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

The following report represents management's discussion and analysis of the financial condition and results of operations of OAO LUKOIL as of March 31, 2008, and for the three months ended March 31, 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

	3 months of		Change, %
	2008	**2007**	
Sales (millions of US dollars)	24,955	15,652	59.4
Net income (millions of US dollars)	3,163	1,299	143.5
EBITDA (millions of US dollars)	4,846	2,432	99.3
Basic earning per share of common stock (US dollars)	3.83	1.56	145.5
Hydrocarbon production by the Group including our share in equity affiliates (thousands of BOE)	199,494	201,537	(1.0)
Crude oil production by the Group including our share in equity affiliates (thousands of tonnes)	23,622	24,431	(3.3)
Gas available for sale produced by the Group including our share in equity affiliates (millions of cubic meters)	4,290	3,581	19.8
Refined products produced by our subsidiaries (thousands of tonnes)	12,460	11,424	9.1

During the first quarter of 2008, our net income was $3,163 million, which is $1,864 million, or 143.5%, more than in the same period of 2007.

The main factor for improvement of our performance in the first quarter of 2008 was an increase in the international crude oil and refined products prices. On the other side we were affected by growing operating expenses, transportation tariffs and tax expenses. However, the negative effect of these factors was partially mitigated by increased volumes of crude oil refining. 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 banking, finance and other activities. Each of our three main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in the "Domestic crude oil and refined products prices" section on page 7, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs, regional market conditions, the cost of refining crude oil and other factors. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of those segments' underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows. However we present the financial data for each in Note 22 "Segment information" to our interim consolidated financial statements.

Executive overview

Changes in the Group structure, acquisition and disposition of assets

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

- An amount of $75 million payable when both the signing of the mining protocol by the AGD shareholders and the decision to mine have been passed by the AGD board of directors.
- An amount of $50 million payable at the commencement of commercial production. The amount will only be payable if the first contingent event has occurred.

The agreement contains a put option in favour of ADC whereby ADC can require the Company to repurchase ADC's 49.99% interest in AGD at the purchase price and adjusted for amounts invested in AGD as defined by the agreement. The option is exercisable within 18 months after completion date where losses relating to tax, environmental or restructuring individually or in aggregate equal or exceed $50 million. It is expected the transaction will be finalized by the end of 2008. In accordance with this agreement, upon completion the litigation and arbitration proceedings between ADC and the Group will be terminated (litigations are described in Note 19 "Commitments and contingencies" to our interim consolidated financial statements). AGD is a company which owns a diamond exploration license in the Timan-Pechora region of the Russian Federation.

In April 2008, the Group sold 7,449 LPG and oil tank-wagons for $256 million and leased them back. These tank-wagons had a carrying value which approximated $93 million and were sold in line with the Group's strategy to dispose non-core assets.

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 approximates their carrying value of $70 million. As of March 31, 2008 and December 31, 2007, the Group classified these tankers as assets held for sale in the consolidated balance sheets.

In March 2008, a Group company entered into agreement to acquire 75 petrol stations and storage facilities in Bulgaria for approximately $367 million. The transaction is expected to be finalised 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.

- An amount of $100 million payable if an agreed level of proved and probable hydrocarbon reserves are verified by an independent petroleum engineer by June 15, 2008.
- An amount of $100 million payable upon approval of the agreed development program by the Uzbekistan authorities and 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 64.3% interest in OAO UGK TGK-8 ("TGK-8") for approximately $2,117 million. Purchase consideration consists of 23.55 million shares of common stock of the Company (at a market value of approximately $1,620 million) and a cash payment of approximately $497 million. The transaction was finalized in May 2008. 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. 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 quarter 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 committed to a plan to sell 162 petrol stations, located in Pennsylvania and southern New Jersey, USA, previously acquired from ConocoPhillips in 2004. In February 2008, this company entered into an agreement to sell these petrol stations to a third party investor for $138 million, less estimated amounts to extinguish environmental remediation liabilities of approximately $19 million. The Group will continue to supply petroleum products to these petrol stations under a 15 year supply contract with the new owners. The transaction is expected to be finalized in the second quarter of 2008. As of March 31, 2008 and December 31, 2007, the Group classified these petrol stations with the carrying value of $134 million as assets held for sale in the consolidated balance sheet, additionally the Group had a liability related to assets held for sale with the carrying value of $15 million included in "Other current liabilities" of the consolidated balance sheet.

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 refined products output 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 $442 million from ConocoPhillips, its related party. The stations located in Finland will be re-branded as Teboil stations. The remaining petrol stations in other European countries will be re-branded as LUKOIL stations.

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

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

Operational highlights

Hydrocarbon production

	3 months of	
	2008	2007
Daily production of hydrocarbons, including Company's share in equity affiliates (thousand BOE per day)	2,193	2,239
- crude oil	1,915	2,005
- natural and petroleum gas*	278	234
Hydrocarbon extraction expenses (US dollar per BOE)	3.86	3.34

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

Crude oil production. In the first quarter of 2008, our total daily crude oil production decreased by 4.5% compared to the same period of 2007. We produced (including the Company's share in equity affiliates) 174.2 million barrels, or 23.6 million tonnes.

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

(thousands of tonnes)	3 months of 2008	Change to 2007			3 months of 2007
		Total, %	Change in structure	Organic change	
Western Siberia	14,331	(5.5)	105	(944)	15,170
Komi Republic	3,194	4.9	–	149	3,045
Ural region	2,837	3.1	–	84	2,753
Volga region	756	2.2	–	16	740
Northern Timan-Pechora	554	4.9	–	26	528
Other in Russia	524	2.1	–	11	513
Crude oil production in Russia	22,196	(2.4)	105	(658)	22,749
Crude oil produced internationally	832	(17.3)	(269)	95	1,006
Total crude oil produced by consolidated subsidiaries	**23,028**	**(3.1)**	**(164)**	**(563)**	**23,755**
Our share in crude oil production of equity affiliates:					
in Russia	73	(49.3)	(69)	(2)	144
outside Russia	521	(2.1)	–	(11)	532
Total crude oil production	**23,622**	**(3.3)**	**(233)**	**(576)**	**24,431**

The main oil producing region of the Company is Western Siberia. In the oil fields of Western Siberia the Company produced 62.2% of its crude oil in the first quarter of 2008 (63.9% in the first quarter of 2007). In the first quarter of 2008, the West Siberian producing assets continue maturing resulting in a production decline and increasing water cut. 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 West Siberia as they face the need to scale up pumping operations supporting crude oil production operations.

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.

We expect to begin production from the Yuzhnoye Khylchuyu oil field, located in Timan-Pechora region, in mid-2008 with approximate planned annual production of 7.5 million tonnes to be reached from 2009. We are close to finalizing infrastructure construction works related to this field including construction of the offshore ice-resistant terminal in Varandey. This oil field is developed within our strategic partnership with ConocoPhillips.

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

	3 months of			
	2008		2007	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	234	32	154	21
Crude oil purchases internationally	11,787	1,608	6,538	892
Total crude oil purchased	**12,021**	**1,640**	**6,692**	**913**

The increase in volumes of crude oil purchased internationally was primarily due to purchases for trading. During the first quarter of 2008, we purchased 459 thousand tonnes in order to process at our and at third parties' refineries compared to 248 thousand tonnes during the first quarter of 2007.

Gas production. In the first quarter of 2008, we produced 4,290 million cubic meters of gas available for sale (including our share in equity affiliates), an increase by 19.8% compared to the same period of 2007.

Our major gas production field is the Nakhodkinskoe gas field, where we produced 2,186 million cubic meters of natural gas in the first quarter of 2008 compared to 2,162 million cubic meters in the first quarter of 2007. We increased production of petroleum gas in Western Siberia by 80 million cubic meters, or by 14.4%, compared to the first quarter of 2007, primarily due to a higher level of petroleum gas utilization. Also, in mid-2007, we began production from the Shakh-Deniz field in Azerbaijan where our share in gas production totaled 127 million cubic meters in the first quarter of 2008. At the end of 2007, we began production from the Khauzak gas field in Uzbekistan, where we produced 416 million cubic meters of natural gas in the first quarter 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. The test run of the Odessa refinery after the completion of the first stage of the upgrade was held in October 2007. The second stage was completed in April 2008. Annual capacity of the Odessa refinery after completion of the upgrade amounts to 2.8 million tonnes per year.

Compared to the first quarter of 2007, production at our refineries increased by 9.1%. Russian refineries increased production by 9.8%. In the first quarter 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. In the first quarter of 2007, we performed a planned upgrade of our Bulgarian refinery resulting in a slight decrease in output. As a result, the production of our overseas refineries increased by 5.2% in the first quarter of 2008 compared to the same period of 2007.

The Group is constantly improving the refined products mix at our refineries in order to produce higher quality and more profitable products. At our Russian refineries we produced 1,764 and 1,673 thousand tonnes of Euro 4 and Euro 5 diesel fuel in the first quarters of 2008 and 2007, respectively. In the first quarters 2008 and 2007, our production of Euro 3 gasoline amounted to 702 and 202 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. To supply our retail networks in Eastern Europe we refined crude oil at third party refineries in Belorussia and Serbia. In early 2007, we decreased processing of our crude oil at Belorussian refineries due to a reduction in profitability 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 Belorussia.

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. As a result of our international expansion, the total volume of refined products purchased from third parties for wholesale and to supply retail networks increased to 9,603 thousand tonnes, or $7,023 million, in the first quarter of 2008 (compared to 9,002 thousand tonnes or $4,388 million in the first quarter 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.

	3 months of	
	2008	**2007**
	(thousand barrels per day)	
Own refinery throughput*	1,069	984
Refinery throughput at third parties refineries	108	85
Total refinery throughput	**1,177**	**1,069**
	(thousand of tonnes)	
Refined products produced at the Group refineries in Russia*	10,545	9,604
Refined products produced at the Group refineries outside Russia	1,915	1,820
Total refined products produced at the Group refineries	**12,460**	**11,424**
Refined products produced at the third party refineries in Russia	702	811
Refined products produced at the third party refineries outside Russia	509	137
Total refined products produced at the third party refineries	**1,211**	**948**
Refined products purchased in Russia	481	300
Refined products purchased internationally	9,616	9,062
Total refined products purchased	**10,097**	**9,362**

* Excluding mini refineries.

Exports of crude oil and refined products from Russia

In the first quarter of 2008, our export of crude oil from Russia was 12.8% less than in the same period of 2007. During the first quarter of 2008, we exported 42.3% of our total domestic crude oil production (47.4% in the first quarter of 2007). The decrease of export was due to increased crude oil refining in Russia.

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

	3 months of			
	2008		**2007**	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Exports of crude oil using Transneft export routes	65,574	8,946	75,785	10,339
Exports of crude oil bypassing Transneft	3,299	450	3,203	437
Total crude oil exports	**68,873**	**9,396**	**78,988**	**10,776**

In the first quarter of 2008, the crude oil exported through our own export infrastructure was 446 thousand tonnes, or by 7.0%, more than in the same period of 2007.

The Group owns and operates the Vysotsk export terminal. In September 2006, we completed the construction of the Vysotsk terminal and its current capacity can be expanded up to 15 million tonnes per year. Currently we use the terminal to export refined products: in the first quarter of 2008, we exported 2,969 thousand tonnes of refined products through this terminal (in the first quarter of 2007 – 2,288 thousand tonnes). In the future we expect to use the terminal to export both crude oil and refined products, depending on market conditions.

In the first quarter of 2008, we exported from Russia 6.6 million tonnes of refined products, an increase of 10.7% compared to the first quarter of 2007. We export from Russia primarily diesel fuel, fuel oil and gasoil. These products account for approximately 87% of our refined products export volumes.

Main macroeconomic factors affecting our results of operations

Change in the price of crude oil and refined products

The price at which we sell crude oil and refined products is the primary driver of our revenues. During the first quarter of 2008, the Brent crude oil price fluctuated between $87 and $110 per barrel and reached its peak of $109.10 at the middle of March.

According to OPEC, the US dollar weakness against major currencies inspired increased investment in the commodities market, particularly for crude oil, pushing prices to record levels. At the same time, concern that economic growth could influence crude oil demand kept prices volatile. Geopolitical tensions in the Middle East pushed crude oil prices up while weak economic indicators revived concerns over a recession in the US, capping further price developments.

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

	3 months of		
	2008	**2007**	**Change, %**
	(in US dollars per barrel, except for figures in percent)		
Brent crude	96.71	57.76	67.4
Urals crude (CIF Mediterranean)*	93.00	54.26	71.4
Urals crude (CIF Rotterdam)*	93.35	54.36	71.7
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil 3.5% (FOB Rotterdam)	442.63	247.37	78.9
Diesel fuel (FOB Rotterdam)	860.67	514.80	67.2
High-octane gasoline (FOB Rotterdam)	837.49	553.70	51.3

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 in the first quarter 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 in the first quarter of 2008 and 2007.

	3 months of		
	2008	**2007**	**Change, %**
	(in US dollars per metric tonne, except for figures in percent)		
Fuel oil	258.45	103.18	150.5
Diesel fuel	666.24	419.46	58.8
High-octane gasoline (Regular)	729.33	495.37	47.2
High-octane gasoline (Premium)	809.99	613.60	32.0

Source: Kortes (excluding VAT).

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenues is either denominated in US dollars or is correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, 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 will generally cause our costs to increase in US dollar terms. The increase of the average real ruble exchange rate for the first quarter of 2008 compared to the first quarter of 2007 amounted to 17.3%. However, an increase of the ruble denominated revenue in Russia in the US dollar terms reduces this adverse effect.

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

	3 months of	
	2008	**2007**
Ruble inflation (CPI), %	4.8	3.4
Change of the ruble-dollar exchange rate, %	4.2	1.2
Average exchange rate for the period (ruble to US dollar)	24.26	26.31
Exchange rate at the end of the period (ruble to US dollar)	23.52	26.01

Tax burden

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

		3 months of		
		2008*	**2007***	**Change, %**
Export tariffs on crude oil	$/tonne	313.92	180.04	74.4
Export tariffs on refined products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	223.81	133.61	67.5
Liquid fuels (fuel oil)	$/tonne	120.60	71.94	67.6
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	3,306.41	1,902.93	73.8
Natural gas	RUR/1,000 m^3	147.00	147.00	–

* Average values.

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

		3 months of		
		2008*	**2007***	**Change, %**
Excise on refined products				
Straight-run gasoline	$/tonne	109.52	100.99	8.5
High-octane gasoline	$/tonne	149.59	137.93	8.5
Low-octane gasoline	$/tonne	109.52	100.99	8.5
Diesel fuel	$/tonne	44.52	41.05	8.5
Motor oils	$/tonne	121.64	112.16	8.5
Mineral extraction tax				
Crude oil	$/tonne	136.29	72.33	88.4
Natural gas	$/1,000 m^3	6.06	5.59	8.5

* Average values.

In the first quarter of 2008, changes in the tax rates specific to the oil industry in Russia were a result of the movements in the Urals crude oil price. These rates 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 the oilfields with depletion below 80%. Each 1% increase of depletion of a particular oilfield above 80% results in a decrease of the coefficient by 0.035. The minimum value of the coefficient is 0.3. The depletion level assessment is based on crude oil production and reserves information reported to the Russian government.

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

Crude oil export duty rate is calculated on a progressive scale. The rate is zero when the average Urals blend international market price is less than or equal to approximately $15.00 per barrel ($109.50 per metric tonne). If the Urals blend price is in a layer between $15.00 and $20.00 per barrel ($146.00 per metric tonne), each $1.00 per barrel increase in the Urals blend price over the layer’s lower bound results in an increase of the crude oil export duty rate by $0.35 per barrel exported. If the Urals blend price is in a layer between $20.00 and $25.00 per barrel ($182.50 per metric tonne), each $1.00 per barrel increase in the Urals blend price over the layer’s lower bound results in an increase of the crude oil export duty rate by $0.45 per barrel exported. Each $1.00 per barrel increase in the Urals blend price over $25.00 per barrel results in an increase of the crude oil export duty rate by $0.65 per barrel exported.

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

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

Crude oil and refined products exported to CIS countries, other than Ukraine, are not subject to export duties. On January 1, 2007, customs regulations between Russia and Belorussia were changed. Crude oil exported from Russia to Belorussia is now subject to export duties. The latest amendments made by customs authorities set a coefficient of 0.293 to be applied from February 1, 2007, to the regular export duty rate set by the Government of the Russian Federation for calculation of export duty on crude oil exports from Russia to Belorussia.

Transportation of crude oil and refined products in Russia

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

Transportation of crude oil produced in Russia to refineries and export destinations is performed primarily through the trunk oil pipeline system of state-owned Transneft. Access to the Transneft crude oil export pipeline network is allocated quarterly, based on recent volumes produced and delivered through the pipeline and proposed export destinations. The crude oil transported by Transneft is Urals blend – a mix of crude oils of various qualities, therefore Russian companies, which produce crude oil of a higher quality, can not obtain benefits from selling it using Transneft's pipeline. Alternative access to international markets bypassing Transneft export routes can be obtained through railroad transport, by tankers, and own export infrastructure of oil producing companies. Our own export infrastructure includes the Vysotsk terminal in the Leningrad region, the Varandey terminal in the Nenetsky Autonomous District and the 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.

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

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

According to the Federal Statistics Service of the Russian Federation, during the year ended March 31, 2008, transportation tariffs increased as follows: transportation of crude oil by pipeline – 21.4%, transportation of refined products by pipeline – 14.0%, transportation by railway – 11.5%. These amounts differ from actual changes in tariffs for transportation of crude oil and refined products by the Group for the period considered due to the specifics in the routes and geography of our supplies from the Russian transportation averages.

Three months ended March 31, 2008, compared to three months ended March 31, 2007

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

	3 months of	
	2008	**2007**
	(millions of US dollars)	
Revenues		
Sales (including excise and export tariffs)	24,955	15,652
Equity share in income of affiliates	129	84
Total revenues	**25,084**	**15,736**
Costs and other deductions		
Operating expenses	(1,908)	(1,443)
Cost of purchased crude oil, gas and products	(8,608)	(5,050)
Transportation expenses	(1,195)	(987)
Selling, general and administrative expenses	(796)	(663)
Depreciation, depletion and amortization	(624)	(547)
Taxes other than income taxes	(3,129)	(1,829)
Excise and export tariffs	(4,585)	(3,268)
Exploration expense	(34)	(75)
Net (loss) gain on disposals and impairments of assets	(5)	2
Income from operating activities	**4,200**	**1,876**
Interest expense	(72)	(77)
Interest and dividend income	25	29
Currency translation gain	110	42
Other non-operating expense	(48)	(19)
Minority interest	(40)	(14)
Income before income taxes	**4,175**	**1,837**
Current income taxes	(1,064)	(630)
Deferred income taxes	52	92
Total income tax expense	**(1,012)**	**(538)**
Net income	**3,163**	**1,299**
Basic earning per share of common stock (in US dollars)	3.83	1.56

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

Sales revenues

Sales breakdown	3 months of 2008	2007
	(millions of US dollars)	
Crude oil		
Export and sales on international markets other than CIS	5,542	3,819
Export and sales to CIS	325	190
Domestic sales	248	82
	6,115	**4,091**
Refined products		
Export and sales on international markets		
Wholesale	11,536	6,918
Retail	2,741	1,599
Domestic sales		
Wholesale	1,913	1,202
Retail	1,116	720
	17,306	**10,439**
Petrochemicals		
Export and sales on international markets	403	347
Domestic sales	225	156
	628	**503**
Gas and gas products		
Export and sales on international markets	157	108
Domestic sales	258	185
	415	**293**
Other products and services	**491**	**326**
Total sales	**24,955**	**15,652**

Sales volumes	3 months of 2008	2007
Crude oil	(thousands of barrels)	
Export and sales on international markets other than CIS	60,040	71,365
Export and sales to CIS	5,439	5,424
Domestic sales	5,380	3,115
Crude oil	(thousands of tonnes)	
Export and sales on international markets other than CIS	8,191	9,736
Export and sales to CIS	742	740
Domestic sales	734	425
	9,667	**10,901**
Refined products	(thousands of tonnes)	
Export and sales on international markets		
Wholesale	16,069	14,250
Retail	1,975	1,651
Domestic sales		
Wholesale	3,617	3,499
Retail	1,241	1,003
	22,902	**20,403**
Total sales volume of crude oil and refined products	**32,569**	**31,304**

Realized average sales prices

	3 months of 2008		3 months of 2007	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	92.30	676.57	53.52	392.27
Oil (CIS)	59.77	438.13	35.10	257.30
Refined products				
Wholesale		717.87		485.45
Retail		1,388.10		968.70
Average realized price within Russia				
Oil	46.11	338.01	26.32	192.90
Refined products				
Wholesale		529.05		343.40
Retail		899.12		718.10

During the first quarter of 2008, our revenues increased by $9,303 million, or by 59.4%, compared to the first quarter of 2007.

The total volume of crude oil and refined products sold was 32.6 million tonnes, which represents an increase of 4.0% compared to the first quarter of 2007. Our revenues from crude oil sales in the first quarter of 2008 increased by $2,024 million, or by 49.5%, compared to the first quarter of 2007. Our revenue from sales of refined products increased by $6,867 million, or by 65.8%.

Sales of crude oil and refined products on international markets, including the CIS, accounted for 82.8% of the total sales volume in the first quarter of 2008 (in the first quarter of 2007 – 84.3%).

The increase in sales was principally due to the following:

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

Sales of crude oil

The 49.5% increase in our total crude oil sales revenue was attributable to the increase in crude oil sales prices, which compensated decrease in volumes sold. The international crude oil prices (excluding CIS) increased by 72.5% compared to the first quarter of 2007. At the same time the total volume of international crude oil sales (other than in CIS) decreased by 15.9%, as a result of increased crude oil refining in Russia. However, we increased domestic crude oil sales volumes due to increased domestic crude oil prices.

Sales of refined products

In the first quarter of 2008, our revenue from the wholesale of refined products outside Russia increased by $4,618 million, or by 66.8%, compared to the same period of 2007, mainly due to increase of the average realized price. Increase in wholesale volumes outside Russia was primarily due to the increase in trading activities.

In the first quarter of 2008, our revenue from international retail sales increased by $1,142 million, or by 71.4%, compared to the first quarter of 2007, mainly due to increase in average retail prices by 43.3%. The increase of retail sales volumes outside Russia in the first quarter of 2008 amounted to 19.6%, or 324 thousand tonnes, compared to the first quarter of 2007. This increase is attributable to additional sales volumes generated by the 376 petrol stations acquired from ConocoPhillips in the second quarter of 2007. Refined products sales at those stations were 303 thousand tonnes in the first quarter of 2008. 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 first quarter of 2008, our revenue from the wholesale of refined products on the domestic market increased by 59.2% compared to the same period of the previous year, due to an increase of the average realized price by 54.1%. Sales volumes increased insignificantly.

In the first quarter of 2008, our revenue from retail sales in Russia increased by $396 million, or by 55.0%, compared to the same period of 2007, due to both volume and price factors. Revenue from retail sales was 36.8% of total refined products sales in Russia in the first quarter of 2008 (in the first quarter of 2007 – 37.5%).

Sales of petrochemical products

Our revenue from sales of petrochemical products increased in the first quarter of 2008 by $125 million, or by 24.9%, compared to the first quarter of 2007. This increase resulted from the increase in prices by 29.4%. At the same time, sales volumes slightly decreased compared to the first quarter of 2007.

Sales of gas and gas products

In the first quarter of 2008, sales of gas and gas refined products amounted to $415 million, which is 41.6% more than in the first quarter of 2007. This increase was due to an increase in gas products sales revenue by $92 million, or by 48.7%, compared to the first 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.

In the first quarter of 2008, sales of natural gas amounted to $127 million (an increase by 27.6% compared to the first quarter of 2007). The increase was explained by 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 first quarter of 2008, we sold 2,019 million cubic meters of natural gas to OAO Gazprom (2,018 million cubic meters in the same period of the previous year), and the average realized price increased by 10% to $44 per 1,000 cubic meters.

Sales of other products

Other sales include revenues from other 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.

Other sales increased by $165 million, or by 50.6%, mainly as a result of the growth in other sales and services provided to third parties both in Russia and abroad.

In the first quarter of 2008, sales of goods and other products from our retail outlets amounted to $141 million, an increase of $67 million above the level of the respective period of 2007. This was mainly attributable to additional sales generated by the 376 petrol stations acquired from ConocoPhillips in the second quarter of 2007.

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 first quarter of 2007, our share in income of affiliates increased by $45 million, or by 53.6%, primarily due to the increase in net income of Turgai-Petroleum, 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 types of costs:

	3 months of 2008	3 months of 2007
	(millions of US dollars)	
Hydrocarbon extraction expenses	748	651
Own refining expenses	268	192
Refining expenses at third parties refineries	69	66
Excise included in processing fee paid to third parties refineries*	33	48
Petrochemical expenses	80	64
Crude oil transportation to refineries	262	189
Other operating expenses	384	217
	1,844	**1,427**
Change in operating expenses in crude oil and refined products inventory originated within the Group**	64	16
Total operating expenses	**1,908**	**1,443**
Cost of purchased crude oil, gas and products	**8,608**	**5,050**

*As a result of recent amendments to the Russian tax legislation, effective from January 1, 2007, 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.

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

Compared to the first quarter of 2007, operating expenses increased by $465 million, or by 32.2%, 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 increase of the average real ruble exchange rate for the first quarter of 2008 compared to the first quarter of 2007 amounted to 17.3%.

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 first quarter of 2008, our extraction expenses rose by $97 million, or by 14.9%, compared to the first quarter of 2007. The increase resulted from the effect of the real ruble appreciation against the US dollar, increased expenses for energy supply and labor. Our average hydrocarbon extraction cost per barrel of oil equivalent increased from $3.34 to $3.86, or by 15.6%, compared to the first quarter of 2007.

Own refining expenses

In the first quarter of 2008, refining expenses increased by $76 million, or by 39.6%, compared to the same period of 2007.

Refining expenses at our domestic refineries increased by 36.9%, or by $52 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 47.1%, or by $24 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 increased production.

Refining expenses at third parties refineries

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

In the first quarter of 2008, refining expenses at third parties refineries increased by 4.5% compared to the same period of 2007 as a result of increased refining volumes in Belorussia.

Petrochemical operating expenses

In the first quarter of 2008, operating expenses of our petrochemical companies increased by $16 million, or by 25.0%, compared to the first quarter of 2007. This was mainly due to increase of expenses at our Stavrolen petrochemical plant as a result of commencement of operation of our polypropylene production facilities in the fourth quarter of 2007.

Crude oil transportation to refineries

Crude oil transportation to refineries increased in the first quarter of 2008 by $73 million, or by 38.6%, 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 other non-core businesses of the Group.

Other operating expenses increased by $167 million, or by 77.0%, 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.

Cost of purchased crude oil, gas and products

Cost of purchased crude oil, gas and products increased by $3,558 million in the first quarter of 2008, or by 70.5%, compared to the same period of 2007, primarily due to an increase in international refined products trading volumes and prices.

Cost of purchased crude oil, gas and products included the result of hedging of international crude oil and refined products sales. In the first quarter of 2008, we recognized a $98 million expense on hedging compared to an expense of $153 million in the first quarter of 2007.

Transportation expenses

Our transportation expenses increased in the first quarter of 2008 by $208 million, or by 21.1%, compared to the same period of 2007. This was due to an increase in transportation tariffs in Russia, the increased volumes of refined products exported from Russia and an overall increase in sales volumes. However, an increase in transportation volumes was partly compensated by decreased average freight rates.

Our actual transportation expenses related to crude oil and refined products deliveries to various export destinations weighted by volumes transported changed in the first quarter of 2008 compared to the same period of the previous year, as follows: crude oil freight rates decreased by 18.3%; refined products freight rates decreased by 8.0%; crude oil pipeline tariffs increased by 24.5%; railway tariffs for refined products transportation increased by 15.2%.

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 first quarter of 2008, our selling, general and administrative expenses increased by $133 million, or by 20.1%, 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, indexation of salaries and increase in information technology 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 $77 million, or by 14.1%, compared to the first quarter of 2007. The increase was a result of the Company's capital expenditures and the corresponding increase in depreciable assets.

Exploration expenses

During the first quarter of 2008, exploration expense decreased by $41 million, or by 54.7%, compared to the same period of 2007. Dry hole costs decreased by $40 million down to $8 million.

Dry hole costs charged to expense in the first quarter of 2008 referred to our project in Saudi Arabia.

In the first quarter of 2007, we completed assessment of two exploratory wells drilled in Saudi Arabia. One of the wells was dry, and its cost of $48 million was charged to expense in the first quarter of 2007. The second well discovered a natural gas reservoir.

Interest expense

Interest expense decreased in the first quarter of 2008 by $5 million, or by 6.5%, compared to the first quarter of 2007. This was mainly due to a decrease in the LIBOR rate, as we have substantial portion of floating rate borrowings.

Taxes other than income taxes

	3 months of	
	2008	**2007**
	(millions of US dollars)	
In Russia		
Mineral extraction taxes	2,840	1,604
Social security taxes and contributions	140	116
Property tax	88	66
Other taxes	24	23
Total in Russia	**3,092**	**1,809**
International		
Social security taxes and contributions	19	12
Property tax	7	6
Other taxes	11	2
Total internationally	**37**	**20**
Total	**3,129**	**1,829**

Taxes other than income taxes increased in the first quarter of 2008 by 71.1%, or by $1,300 million, compared to the first quarter of 2007, due to an increase in mineral extraction tax resulting from an increase of crude oil extraction tax rate by 88.4%.

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.

	3 months of	
	2008	2007
	(millions of US dollars)	
In Russia		
Excise tax	202	174
Export tariffs	3,472	2,397
Total in Russia	**3,674**	**2,571**
International		
Excise tax and sales taxes on refined products	907	692
Export tariffs	4	5
Total internationally	**911**	**697**
Total	**4,585**	**3,268**

Excise and export tariffs increased by $1,317 million, or by 40.3%, compared to the first quarter of 2007. The increase in export tariffs resulted mainly from the increase in tariff rates. This factor was partly compensated by a decrease in crude oil export.

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 of excise rates in Bulgaria, increase in volumes sold and an 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 $474 million, or by 88.1%, compared to the first quarter of 2007, due to an increase of income before income tax by $2,338 million, or by 127.3%.

Our effective income tax rate in the first quarter of 2008 was 24.2% compared to 29.3% in the first quarter of 2007. As a result of recent amendments to Russian tax legislation related to taxation of dividends payments, we recovered the deferred tax liability on undistributed retained earnings of our subsidiaries where our share less than 100% as of January 1, 2008. This factor led to a decrease of our effective income tax rate.

Our effective income tax rate in the first quarter of 2007 was higher than the maximum statutory rate for the Russian Federation (24%). This was attributable to the fact that some costs incurred during the period are not tax deductible or only deductible to a certain limit.

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

	3 months of	
	2008	**2007**
	(millions of US dollars)	
Net income	**3,163**	**1,299**
Add back:		
Income tax expense	1,012	538
Depreciation and amortization	624	547
Interest expense	72	77
Interest and dividend income	(25)	(29)
EBITDA	**4,846**	**2,432**

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. Our EBITDA calculation is commonly used as a basis for some investors, analysts and credit rating agencies to evaluate and compare the periodic and future operating performance and value of companies within the oil and gas industry. EBITDA should not be considered in isolation as an alternative to net income, operating income or any other measure of performance under US GAAP. EBITDA does not include our need to replace our capital equipment over time.

Liquidity and capital resources

	3 months of 2008	3 months of 2007
	(millions of US dollars)	
Net cash provided by operating activities	3,658	2,020
Net cash used in investing activities	(3,161)	(2,184)
Net cash (used in) provided by financing activities	(208)	43

Operating activities

Our primary source of cash flow is funds generated from our operations. During the first quarter of 2008, cash generated by operating activities was $3,658 million, an increase of 81.1% compared to the same period of 2007. In the first quarter of 2008, our operating cash inflows were affected by an increase of working capital by $382 million compared to January 1, 2008. This was mainly caused by:

- a $633 million net increase in trade accounts receivable and payable
- an increase in inventory of $578 million, primarily resulting from increased volumes of refined products held
- a $143 million net increase in other assets and liabilities

At the same time, the negative effect from the above mentioned factors was partly offset by a $972 million 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 first quarter of 2008, we made a final payment of $157 million for acquisition of upstream assets in Uzbekistan (SNG Holdings Ltd.), $64 million for increase of our share in share capital of our refinery in Nizhny Novgorod. The other payments were related to planned acquisitions of marketing assets in Russia and abroad.

Capital expenditures increased by $463 million, or by 24.4%, compared to the first quarter of 2007 (for detailed analysis of the capital expenditures see the next page).

During the first quarter of 2007, the Company paid $246 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 first quarter of 2008 were $10 million.

Financing activities

In the first quarter of 2008, net movements of short-term and long-term debt generated an outflow of $158 million compared to an inflow of $120 million in the same period of 2007. The outflow in the first quarter of 2008 was due to net movements of short-term debt, which generated an outflow of $197 million.

Inflows of cash in the first quarter of 2008 included long-term loans of $102 million received from ConocoPhillips as its part of financing our joint venture in the Timan-Pechora region. In the first quarter of 2007, we received $156 million from ConocoPhillips as its part of financing the joint venture.

During the first quarter of 2007, as a result of settlement of a stock-based compensation plan employees purchased 8.8 million shares held by the Group as a 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

	3 months of	
	2008	**2007**
	(millions of US dollars)	
Exploration and production		
Russia	1,779	1,565
International	202	151
Total exploration and production	1,981	1,716
Refining, marketing and distribution		
Russia	229	149
International	127	128
Total refining, marketing and distribution	356	277
Chemicals		
Russia	5	18
International	22	26
Total chemicals	27	44
Other	48	25
Total capital expenditures*	**2,412**	**2,062**
Acquisitions of subsidiaries**		
Exploration and production		
Russia	–	5
International	157	–
Total exploration and production	157	5
Refining, marketing and distribution		
Russia	455	12
International	165	1
Total refining, marketing and distribution	620	13
Other	2	6
Less cash acquired	**(8)**	–
Total acquisitions of subsidiaries	**771**	**24**

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

During the first quarter of 2008, our capital expenditures, including non-cash transactions, amounted to $2,412 million, or $350 million more than in the same period of 2007. The growth mainly resulted from expenditures in our exploration and production segment, which increased by $265 million, or by 15.4%, compared to the same period of 2007. The exploration and production capital expenditures in new regions increased by $54 million. The capital expenditures in traditional exploration and production region of Western Siberia increased by $99 million as a result of an increase in production drilling. The capital expenditures in European Russia increased by $59 million substantially as a result of an increase in investments in pipelines and machinery. An increase in the capital expenditures in our overseas exploration projects (excluding Caspian region) amounted to $53 million and primarily related to our projects in Kazakhstan and Saudi Arabia.

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

	3 months of	
	2008	**2007**
	(millions of US dollars)	
Northern Timan-Pechora	547	547
Yamal	14	8
Caspian region*	100	52
Total	**661**	**607**

* Russian and international projects.