

Open Joint Stock Company "Oil Company "LUKOIL"

Summary of 2005 performance results and main objectives for 2006

In 2005 the Company continued to develop its business, retaining a stable financial position that allowed it to meet its commitments to shareholders, creditors and the state. Implementation continued of a strategy aimed at high-quality growth, maximising shareholder value and an increase in return on invested capital. The year was characterised by a favourable situation on the market for oil and oil products, which together with expanded operations and greater efficiency allowed the Company to achieve significant results.

In the reporting period the Company's efforts were aimed primarily at increasing operating efficiency in the areas of exploration, production, refining and marketing. The Company paid special attention to optimising and expanding its asset portfolio, as well as optimising the corporate structure and improving corporate governance.

The most important events of 2005 were: acquisition of Nelson Resources Limited, which owns production assets in Kazakhstan; discovery of a major deposit of high-quality oil in the Northern Caspian; acquisition of OAO Primorieneftgaz, which owns licenses for exploration of the Poymennyy block (Lower Volga), where the major Tsentralno-Astrakhanskoe gas-condensate deposit was discovered in 2004.

Another important event in 2005 was the creation of the joint venture OOO Naryanmarneftgaz with the LUKOIL Group's strategic partner ConocoPhillips. The joint venture has begun the development of resources in the north of the Timano-Pechora oil and gas province.

Financial performance excluding subsidiaries. Revenues from the sale of goods, products, work and services (less VAT, excise and similar mandatory payments) were 612 billion roubles; net profits were 66.3 billion roubles.

Exploration work and reserves of oil and gas. In 2005, as in 2004, the bulk of exploration work was performed in the regions of the Timano-Pechora oil and gas province, Western Siberia and the floor of the Caspian Sea.

As of 1 January 2006 the proved reserves of the LUKOIL Group under international classifications* were 20.331 billion BOE, including 16.115 billion BOE of oil reserves and 25.298 trillion cubic feet of gas.

Over 2005 the hydrocarbon reserves of the LUKOIL Group rose by 4.8% taking production into account, and by 1.3% without taking production into account. The level of replacement of hydrocarbon production with new reserves was 137%. The main increase in proved oil reserves was achieved in Western Siberia and in international projects. The level of replacement of oil production with new reserves was 122%.

Oil production. Oil production of the LUKOIL Group in 2005 was 90.16** million tonnes, including 86.19 million tonnes produced by subsidiaries. The LUKOIL Group's average daily production was 4.7% higher than in 2004.

* In 2005 Miller and Lents (USA) performed the eleventh annual technical and economic audit of the reserves of the LUKOIL Group in accordance with US SPE requirements.

** Under US GAAP methodology, includes the production of subsidiaries and share in the production of associates.

As part of the “Comprehensive program to optimise OAO “LUKOIL” oil development and production in 2003–2005”, 425 low-yield and high-water-cut wells (average water cut 98.7%) were taken out of production in 2005, which together with the use of modern technology to increase formation yield and the drilling of horizontal and secondary holes made it possible to increase the average oil-well yield by 3.5% to 11.1 t/day, and also to maintain the water cut of products at the existing level.

Gas production. In 2005 the LUKOIL Group produced 7.569 billion m³ (732 million cubic feet per day)^{***} of which the production of subsidiaries accounted for 7.267 billion m³. The Company’s average daily production was 17.3% higher than in 2004.

The production of natural gas was 2.628 billion m³, or 43.8% higher than in 2004. The share of associated gas in total production was 65.3%, or 4.941 billion m³. The level of use of associated gas was 79%, which corresponds to the 2004 level.

In April 2005, the Nakhodkinskoe gas deposit in the Bolshekhetskaya depression went into operation. Over the course of the year, 472 million m³ of gas were produced at the deposit. The start of production at this deposit marked the transition of the LUKOIL Group gas programme into its active phase.

Oil refining. The volume of oil refining rose by 8.0%, from 44.03 million tonnes to 47.55 million tonnes (taking into account processing at third-party refineries, refining volume rose by 11.3% to 50.4 million tonnes). Production of high-quality fuels increased. At the Russian refineries of the Company the output of high-quality diesel fuel that meets the most modern ecological standards (Euro-3, Euro-4 and Euro-5) rose by a factor of four, to 5.2 million tonnes (50.7% of the total output of diesel fuel). In 2005, LUKOIL became the first Russian oil company to begin large-scale production of LUKOIL Euro-4 diesel, with improved ecological characteristics, and begin its widespread sale. This fuel meets European EN-590:2004 environmental standards for diesel in effect in the European Union from 2005.

Production of petrochemical products. In 2005, the petrochemical enterprises of the LUKOIL Group produced more than 1.8 million tonnes of products, including 402,000 tonnes of polyethylene (8% more than in 2004), 53,000 tonnes of vinyl acetate (30% more than in 2004), and 128,000 tonnes of acrylonitrile (9% more than in 2004). In addition, the Bulgarian refinery LUKOIL Neftokhim Burgas produced 372,500 tonnes of petrochemical products, including 181,600 tonnes of organic synthesis products and 179,700 tonnes of polymers, including 68,200 tonnes of high-pressure polyethylene.

Processing of raw materials at the Company’s gas-refining enterprises. In 2005, the gas refineries of the LUKOIL Group processed 2.691 billion m³ of gas stock and 479,000 tonnes of broad-fraction light hydrocarbons. Output included 2.192 billion m³ of gas products, 574,000 tonnes of liquefied gases and 571,000 tonnes of liquid hydrocarbons (stable natural gasoline, isopentane and hexane heptane fractions, broad fractions of light hydrocarbons).

Oil exports. In 2005, growing export duties and rising domestic oil prices led to a reduction in the attractiveness of oil exports. The freed-up amounts were used to feed the Company’s Russian refineries and third-party Russian refineries. Exports of oil by the subsidiaries within

^{***} Under US GAAP methodology, includes the production of subsidiaries and share in the production of associates; also includes gas for sale and internal use, as well as process losses.

the LUKOIL Group (including oil obtained from third-party producers) dropped by 1% year-on-year to 45.8 million tonnes. Of this amount 40.1 million tonnes were exported to countries outside the former Soviet Union, 5.7 million tonnes to other countries of the former Soviet Union.

The bulk of exports in 2005 were made using the Transneft transport system. Exports using this system totalled 38.5 million tonnes, or 1% less than in 2004.

LUKOIL also used alternative delivery methods in 2005, including through the infrastructure of its own refineries. These alternative methods were used to deliver 7.3 million tonnes of oil in 2005, or 1.4% less than in 2004.

Sale of oil products. In 2005, LUKOIL brand oil products were sold through more than 5,800 filling stations in Russia and the former Soviet Union, Europe and the Baltics, and also the USA. Total sales of the Company's oil products in 2005 were 76.6 million tonnes, an increase of 25.3% year-on-year. The Company's own stations sold 10.7 million tonnes of oil products, 29.7% more than in 2004.

In March 2005 the Company acquired the Finnish companies Oy Teboil Ab and Suomen Petrooli Oy. The transaction amount was USD 160 million. The main lines of business of Oy Teboil Ab and Suomen Petrooli Oy are the management of a chain of 289 filling stations and 132 diesel stations (separate underground tanks and pumps for diesel), wholesale sales of oil products and also the production and sale of oils.

In 2005 the **OAo "LUKOIL" Strategic Development Programme** continued, aimed at increasing the operating efficiency and shareholder value of the Company:

- **Exploration and production sector:** implementation of new exploration technologies continued, with the aim of raising the effectiveness of exploration work. In order to raise the effectiveness of oil production, low-yield and high-water-cut wells are being taken out of operation, horizontal wells and sidetracks are being drilled, and modern production enhancement technologies are being used. As part of its strategy to become a global energy company, LUKOIL acquired Nelson Resources Limited, which significantly improved the Group's strategic position in the Caspian region.
- **Oil refining sector:** Due to the increase in the oil-refining margin, the capacity usage of the Company's Russian refineries has been increased; these refineries processed 37.3 million tons of oil. In 2005 LUKOIL began the reconstruction and modernisation of the Nizhny Novgorod refinery, which will be completed by 2009. The total volume of capital investments is estimated at approximately USD 600 million, which will go mainly to the construction of catalytic cracking, alkylation and visbreaking units. The Odessa refinery has been closed for comprehensive overhaul since July 2005. The core of this project is the construction of a catalytic cracking facility and a power unit. Total investments are estimated at USD 320 million. The upgrade will be performed over the course of five years.
- **Disposal of non-core assets:** In July 2005 LUKOIL completed the sale of a 100% shareholding in ZAO Arcticneft. The purchaser was the Cypriot company Urals Energy Holdings Limited. The total transaction amount of about USD 40 million includes about USD 20 million for shares in ZAO Arcticneft and the repayment of

about USD 20 million in debts to the LUKOIL Group. In June 2005 LUKOIL sold its 38-percent share in ZAO Globalstroi-Engineering (previously ZAO LUKOIL-Neftegazstroi) for USD 69 million.

OAO “LUKOIL” shares are one of the most liquid instruments on the stock market.

During the reporting year, Company shares were traded on the Russian exchanges RTS and MICEX. The programme of American depositary receipts and global depositary receipts for Company shares continued in 2005; these were traded on the London, Berlin, Frankfurt, Munich and Stuttgart exchanges, and also on the over-the-counter market in the USA.

In May 2005 the ratio of shares and ADRs of the Company was changed for the two most liquid depositary receipts programmes: from one ADR representing four ordinary shares, to one ADR representing one ordinary share. The main purpose of the change was to create additional liquidity and increase the appeal of depositary receipts to all categories of investors.

The year 2005 was one of record growth in the Company’s capitalisation. The OAO “LUKOIL” share price on the RTS exchange grew 95.7%, compared to the increase in the RTS index of 83.3%, and in the Bloomberg Oils index of international oil majors of 25.1%. Thus, the market continued to value the Company higher than market indexes, which shows a significant rise in its investment appeal.

Thanks to an increase in operating efficiency and a higher level of corporate governance, investor interest in the securities of OAO “LUKOIL” rose during the year. In Q4 2005, the turnover on Company shares (ADRs) on the major exchanges (MICEX and the LSE) was USD 19.47 billion, which is 130.3% higher than Q1 2005. This increase is due not only to the growth in market capitalisation but also to an increase in the number of securities being traded.

Main objectives of the Company for 2006. The Company will make every effort in 2006 to ensure stable and successful operations under market conditions, with the aim of increasing share capitalisation. This past year has proven that the Company is capable of maintaining the required balance between its long-term and short-term goals in order to achieve the greatest possible economic benefit.

The Company’s main objectives in the near future include:

In the area of investing:

- ensuring the further growth in the Company’s value and an increase in profits based on improved efficiency of operations in all lines of business.

In the Exploration and Production business segment:

- maintenance of an annual growth of production of at least 7.9 percent and replenishment of hydrocarbon raw material reserves of at least 100 percent of production volumes;
- an increase in the value of hydrocarbon reserves by converting undeveloped reserves into developed reserves;
- a further increase in the share of foreign projects in the Company’s reserves and production through the acquisition of assets and participation in projects at the exploration stage;

- preparation of the raw materials base for organisation of oil and gas production in the Northern Caspian, the Nenets and Yamal-Nenets Autonomous Okrugs;
- continued expansion of the raw materials base for organisation of large-scale production of natural gas.

In the Refining and Distribution business segment:

- an increase in the efficiency of refining of crude oil at Russian and foreign refineries through better logistics, optimisation of the capacity usage of installations, and an increase in the share of high added-value products;
- the orientation of priority investment programmes in oil refining to the creation of modern, world-class refining facilities;
- development of the possibility to position the LUKOIL brand as a leader in the manufacture of quality products that meet European quality standards (Euro-3 and Euro-4);
- the completion of the reconstruction programme of retail networks in 2005–2006, and the medium-term programme for optimisation of retail networks.

Another priority area of activity for OAO “LUKOIL” is further development and optimisation of the portfolio of foreign oil-and-gas assets, since increasing the scope of international exploration and development activity is an important factor in growing the Company’s shareholder value.

In the area of corporate governance:

- development of the system of corporate governance in order to achieve the strategic goals of the LUKOIL Group and make management decision-making faster and more efficient;
- implementation of a programme aimed at further improvement of the Company’s information transparency and openness.

Among the measures to be taken to increase the Company’s market capitalisation, the most notable is the rigorous implementation of the Programme for Strategic Development to 2014, in the area of a reduction in production costs, efficient use of oil resources, asset optimisation and improved corporate governance. Attaining these goals will allow us to meet our obligations to shareholders and investors to increase the value of the Company and the income of shareholders and investors.

Board of Directors of OAO “LUKOIL”