95)	(86)
Interest and dividend income	39	29
Currency translation (loss) gain	(292)	51
Other non-operating income (expense)	3	(56)
Minority interest	26	(48)
Income before income taxes	**4,743**	**3,394**
Current income taxes	(1,459)	(906)
Deferred income taxes	188	(6)
Total income tax expense	**(1,271)**	**(912)**
Net income	**3,472**	**2,482**
Basic earnings per share of common stock (in US dollars)	4.09	3.01
Diluted earnings per share of common stock (in US dollars)	4.09	3.00

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

Sales revenues

Sales breakdown	3rd quarter of 2008	2007
	(millions of US dollars)	
Crude oil		
Export and sales on international markets other than CIS	6,866	4,664
Export and sales to CIS	420	167
Domestic sales	229	121
	7,515	**4,952**
Refined products		
Export and sales on international markets		
Wholesale	15,070	9,839
Retail	3,520	2,630
Domestic sales		
Wholesale	2,573	1,574
Retail	1,868	1,010
	23,031	**15,053**
Petrochemicals		
Export and sales on international markets	285	396
Domestic sales	249	180
	534	**576**
Gas and gas products		
Export and sales on international markets	267	143
Domestic sales	293	201
	560	**344**
Other products and services	**735**	**390**
Total sales	**32,375**	**21,315**

Sales volumes	3rd quarter of 2008	2007
Crude oil	(thousands of barrels)	
Export and sales on international markets other than CIS	61,440	64,929
Export and sales to CIS	7,360	3,555
Domestic sales	5,395	3,042
Crude oil	(thousands of tonnes)	
Export and sales on international markets other than CIS	8,382	8,858
Export and sales to CIS	1,004	485
Domestic sales	736	415
	10,122	**9,758**
Refined products	(thousands of tonnes)	
Export and sales on international markets		
Wholesale	16,751	16,567
Retail	2,125	2,207
Domestic sales		
Wholesale	3,400	3,606
Retail	1,728	1,303
	24,004	**23,683**
Total sales volume of crude oil and refined products	**34,126**	**33,441**

Realized average sales prices

	3rd quarter of			
	2008		2007	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	111.74	819.02	71.83	526.54
Oil (CIS)	57.12	418.68	47.04	344.81
Refined products				
Wholesale		899.64		593.90
Retail		1,656.66		1,192.15
Average realized price within Russia				
Oil	42.51	311.60	39.69	290.92
Refined products				
Wholesale		757.18		436.51
Retail		1,080.29		775.23

During the third quarter of 2008, our revenues increased by $11,060 million, or by 51.9%, compared to the same period of 2007.

The total volume of crude oil and refined products sold was 34.1 million tonnes, which represents an increase of 2.0%, compared to the third quarter of 2007. Our revenues from crude oil sales in the third quarter of 2008 increased by $2,563 million, or by 51.8%, compared to the third quarter of 2007. Our revenue from sales of refined products increased by $7,978 million, or by 53.0%.

Sales of crude oil and refined products on international markets, including the CIS, accounted for 82.8% of the total sales volume in the third quarter of 2008 (in the third quarter of 2007 – 84.1%).

The increase in sales was principally due to the following:

- increase in hydrocarbon prices
- increase in crude oil refining, resulting from high refining margins

Sales of crude oil

The 51.8% increase in our total crude oil sales revenue was attributable to the increase in crude oil sales prices. The international crude oil prices (excluding CIS) increased by 55.5%, compared to the third quarter of 2007. At the same time the total volume of international crude oil sales (other than in CIS) decreased by 5.4%, as a result of decreased our crude oil export from Russia and an increase in our international refining.

Sales of refined products

In the third quarter of 2008, our revenue from the wholesale of refined products outside Russia increased by $5,231 million, or by 53.2%, compared to the same period of 2007, mainly due to an increase in the average realized price.

In the third quarter of 2008, our revenue from international retail sales increased by $890 million, or by 33.8%, compared to the third quarter of 2007, mainly due to an increase in average retail prices by 39.0%. Our international retail sales include supplies of refined products to third party retail networks under long-term contracts with pricing similar to retail pricing.

In the third quarter of 2008, our revenue from the wholesale of refined products on the domestic market increased by 63.5%, compared to the same period of the previous year, due to an increase in the average realized price by 73.5%.

In the third quarter of 2008, our revenue from retail sales in Russia increased by $858 million, or by 85.0%, compared to the same period of 2007, due to both volume and price factors. Revenue from retail sales was 42.1% of total refined products sales in Russia in the third quarter of 2008 (in the third quarter of 2007 – 39.1%).

Sales of petrochemical products

Our revenue from sales of petrochemical products decreased in the third quarter of 2008 by $42 million, or by 7.3%, compared to the third quarter of 2007.

Sales of gas and gas products

In the third quarter of 2008, sales of gas and gas refined products amounted to $560 million, which is 62.8% more than in the third quarter of 2007. This increase was due to an increase in gas products sales revenue by $108 million, or by 41.3%, compared to the third quarter of 2007, as a result of an increase in prices for gas products both in Russia and abroad, and an increase in natural gas sales revenue. This revenue increased by $109 million, or by 139.9%, compared to the third quarter of 2007. This increase was as a result of the commencement of natural gas production in Uzbekistan and Azerbaijan, and an increase in average realized prices in Russia.

Our major purchaser of natural gas produced in the Russian Federation is OAO Gazprom. In the third quarter of 2008, we sold 2,019 million cubic meters of natural gas to OAO Gazprom (1,398 million cubic meters in the same period of the previous year), and the average realized price increased by 4.6% to $44 per 1,000 cubic meters.

Sales of other products

In the third quarter of 2008, other sales increased by $345 million, or by 88.5%, mainly as a result of the growth in other sales and services provided to third parties both in Russia and abroad.

In the third quarter of 2008, sales of goods and other products from our retail outlets amounted to $179 million, an increase of $42 million above the level of the respective period of 2007.

The Group develops its electric power business. Related sales increased compared to the third quarter of 2007 by $137 million as a result of the acquisition of TGK-8.

Equity share in income of affiliates

Compared to the third quarter of 2007, our share in income of affiliates increased by $80 million, or by 80.0%, primarily due to the increase in net income of our exploration and production affiliates, Turgai-Petroleum and LUKARCO B.V., and a general increase in profitability of our affiliates because of an increase in crude oil and refined products prices.

Operating expenses

Operating expenses include the following:

	3rd quarter of	
	2008	**2007**
	(millions of US dollars)	
Hydrocarbon extraction expenses	850	699
Own refining expenses	294	221
Refining expenses at third party refineries	121	48
Excise included in the processing fee paid to third party refineries*	26	45
Petrochemical expenses	46	64
Crude oil transportation to refineries	286	196
Other operating expenses	512	361
	2,135	**1,634**
Change in operating expenses in crude oil and refined products inventory originating within the Group**	69	(79)
Total operating expenses	**2,204**	**1,555**
Cost of purchased crude oil, gas and products	**10,837**	**7,384**

*As a result of recent amendments to the Russian tax legislation, effective from January 1, 2007, the responsibility to pay excises on refined products (except for straight-run gasoline) was transferred from traders and retailers to refineries. Therefore excises are included in processing fees.

** The change in operating expenses in crude oil and refined products inventory originating within the Group included extraction and refining expenses related to crude oil and refined products produced by the Group during the reporting period, but not sold to third parties.

Compared to the third quarter of 2007, our operating expenses increased by $649 million, or by 41.7%, which is mainly explained by the growth of other operating expenses, hydrocarbon extraction expenses and processing and refining costs. Real appreciation of the ruble against the US dollar is a significant factor affecting our operating expenses in Russia. The devaluation of the purchasing power of the US dollar in the Russian Federation in the nine months of 2008 was 23.0%, compared to the same period of 2007.

Hydrocarbon extraction expenses

In the third quarter of 2008, our extraction expenses increased by $151 million, or by 21.6%, compared to the third quarter of 2007. The increase resulted from the effect of the real ruble appreciation against the US dollar, increased hydrocarbon production and increased expenses for energy supply, materials, artificial stimulation of reservoirs and labor. Our average hydrocarbon extraction cost per barrel of oil equivalent increased from $3.68 to $4.29, or by 16.6%, compared to the third quarter of 2007.

Own refining expenses

In the third quarter of 2008, refining expenses increased by $73 million, or by 33.0%, compared to the same period of 2007.

Refining expenses at our domestic refineries increased by 32.7%, or by $53 million, mainly as a result of the increased expenses for power supply, real ruble appreciation against the US dollar and increased production volumes.

Refining expenses at our international refineries increased by 33.9%, or by $20 million. This resulted mainly from increased expenses for power supply, the effect of appreciation of the exchange rates of the Bulgarian lev to the US dollar, and an increase in production volumes mainly as a result of commencement of operations of Odessa refinery after a wide-scale upgrade.

Refining expenses at third party refineries

In the third quarter of 2008, refining expenses at third party refineries increased by 152.1%, compared to the same period of 2007, primarily as a result of increased refining costs in Russia that are linked to crude oil prices.

Petrochemical operating expenses

In the third quarter of 2008, operating expenses of our petrochemical companies decreased by $18 million, or by 28.1%, compared to the third quarter of 2007.

Crude oil transportation to refineries

Crude oil transportation to refineries increased in the third quarter of 2008 by $90 million, or by 45.9%, compared to the same period of 2007, due to an increase in transportation tariffs and volumes transported.

Other operating expenses

In the third quarter of 2008, other operating expenses increased by $151 million, or by 41.8%, compared to the same period of 2007. This was due to a general increase in other sales including growth of transportation and other services provided by the Group in the international segment. More than one third of the increase of other operating expenses was attributable to changes in Group structure, namely the acquisition of TGK-8 in May 2008.

Cost of purchased crude oil, gas and products

Cost of purchased crude oil, gas and products increased by $3,453 million in the third quarter of 2008, or by 46.8%, compared to the same period of 2007, primarily due to increases in international crude oil and refined products prices and increased volume of crude oil purchases. The effect of increased refined products price was partly compensated by decreased volumes of purchased refined products.

Cost of purchased crude oil, gas and products included the result of hedging of international crude oil and refined products sales. In the third quarter of 2008, we recognized a $623 million income on hedging, compared to an expense of $136 million in the third quarter of 2007.

Cost of purchased crude oil, gas and products for third quarter of 2008 included purchases of gas and fuel oil to supply TGK-8.

Transportation expenses

Our transportation expenses increased in the third quarter of 2008 by $378 million, or by 33.9%, compared to the same period of 2007 mainly due to an increase in transportation tariffs.

Selling, general and administrative expenses

In the third quarter of 2008, our selling, general and administrative expenses increased by $246 million, or by 30.9%, compared to the same period of 2007.

The growth was mainly due to real ruble appreciation, expansion of our activities both in Russia and internationally, and an overall increase in selling expenses.

Depreciation, depletion and amortization

Our depreciation, depletion and amortization expenses increased by $201 million, or by 35.3%, compared to the third quarter of 2007. The increase was a result of the Company’s capital expenditures and acquisitions and the corresponding increase in depreciable assets.

Exploration expenses

During the third quarter of 2008, exploration expense increased by $137 million, compared to the respective period of 2007. Dry hole costs increased from $12 million in the third quarter of 2007 to $143 million in the third quarter of 2008.

In the third quarter of 2008 we charged to expense the costs of three dry wells totaling $105 million related to our project in Saudi Arabia. Other dry hole write-offs related to our projects in Kazakhstan and Columbia and amounted to $7 million and $27 million, respectively.

Taxes other than income taxes

	3rd quarter of	
	2008	**2007**
	(millions of US dollars)	
In Russia		
Mineral extraction taxes	4,080	2,290
Social security taxes and contributions	98	77
Property tax	96	68
Other taxes	43	16
Total in Russia	**4,317**	**2,451**
International		
Social security taxes and contributions	19	16
Property tax	9	8
Other taxes	27	11
Total internationally	**55**	**35**
Total	**4,372**	**2,486**

Taxes other than income taxes increased in the third quarter of 2008 by 75.9%, or by $1,886 million, compared to the same period of 2007, mainly due to an increase in mineral extraction tax resulting from an increase in the crude oil extraction tax rate.

Excise and export tariffs

	3rd quarter of 2008	2007
	(millions of US dollars)	
In Russia		
Excise tax	272	170
Crude oil export tariffs	3,723	2,112
Refined products export tariffs	1,361	748
Total in Russia	**5,356**	**3,030**
International		
Excise tax and sales taxes on refined products	1,085	923
Crude oil export tariffs	60	–
Refined products export tariffs	65	1
Total internationally	**1,210**	**924**
Total	**6,566**	**3,954**

In spite of a decrease in crude oil export volumes, excise and export tariffs increased by $2,612 million, or by 66.1%, compared to the third quarter of 2007. This was resulted from the increase in tariff rates.

The growth in international excises was mainly due to increase in volumes sold and the appreciation of the Euro against the US dollar, as the excise rates in most European countries we operate in are either denominated in Euro or tied to it.

Income taxes

Our total income tax expense increased by $359 million, or by 39.4%, compared to the third quarter of 2007, due to an increase of income before income tax of $1,349 million, or 39.7%.

Our effective income tax rate in the third quarter of 2008 was 26.8%, compared to 26.9% in the third quarter of 2007.

The Group's effective income tax rate for the periods presented differs from the statutory income tax rate primarily due to domestic and foreign rate differences and the incurrence of costs that are either not tax deductible or only deductible to a certain limit.

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

	3rd quarter of 2008	2007
	(millions of US dollars)	
Net income	**3,472**	**2,482**
Add back:		
Income tax expense	1,271	912
Depreciation and amortization	771	570
Interest expense	95	86
Interest and dividend income	(39)	(29)
EBITDA	**5,570**	**4,021**

Liquidity and capital resources

	9 months of 2008	9 months of 2007
	(millions of US dollars)	
Net cash provided by operating activities	10,943	7,251
Net cash used in investing activities	(9,703)	(6,476)
Net cash provided by (used in) financing activities	86	(704)

Operating activities

Our primary source of cash flow is funds generated from our operations. During the nine months of 2008, cash generated by operating activities was $10,943 million, an increase of 50.9% compared to the same period of 2007. In the nine months of 2008, our operating cash inflows were affected by an increase of working capital by $1,925 million, compared to January 1, 2008. This was mainly caused by:

- an increase in inventory of $1,241 million, resulting from increased volumes of crude oil and refined products in transit and increased hydrocarbons prices
- a $379 million net increase in trade accounts receivable and payable
- a $286 million net increase in other assets and liabilities
- a $19 million net increase in tax accounts payable

Investing activities

An increase in cash used in investing activities resulted from an increase in cash paid for acquisitions of subsidiaries and cash spent on capital expenditures.

In the nine months of 2008, we made a final payment of $157 million and a first contingent payment of $100 million for the acquisition of upstream assets in Uzbekistan (SNG Holdings Ltd.), $64 million for the increase in our share of the share capital of our refinery in Nizhny Novgorod. We paid $1,218 million as the cash part of the consideration of the TGK-8 acquisition, including $1,019 million in the third quarter of 2008. The other payments were primarily advances related to acquisitions of marketing assets in Russia and abroad.

In the nine months of 2007, cash flows from investing activities included $1,155 million of cash received from the sale of our 50% interest in Caspian.

Capital expenditures increased by $1,261 million, or by 19.6%, compared to the nine months of 2007 (for a detailed analysis of capital expenditures see a later section).

During the nine months of 2007, the Company paid $249 million for the acquisition of licenses for crude oil exploration and production on two oil fields in the Komi Republic. Payments for acquisition of licenses in the nine months of 2008 were $12 million.

Financing activities

In the nine months of 2008, net movements of short-term and long-term debt generated an inflow of $884 million, compared to an inflow of $418 million in the same period of 2007.

Net inflows of cash in the nine months of 2008 included long-term loans of $639 million received from ConocoPhillips as its part of financing of our joint venture in the Timan-Pechora region. In the nine months of 2007, we received $456 million from ConocoPhillips as its part of financing the joint venture.

Cash inflows in the nine months of 2008 included $235 million related to the sale of 7,449 LPG and oil tank-wagons, which were leased back by the Group under a capital lease agreement.

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

Analysis of capital expenditures

	9 months of		3rd quarter of	
	2008	**2007**	**2008**	**2007**
	(millions of US dollars)			
Exploration and production				
Russia	5,439	4,699	1,760	1,659
International	712	559	298	214
Total exploration and production	6,151	5,258	2,058	1,873
Refining, marketing and distribution				
Russia	914	743	364	333
International	525	426	186	169
Total refining, marketing and distribution	1,439	1,169	550	502
Chemicals				
Russia	16	60	6	5
International	77	59	42	25
Total chemicals	93	119	48	30
Other	87	56	39	22
Total capital expenditures*	**7,770**	**6,602**	**2,695**	**2,427**
Acquisitions of subsidiaries**				
Exploration and production				
Russia	–	23	–	18
International	257	410	–	6
Total exploration and production	257	433	–	24
Refining, marketing and distribution				
Russia	500	147	–	76
International	379	442	–	–
Total refining, marketing and distribution	879	589	–	76
Other	3,189***	17	1,019	11
Less cash acquired	(167)	(100)	(23)	–
Total acquisitions of subsidiaries	**4,158**	**939**	**996**	**111**

* Including non-cash transactions and prepayments.

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

*** Including $1,969 million of non-cash part of consideration for acquisition of TGK-8.

During the nine month of 2008, our capital expenditures, including non-cash transactions, amounted to $7,770 million, or $1,168 million more than in the same period of 2007. The growth mainly resulted from expenditures in our exploration and production segment, which increased by $893 million, or by 17.0%, compared to the same period of 2007. The exploration and production capital expenditures in new regions decreased by $80 million. The capital expenditures in the traditional exploration and production region of Western Siberia increased by $550 million mainly as a result of an increase in production drilling. The capital expenditures in European Russia increased by $265 million also substantially as a result of increased production drilling. An increase in the capital expenditures in our overseas exploration projects (excluding the Caspian region) amounted to $158 million and was primarily related to our projects in Kazakhstan and Saudi Arabia.

Due to unfavorable conditions on hydrocarbon markets the Company reduced the planned level of capital expenditures for 2009 from $11.2 billion to $9.7 billion. In case of crude oil price decreases the Company is ready to further reduce capital expenditures in order to maintain positive cash flows. This decrease will not affect the Company’s key projects.

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

	9 months of		3rd quarter of	
	2008	**2007**	**2008**	**2007**
	(millions of US dollars)			
Northern Timan-Pechora	1,366	1,595	472	586
Yamal	133	65	78	31
Caspian region*	343	262	122	143
Total	**1,842**	**1,922**	**672**	**760**

* Russian and international projects.