



**Management's Discussion and Analysis of Financial Condition and Results
of Operations for 2008, 2007 and 2006**

The following discussion is intended to assist you in understanding of JSC Gazprom Neft's financial position as of December 31, 2008 and 2007 and results of operations for the three years ended December 31, 2008 and should be read in conjunction with the Consolidated Financial Statements and notes thereto, which were prepared in accordance with accounting principles generally accepted in the United States of America.

Such terms as "Gazprom Neft", "Company" and "Group" in their different forms in this report represent JSC Gazprom Neft and its consolidated subsidiaries and affiliated companies. This report represents JSC Gazprom Neft's financial condition and results of operations on a consolidated basis.

Tonnes of crude oil produced are translated into barrels using conversion rates reflecting oil density from each of our oil fields. Crude oil purchased as well as other operational indicators expressed in barrels are translated into barrels using a 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.

Forward-Looking Statements

This discussion contains forward-looking statements concerning the financial condition, results of operations and businesses of Gazprom Neft and its consolidated subsidiaries. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. Forward-looking statements are statements of future expectations that are based on management's current expectations and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in these statements.

Forward-looking statements include, among other things, statements concerning the potential exposure of Gazprom Neft to market risks and statements expressing management's expectations, beliefs, estimates, forecasts, projections and assumptions. These forward-looking statements are identified by their use of terms and phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "objectives", "outlook", "probably", "project", "will", "seek", "target", "risks", "goals", "should" and similar terms and phrases. There are a number of factors that could affect the future operations of Gazprom Neft and could cause those results to differ materially from those expressed in the forward-looking statements included in this Report, inclusively (without limitation): (a) price fluctuations in crude oil and gas; (b) changes in demand for the Company's products; (c) currency fluctuations; (d) drilling and production results; (e) reserve estimates; (f) loss of market and industry competition; (g) environmental and physical risks; (h) risks associated with the identification of suitable potential acquisition properties and targets, and successful negotiation and completion of such transactions; (i) economic and financial market conditions in various countries and regions; (j) political risks, project delay or advancement, approvals and cost estimates; and (k) changes in trading conditions.

All forward-looking statements contained in this discussion are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Readers should not place undue reliance on these forward-looking statements. Each forward-looking statement speaks only as of the date of this discussion. Neither Gazprom Neft nor any of its subsidiaries undertake any obligation to publicly update or revise any forward-looking statement as a result of new information, future events or other information.

Overview

JSC Gazprom Neft and its subsidiaries (the “Company”) is a vertically integrated oil company operating principally in the Russian Federation. The Company’s activities include the exploration, production and development of crude oil and gas, the production of refined petroleum products and distribution and marketing operations through its retail outlets.

The Company is engaged in the exploration, development and production of crude oil and gas principally through fields located in the Yamal-Nenetsky and Khanti-Mansiysky autonomous districts of Western Siberia, Omsk and Tomsk regions and Chukotka.

Gazprom Neft owns 49.9% of JSC Slavneft (“Slavneft”) and 50.0% of JSC Tomskneft VNK (“Tomskneft”), which develop crude oil and gas in the Urals and Siberian federal district. The Company accounts for Slavneft and Tomskneft as equity investees and purchases, at agreed-upon prices, their related crude oil production in proportion to the Company’s share in each investee.

Gazprom Neft’s primary oil refinery is JSC Omsk Refinery (“Omsk Refinery”) in South-western Siberia. Omsk Refinery is Russia’s second largest refinery, and is also among the most technologically advanced in the country. The Company also has a 50.0% interest in Moscow NPZ Holdings B.V., which holds 77.25% stake in JSC Moscow Oil Refinery (“Moscow Refinery”), and access to JSC Yaroslavl Refinery (“Yaroslavl Refinery”), which is owned by Slavneft. The Company has access to both of these refineries’ processing capacities in proportion to its equity interest in each affiliated company. The Company’s crude oil is processed at these refineries based on tolling agreements.

Gazprom Neft distributes its refined petroleum products within Russia and CIS primarily through its own subsidiaries. Export trade is conducted through a wholly owned subsidiary Gazprom Neft Trading GmbH, which operates as a trader for the Company’s crude oil and refined petroleum products export sales.

Key Financial and Operating Results

	Change, %				
	2008	2007	2006	2008-2007	2007-2006
Revenues (US\$ million)	33,075	21,767	20,176	52.0	7.9
Net income (US\$ million)	4,658	4,143	3,661	12.4	13.2
EBITDA (US\$ million)	7,965	6,236	5,676	27.7	9.9
Crude oil production including our share of equity investees (millions of barrels)	337.3	319.4	318.0	5.6	0.4
Refining throughput at own and equity investee refineries (millions of tonnes)	28.4	26.2	24.4	8.8	7.4

Operating Segments

The Company’s activities are divided into two main operating segments:

- Exploration and production segment- which includes exploration, development and production of crude oil and gas.
- Refining, Marketing and Distribution - which includes refining of crude oil, purchases, sales and transportation of crude oil and refined petroleum products.

These segments are interdependent; a portion of the revenues of one segment forms a part of the costs of the other segment. In particular, JSC Gazprom Neft, as a holding company, buys crude oil from its production subsidiaries, part of which is processed at the Company's refinery and other refineries; the remaining production is primarily exported through a wholly owned export trading company. The refined petroleum products are then distributed on the international or domestic markets through the Company's own marketing subsidiaries. In most cases it is difficult to determine market prices for crude oil in the domestic market due to the significant intragroup turnover within the vertically integrated oil companies. The prices set for intragroup purchases of crude oil reflects a combination of market factors such as international crude oil prices, transportation costs, the cost of crude oil refining, capital investment requirements of the individual upstream subsidiaries and other factors. Accordingly, the results of operations of these segments on a stand-alone basis do not necessarily represent each segment's underlying financial position and results of operations. For this reason, we do not analyze our segments separately. Refer to financial data by operating segments in Note 20 of the Consolidated Financial Statements.

Acquisitions and Changes in the Company's Structure

2008

Naftna Industrija Srbije

In February 2009 JSC Gazprom Neft completed the acquisition of 51% interest in the Serbian oil company Naftna Industrija Srbije ("NIS") at a price of € 400 million.

The purchase agreement also provides for the reconstruction and upgrading of NIS refining facilities by 2012; this investment will amount to at least € 500 million. As part of the upgrade, measures will be taken to improve the quality of produced oil products to ensure that they meet European standards (Euro-5). A substantial portion of the investment will be aimed at improving the environmental safety of production processes.

Gazprom Neft will strictly follow all of the requirements documented in the purchase agreement. The Company's aim is to enhance the efficiency of NIS and transform it into an oil industry leader in Southeast Europe.

NIS is one of the largest vertically integrated oil companies in Central Europe. NIS refines oil, sells oil products and produces hydrocarbons in Serbia and Angola. Annual production is approximately 0.7 million tonnes of crude oil. NIS owns refineries in Pancevo and Novi Sad with a total capacity of 7.2 million tonnes annually. NIS has its own distribution chain of crude oil storages and 480 oil and gas retail stations and is a leading supplier of oil products in the Serbian market. NIS produces about 85% of all domestically consumed oil products.

Moscow Refinery

During 2008 Gazprom Neft and MNGK registered a joint venture - Moscow NPZ Holdings B.V. (Moscow NPZ) in the Netherlands, into which both parties contributed their respective interests in the Moscow Refinery. As a result the venture controls 77.25% of the Moscow Refinery. The Company and MNGK each own 50% of the Moscow NPZ and agreed to jointly manage Moscow Refinery and make all decisions on an equal basis. This transaction will allow for modernization project to be completed at Moscow Refinery.

Burgas-Alexandroupolis Oil Pipeline

Gazprom Neft is a party to the construction project for the Burgas-Alexandroupolis oil pipeline, which is intended to be routed through the territories of Bulgaria and Greece. The expected length of the pipeline is 280-290 km, depending on the exact route of the pipeline, which has not yet been approved. The pipeline's initial capacity is expected to be 35 million tonnes of crude oil per year and could potentially be increased to 50 million tonnes per year. Preliminary estimates indicate the cost of constructing the pipeline will be approximately US\$ 1.2 billion. The pipeline will comprise an oil terminal in Burgas (Bulgaria) and Alexandroupolis (Greece) and a trunk pipeline connecting these terminals with oil pumping stations, oil storages and other related facilities. The pipeline is expected to provide a route for crude oil transportation from the ports of the Black Sea to the markets of Europe, the USA and Asian-Pacific countries. Russia's 51% interest in the project is managed by Truboprovodny Konsortsium Burgas-Alexandroupolis LLC, of which 33.33% is owned by Rosneft, 33.34% is owned by Transneft and 33.33% is owned by Gazprom Neft. The Government of Greece and Bulgaria hold the remaining stake in equal proportions. In January 2008, a shareholders agreement of the Russian-Greek-Bulgarian company was signed. In February 2008, a new company, Trans-Balkan Pipeline B.V., was registered in the Netherlands. The current project phase is developing a feasibility study and obtaining all the necessary approvals in Bulgaria and Greece.

2007

Tomskneft

In December 2007 the Company acquired a 50% equity interest in Tomskneft and its subsidiaries from a subsidiary of OJSC Oil Company Rosneft for US\$ 3,567 million. The purchase price was based on the fair value of Tomskneft as determined by an independent appraiser. As part of this transaction, the Company and Rosneft agreed to jointly manage the business operations of Tomskneft and purchase their respective share of Tomskneft's annual production. As described in Note 7 of the Consolidated Financial Statements the acquisition of Tomskneft was accounted for as a transaction between entities under common control.

Oil Services

In September 2007 Gazprom Neft established a new company - Gazprom Neft-Nefteservice (Nefteservice) LLC - to manage its existing oil service companies. At present, the Company manages ten service companies, which provide a wide range of services, such as development and survey work, drilling, well-workover, geophysical services, construction of drilling rigs, transportation and others.

Main Macroeconomic Factors Affecting Results of Operations

The main factors affecting the Company's results of operations include:

- Changes in market prices of crude oil and petroleum products;
- Russian Ruble ("RR") exchange rate versus the US Dollar ("USD"); inflation;
- Taxation;
- Changes in transportation tariffs of crude oil and petroleum products.

Changes in Market Prices of Crude Oil and Petroleum Products

The prices of crude oil and petroleum products in the international and Russian markets are the primary driver of the Company's results of operations. We do not use derivative instruments to manage our trade operations. Accordingly, market crude oil prices are the main driver of the Company's revenues.

During 2008, Brent crude oil price grew from average of US\$ 92.00 per barrel in January 2008 to its historical high US\$ 144.22 in July 2008, and then collapsed to US\$ 36.55 at the end of December 2008. In the first half of 2008, the price growth was driven by financial market fluctuations and weakening US dollar. In the second half of 2008 global money supply decrease and falling demand for crude oil and oil products caused crude oil price fall to a four year low. In the fourth quarter 2008 crude oil prices were below a level at which development of many oilfields worldwide and in the Russian Federation is profitable.

The following table provides information on average crude oil and petroleum products prices in the international and domestic markets during the periods analyzed:

	Change %				
	2008	2007	2006	2008-2007	2007-2006
International market	(in US\$ per barrel)				
Brent	97.26	72.34	65.14	34.4	11.1
Urals Spot (average Med. + NWE)	94.79	69.23	61.28	36.9	13.0
	(in US\$ per tonne)				
Premium gasoline (average NWE)	841.55	697.41	622.79	20.7	12.0
Regular gasoline (average NWE)	840.31	690.83	616.23	21.6	12.1
Naphtha (average Med. + NWE)	779.84	662.27	563.33	17.8	17.6
Diesel fuel (average NWE)	948.49	667.70	609.37	42.1	9.6
Gasoil 0.2% (average Med. + NWE)	903.81	640.69	581.44	41.1	10.2
Fuel oil 3.5% (average NWE)	452.55	330.76	282.25	36.8	17.2
Domestic market	(in US\$ per tonne)				
High-octane gasoline	1,023.15	835.47	737.17	22.5	13.3
Low-octane gasoline	803.38	656.82	589.81	22.3	11.4
Diesel fuel	880.67	617.92	590.78	42.5	4.6
Fuel oil	329.05	219.45	206.92	49.9	6.1

Source: Platts (international market) and Kortes (domestic market)

In 2008 the Brent average price was US\$ 97.26 per barrel, which is 34.4% higher than the corresponding period of 2007; in 2007 the Brent average price was US\$ 72.34 per barrel, which is 11.1% higher than the corresponding period of 2006. The average Urals price in 2008 increased by 36.9% to US\$ 94.79 per barrel as compared to 2007; in 2007 the average Urals price increased by 13.0% to US\$ 69.23 compared to 2006.

Ruble vs. US Dollar Exchange Rate and Inflation

A substantial part of the Company's revenues from sales of crude oil and petroleum products is denominated in US Dollars, while most of the expenses are settled in Russian Rubles. Accordingly, any real Ruble appreciation to the US Dollar negatively affects the results of the Company's operations, though this fact is partially offset by an increased Ruble denominated revenue from sales in Russia. Ruble appreciated against the US Dollar in real and nominal terms during of the years 2006 and 2007 and throughout the first half of 2008. However, as a result of the sharp decline of crude oil prices and a global economic slowdown in the second half of 2008, Ruble depreciated significantly against the US Dollar in both real and nominal terms. In order to mitigate the effects of fluctuation in Ruble - US Dollar exchange rate, in April 2008 the Company began using derivative instruments. Refer to additional information in Note 16 of the Consolidated Financial Statements.

The following table comprises the information on exchange rate movements and inflation during the periods analyzed:

	2008	2007	2006
Inflation (CPI), %	13.30	11.90	9.00
Ruble/US dollar exchange rate as of the end of the period	29.38	24.55	26.33
Average Ruble/US dollar exchange rate for the period	24.86	25.58	27.19
Real appreciation (depreciation) of the Ruble against the US dollar, %	(5.3)	20.0	19.1

Source: the Central Bank of the Russian Federation, the Federal State Statistics Service.

Taxation

The following table provides information on average enacted tax rates specific to the oil and gas industry in Russia for the periods indicated:

	Change %				
	2008	2007	2006	2008-2007	2007-2006
Export customs duty					
Crude oil (US\$ per tonne)	355.08	206.70	197.01	71.8	4.9
Crude oil (US\$ per barrel)	48.44	28.20	26.88	71.8	4.9
Light and middle distillates products (US\$ per tonne)	251.53	151.59	143.40	65.9	5.7
Fuel oil (US\$ per tonne)	135.51	81.64	77.27	66.0	5.7
Mineral extraction tax					
Crude oil (RUR per tonne)	3,329.09	2,472.69	2,265.72	34.6	9.1
Crude oil (US\$ per barrel)	18.27	13.19	11.37	38.5	16.0
Natural gas (RUR per 1000 cm)	147.00	147.00	147.00	00.0	00.0

Crude oil export customs duty rate. Export custom duty rate per tonne of crude oil is enacted by the Government of the Russian Federation based on the average Urals blend prices, referred to as the monitoring period. The monitoring period comprises two months starting from November 1, 2001. The rate is effective of the first day of the second month after the monitoring period.

In December 2008 the Government approved as amended the new mechanism: export custom duty rate is revised monthly according to data provided by monitoring of the world crude oil price. The special export custom duty rate in October - November 2008 (US\$ 372.20 and US\$ 287.30 per tonne, respectively) led to partial offset of the negative influence of arising difference between the estimated export custom duty rate and the actual sales price.

The Government determines the export custom duty rate, which is dependent on the average Urals price for the monitoring period according to the following table:

Quoted Urals price (P), USD per tonne	Maximum Export Custom Duty Rate
0 - 109.50	0%
109.50 - 146.00	35.0% * (P - 109.50)
146.00 - 182.50	USD 12.78 + 45.0% * (P - 146.00)
>182.50	USD 29.20 + 65.0% * (P - 182.50)

The export customs duty on crude oil increased by 71.8% in 2008 to US\$ 355.08 per tonne (US\$ 48.44 per barrel) from US\$ 206.70 per tonne (US\$ 28.20 per barrel) in 2007. The increase in these comparative periods was associated with the growth of Urals prices, which increased by 36.9% to US\$ 94.79 per barrel in 2008 compared to US\$ 69.23 per barrel in 2007.

The export customs duty on crude oil in 2007 increased by 4.9% to US\$ 28.20 per barrel compared to the corresponding period of 2006. The growth was due to higher Urals prices in 2007.

Export customs duty rate on petroleum products. Export custom duty rate on oil products is determined by the Government based on the prices for crude on international markets separately for light and middle distillates and for fuel oil.

Crude oil mineral extraction tax rate. Starting from January 1, 2007 mineral extraction tax rate on crude oil (R) is determined based on the formula $R = 419 * (P - 9) * D/261$ where P - is the average monthly Urals oil price on Rotterdam and Mediterranean markets (US\$/bbl) and D - is the RUR/US\$ average exchange rate for the month.

In case of the depletion, which is determined as the accumulated volume of crude produced from the field (N) divided by the total volume of reserves ($V = A + B + C1 + C2$, as determined by Russian Resources Classification), equals or exceeds 80%, there is a special ratio (C) added to the formula ($419 * (P - 9) * D/261 * C$), where $C = -3.5 * N/V + 3.8$. This adjustment provides a reduction of the tax payable in accordance with the formula provided above by 3.5% for every 1% of depletion over 80%.

Because of the current economic downturn, starting from September 2008, the Government revised the calculation of mineral extraction tax on crude oil described above. Effective from January 1, 2009 the Urals crude oil price used in the formula above will increase from US\$9 per barrel to US\$ 15 per barrel. This change in the tax rate will lead to reduction of the Company's mineral extraction tax payments.

In 2008 mineral extraction tax rate on crude oil increased by 38.5% to US\$ 18.27 per barrel primarily due to a 36.9% increase in average crude oil prices as compared to the corresponding period of 2007.

In 2007 mineral extraction tax rate on crude oil increased by 16.0% to US\$ 13.19 per barrel primarily due to a 13.0% increase in average crude oil prices as compared to the same period of 2006.

Natural gas mineral extraction tax rate. The rate of mineral extraction tax for natural gas has remained stable since January 1, 2006 and equals 147.00 Rubles per thousand cubic meters of natural gas.

Transportation of Crude Oil and Petroleum Products

Gazprom Neft transports its crude oil for export primarily through Russia's state-owned pipeline system, which is operated by JSC Transneft ("Transneft"). Access to this pipeline system in accordance with Russian legislation is regulated by the Russian Ministry of Industry and Energy. Capacity of the pipeline network system is generally allocated among all users in proportion to their quarterly supply volumes to the system and on the basis of their requests. Pursuant to the Natural Monopolies Law, pipeline terminal access rights are allocated among oil producers and their parent companies in proportion to the volumes of oil produced and delivered to the Transneft pipeline system (and not in proportion only to oil production volumes).

The Federal Energy Agency currently approves quarterly schedules detailing the precise volumes of oil each producer can pump through the Transneft system. Once the access rights are allocated, oil producers generally cannot increase their allotted capacity in the export pipeline system, although they have limited flexibility in altering delivery routes. Oil producers are generally allowed to assign their access rights to others. Alternative access to international markets bypassing Transneft export routes can be obtained through railroad transport, by tankers, and by own export infrastructure of oil producing companies.

Most of the oil produced by the Company is classified as "Siberian Light" crude or "SILCO" and has sub-average density of 34.20 degrees API or 830-850 kg/cm and sub-average sulfur content of 0.56% compared to average Russian crude oil. When not blended with other Russian crude oil, crude oil produced by the Company might be sold with a premium over the Urals blend. This advantage, however, is generally lost because crude oil produced by the Company is blended with crude oil belonging to other Russian companies when transported through the trunk pipeline system.

The Company exports SILCO through Tuapse, where the delivery is made through a special pipeline for this type of crude oil. In 2008, the Company's sales of SILCO through Tuapse accounted for 6.5% of total export sales.

In 2008 the Company shipped 45% of crude oil for export through Baltic Sea ports (mainly Primorsk); 27.4% of crude oil was exported through Transneft's Druzhba pipeline (mainly to Germany, Poland and Slovakia); 24.9% of crude oil shipped from various Black Sea ports Novorossiysk, Tuapse and the Ukrainian port Yuzhnyi and 2.7% of crude oil was exported to China via transit pipeline through Kazakhstan.

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

The transportation 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 Tariffs Service of the Russian Federation ("FTS"). 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 FTS at least annually, comprising a dispatch tariff, loading, transshipment, pumping and other tariffs.

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 results.

Resource Base

The following table represents the Company's reserves for the periods indicated:

(millions barrels of oil equivalent (BOE))	Changes in 2008			
	December 31, 2008	Production	Revision of previous estimates	December 31, 2007
Gazprom Neft	4,847	(234)	136	4,945
Company's share in equity investees*	1,961	(109)	109	1,961
Proved oil and gas reserves	6,808	(343)	245	6,906
Gazprom Neft	3,630			1,448
Company's share in equity investees*	1,297			1,520
Probable oil and gas reserves	4,927			2,968
Gazprom Neft	4,708			1,568
Company's share in equity investees*	1,856			3,363
Possible oil and gas reserves	6,564			4,931

* 49.9% of Slavneft's reserves and 50% of Tomskneft's reserves

According to the independent reservoir engineers, DeGolyer and MacNaughton (Miller and Lents in 2007 and 2006) on the basis of the standards set forth by the Society of Petroleum Engineers, Petroleum Reserves Management System ("PRMS") as of December 31, 2008 the Company had 4,847 millions of barrel of oil equivalent (BOE), including proved crude oil reserves of 4,488 millions of crude oil and proved gas reserves of 2.2 trillion cubic feet.

The PRMS reserves above differ from those reported in the supplementary information on oil and gas activities included with our consolidated financial statements. Oil and gas reserves included in this supplementary information are prepared using definitions provided by the US Securities and Exchange Commission (SEC), which require the use of period end market prices and costs when determining oil and gas reserve estimates. The PRMS reserves above use management's best estimate of future crude oil and natural gas prices.

The Company's proved reserves including equity investees were 6,808 millions of BOE, including proved crude oil reserves of 6,303 millions of BOE and proved gas reserves of 3.0 trillion cubic feet.

The Company's reserves are all located in the Russian Federation, primarily in the Western and Eastern Siberia and in the Far East.

Production of Crude Oil, Gas and Petroleum Products

Crude Oil Production

Gazprom Neft is engaged in the exploration, development and production of crude oil and gas principally through fields located in the Yamal-Nenetsky and Khanti-Mansiysky autonomous districts, the Omsk, Tomsk, Tumen and Irkutsk regions and the Chukotka autonomous district.

The Company's crude oil production activity has been primarily undertaken by three of its operating subsidiaries, JSC Gazpromneft-Noyabrskneftegaz (Noyabrskneftegaz), Gazpromneft-Khantos LLC (Khantos) and Gazpromneft-Vostok LLC (Vostok). During 2007 the Company created two new operating subsidiaries: Gazpromneft-Yamal LLC (Yamal) for exploration and development of JSC Gazprom's oil fields (the Company's primarily shareholder) and Gazpromneft-Angara LLC (Angara) for exploration and development of the Company's new crude oil fields in the Eastern Siberia.

Noyabrskneftegaz, the primary Gazprom Neft production subsidiary, operates about 30 fields in the Yamal-Nenetsky and Khanti-Mansiysky autonomous districts, which account for 58% of the Company's total proved reserves based on PRMS classification. Additionally, it provides operating services to other Company's production subsidiaries such as JSC Meretoyakhaneftegaz ("Meretoyakhaneftegaz"), Sibneft-Chukotka LLC ("Sibneft-Chukotka") and recently acquired subsidiaries: Pechora Neftegaz LLC, NGP Ortjagynskoe LLC. Meretoyakhaneftegaz, of which the Company owns a 67% interest, has a license for the Meretoyakhinskoye field in the north of the Noyabrsk region.

Khantos produces crude oil from Zimnee field in the Khanti-Mansiysky autonomous district and Tumen region and provides operating services for Sibneft-Yugra LLC ("Sibneft-Yugra"). Sibneft-Yugra, of which the Company owns a 99% interest, has production licenses for two fields: Priobskoye and Palyanovskoye in the Khanti-Mansiysky autonomous district. Priobskoye field is one of the Company's largest and most prospective oil fields. Its active development began in 2004 and just three years later, in 2007, the field already produced over 19% of the Company's total production excluding share in equity investees. Priobskoye field is a key asset with a strategic role in the Company's future development opportunities and is expected to become the Company's primary source of crude oil production growth over the long-term.

Vostok operates Krapivinskoye field in Omsk region and Archinskoye, Shinginskoye and Urmanskoye fields in Tomsk region. All those fields form a new production center with a yearly increase in crude oil output.

Slavneft, which Gazprom Neft and TNK-BP own on an equal interest, develops reserves in the Urals federal district and conducts exploration in the Siberian Federal district.

Tomskneft which Gazprom Neft and Rosneft own an equal interest holds licenses for the development of fields in the Tomsk region and Khanty-Mansiysky autonomous district.

The following table represents the Company's production for the periods indicated:

(millions of barrels)	Change %				
	2008	2007	2006	2008-2007	2007-2006
Crude oil produced by consolidated subsidiaries	228.6	243.2	243.3	(6.0)	-
Company's share in production of equity investees	108.7	76.2	74.7	42.7	2.0
Total crude oil production	337.3	319.4	318.0	5.6	0.4

In 2008 the Company's crude oil production decreased by 6.0% to 228.6 million barrels (30.8 million tonnes), compared to 2007. The reduction in this period was primarily a result of a decrease in output at Noyabrskneftegaz, which was partially offset by an increase in production in new fields such as Priobskoye and certain fields in Tomsk and Omsk regions.

In 2007 the Company's crude oil production was approximately the same as in 2006 - 243.2 million barrels (32.7 million tonnes respectively).

In 2008 the Company's share in production of equity investees increased by 42.7% to 108.7 million barrels (14.8 million tonnes) compared to 2007. The increase was primarily due to the acquisition of our 50% interest in Tomskneft in December 2007.

In 2007 the Company's share in production of equity investees increased by 2.0% to 76.2 million barrels (10.4 million tonnes) compared to 2006.

The following table summarizes the Company's crude oil purchases for the periods indicated:

(millions of barrels)	Change %				
	2008	2007	2006	2008-2007	2007-2006
Crude oil purchases in Russia and CIS*	12.0	16.3	14.2	(26.4)	14.8
Crude oil purchases internationally	15.3	3.9	6.8	292.3	(42.6)
Total crude oil purchases	27.3	20.2	21.0	35.1	(3.8)

* Crude oil purchases in Russia and CIS exclude purchases from Company's equity investees Slavneft and Tomskneft.

In 2008 the Company increased the volumes of crude oil purchased internationally due to the expansion in its marketing activities.

Gas Production

The following table represents the Company's gas production for the periods indicated:

(billions of cubic meters)	Change %				
	2008	2007	2006	2008-2007	2007-2006
Gas produced by consolidated subsidiaries	2.2	1.8	2.1	22.2	(14.3)
Company's share in production of equity investees	1.0	0.4	0.4	150.0	-
Total gas production	3.2	2.2	2.5	45.5	(12.0)
Gas purchased in Russia*	1.2	0.5	0.8	140.0	(37.5)

* Gas purchases in Russia exclude purchases from Company's equity investees Slavneft and Tomskneft.

In 2008 the Company produced 2.2 billions of cubic meters of associated and natural gas with an increase of 22.2% compared to 2007. This increase relates to the Company's program for the utilization of associated gas, which is described below.

Including share in gas production of equity investees the Company's production increased by 45.5% to 3.2 billions of cubic meters in 2008 compared to 2007. The increase was attributed to the acquisition of our 50% interest in Tomskneft in December 2007.

In 2007 including share in gas production of equity investees the Company produced 2.2 billions of cubic meters of associated and natural gas, which is slightly less than 2.5 billions of cubic meters produced in 2006.

In February 2008, Gazprom Neft adopted a medium term program for the utilization of associated gas with the goal of increasing its efficient use, mitigating environmental and tax risks and increasing revenues from the sale of additional volumes of associated gas and its refined products. The Company plans to invest Rubles 18 billion (approximately US\$ 600 million) to implement this program during the period from 2008 through 2010. In particular, the program provides for the construction of associated gas transportation facilities from the Ety-Purovskoye, Meretoyakhinskoye, Severo-Yangtinskoye, Chatylkinskoye, Kholmistoye, Yuzhno-Udmurtskoye, Ravninnoye, Vorgenskoye, Urmanskoye and Shinginskoye fields.

Production of Petroleum Products

The following table summarizes the Company's petroleum products production for the periods indicated:

(millions of tonnes)	Change %				
	2008	2007	2006	2008-2007	2007-2006
Production of petroleum products at the Company's refinery	17.3	15.5	15.2	11.6	2.0
Production of petroleum products at equity refineries	9.5	9.2	7.6	3.3	21.1
Total production of petroleum products	26.8	24.7	22.8	8.5	8.3
Petroleum products purchases in Russia and CIS	1.1	0.3	1.7	266.7	(82.4)
Petroleum products purchases internationally	1.7	1.6	1.5	6.3	6.7
Total petroleum products purchases	2.8	1.9	3.2	47.4	(40.6)

In 2008 the Company increased the volumes of refined petroleum products by 8.5% to 26.8 million tonnes from 24.7 million tonnes in 2007. The increase was associated with the extension in the domestic petroleum market capacity, an expansion of the Company's retail network and increasing of regional sales.

The Company processes domestic crude oil into refined products primarily at its Omsk Refinery, Moscow Refinery and Yaroslavl Refinery. Gazprom Neft owns the Omsk Refinery and has access to the Moscow Refinery and Yaroslavl Refinery in proportion of its equity interest. Gazprom Neft owns both the crude oil processed at these oil refineries and the products produced from refining and pays each refinery a fee for their processing services.

The Company primarily markets its own crude oil and petroleum products for export through Gazprom Neft Trading GmbH, its trading subsidiary in Austria.

The Company's petroleum products are distributed within Russia primarily through 21 subsidiaries. Most of these subsidiaries are retail distribution companies engaged in wholesale distribution, providing petroleum oil products for Rosreserv or operate in the gas station retail markets. Gazprom Neft Aero JSC, Gazpromneft Smazochny materialy LLC and Gazprom Neft Marine Bunker LLC specialize in the sale of particular petroleum products. Gazprom Neft distributes its refined products in central Asia through three subsidiaries: Gazpromneft Asia LLC in Kyrgyzstan; Gazpromneft – Tajikistan LLC and Gazpromneft – Kazakhstan LLC.

Results of Operations

The following table represents the Company's results of operations for 2008, 2007 and 2006:

(in US\$ million)	2008	2007	2006	Change, %	
				2008-2007	2007-2006
Revenues					
Refined products and oil and gas sales	32,410	21,247	19,931	52.5	6.6
Other	665	520	245	27.9	112.2
Total	33,075	21,767	20,176	52.0	7.9
Costs and other deductions					
Crude oil, petroleum and other products purchased	8,296	3,928	3,705	111.2	6.0
Operating expenses	2,060	1,981	1,635	4.0	21.2
Selling, general and administrative expenses	1,078	874	563	23.3	55.2
Transportation expenses	1,661	1,279	1,348	29.9	(5.1)
Depreciation, depletion and amortization	1,309	929	803	40.9	15.7
Export duties	6,533	3,371	4,669	93.8	(27.8)
Taxes other than income taxes	5,222	3,998	2,940	30.6	36.0
Exploration expenses	193	184	107	4.9	72.0
Cost of other sales	474	324	40	46.3	710.0
Total	26,826	16,868	15,810	59.0	6.7
Operating income	6,249	4,899	4,366	27.6	12.2
Other income (expense)					
Income from equity affiliates	407	408	507	(0.2)	(19.5)
Interest income	100	94	39	6.4	141.0
Interest expense	(167)	(149)	(126)	12.1	18.3
Other income (expense), net	89	45	(6)	97.8	(850.3)
Foreign exchange (loss) gain, net	(517)	161	74	(421.1)	117.6
Minority interest	(39)	-	-		
Total	(127)	559	488	(122.7)	14.5
Income before provision for income taxes	6,122	5,458	4,854	12.2	12.4
Provision for income taxes	1,425	1,342	1,113	6.2	20.6
Deferred income tax (benefit) expense	39	(27)	80	(244.4)	(133.8)
Total	1,464	1,315	1,193	11.3	10.2
Net income	4,658	4,143	3,661	12.4	13.2

Revenues

The following table analyses revenues for the periods indicated:

(in US\$ million)	Change %				
	2008	2007	2006	2008-2007	2007-2006
Crude oil					
Export	11,229	6,861	7,945	63.7	(13.6)
CIS	1,090	766	707	42.3	8.3
Domestic	297	486	27	(38.9)	1700.0
Total crude oil sales	12,616	8,113	8,679	55.5	(6.5)
Gas	148	44	49	236.4	(10.2)
Petroleum products					
Export	8,072	6,177	6,055	30.7	2.0
CIS	1,267	820	526	54.5	55.9
Domestic	10,307	6,093	4,622	69.2	31.8
Total petroleum products sales	19,646	13,090	11,203	50.1	16.8
Other sales	665	520	245	27.9	112.2
Total sales	33,075	21,767	20,176	52.0	7.9

Sales Volumes

The following table analyses sales volumes for the periods indicated:

	Change %				
	2008	2007	2006	2008-2007	2007-2006
Crude oil (millions of barrels)					
Export	118.7	109.9	132.5	8.0	(17.1)
CIS	24.0	18.2	18.9	31.9	(3.7)
Domestic	6.6	11.6	0.7	(43.1)	1571.1
Crude oil (millions of tonnes)					
Export	16.3	15.1	18.2	7.9	(17.0)
CIS	3.3	2.5	2.6	32.0	(3.8)
Domestic	0.9	1.6	0.1	(43.8)	1500.0
Total crude oil sales	20.5	19.2	20.9	6.8	(8.1)
Gas (bcm)	3.7	2.2	3.0	68.2	(26.7)
Petroleum products (millions of tonnes)					
Export	11.4	11.4	12.2	-	(6.6)
CIS	1.9	1.9	1.3	-	46.2
Domestic	15.7	13.4	11.9	17.2	12.6
Total petroleum products sales	29.0	26.7	25.4	8.6	5.1

Realized Average Sales Prices.

The following table analyses the Company's average realized export and domestic prices for the periods indicated:

	Change %				
	2008	2007	2006	2008-2007	2007-2006
Crude oil (US\$ per barrel)					
Export	94.60	62.43	59.96	51.5	4.1
CIS	45.42	42.09	37.41	7.9	12.5
Domestic	45.00	41.90	38.57	7.4	8.6
Crude oil (USD per tonne)					
Export	688.90	454.37	436.54	51.6	4.1
CIS	330.30	306.40	271.92	7.8	12.7
Domestic	330.00	303.75	270.00	8.6	12.5
Gas (US\$ per bcm)	40.00	20.00	16.33	100.0	22.5
Petroleum products (USD per tonne)					
Export	708.07	541.84	496.31	30.7	9.2
CIS	666.84	431.58	404.62	54.5	6.7
Domestic*	656.50	454.70	388.40	44.4	17.1

During 2008 the Company's revenues increased by 52.0% to US\$ 33,075 million compared to US\$ 21,767 million in 2007 (in 2007 increased by 7.9% compared to 2006 results). The growth in revenues was primarily due to the following:

- an increase in crude oil and petroleum products production;
- an increase in sales volumes of crude oil and petroleum products.
- an increase in average prices

Crude Oil Export Sales

In 2008 our revenues from export crude oil sales increased by 63.7% to US\$ 11,229 million compared to US\$ 6,861 million in 2007. This growth was primarily due to an increase in sales prices by 51.5% and a 8.0% increase in sales volumes. The price increase was attributable to the growth in Urals price by 36.9%. The growth in volumes was primarily due to the acquisition of our 50% interest in Tomskneft in December 2007.

In 2007 our revenues from export crude oil sales decreased by 13.6% to US\$ 6,861 million compared to US\$ 7,945 million in 2006. This decrease was primarily due to a decrease in sales volumes by 17.1% accompanied by a slight increase in sales prices by 4.1%. The price increase was attributable to the growth in Urals price by 13.0%. A decrease in sales volumes was primarily driven by the reallocation of export sales volumes and due to a decrease in crude oil purchases by 3.8%.

Crude Oil Sales to CIS

In 2008 the Company's revenues from CIS crude oil sales increased by 42.3% to US\$ 1,090 million compared to US\$ 766 million in 2007. This growth was primarily due to an increase in sales prices by 7.9% and a 31.9% increase in sales volumes. The price increase was driven by the general growth in world prices and an increase in sales volumes was primarily due to the acquisition of our 50% interest in Tomskneft in December 2007.

In 2007 the Company's revenues from CIS crude oil sales increased by 8.3% to US\$ 766 million compared to US\$ 707 million in 2006. This was primarily due to an increase in sales prices by 12.5%, which was offset by slightly decreased in sales volumes by 3.7%. The price increase was due to the general growth in world prices.

Crude Oil Domestic Sales

In 2008 our revenues from domestic crude oil sales decreased by 38.9% to US\$ 297 million compared to US\$ 486 million in 2007. The decrease in domestic crude oil sales was caused by an increase in the relative volume of crude oil that the Company sent to the export and CIS markets.

In 2007 our revenues from domestic crude oil sales increased to US\$ 486 million compared to US\$ 27 million in 2007. This growth was attributable to an increase in crude oil purchased volumes in Russia by 14.8% and an increase in sales prices by 8.6%. The price increase was driven by the general growth in world prices.

Petroleum Products Export Sales

In 2008 the Company's revenues from export petroleum product sales increased by 30.7% to US\$ 8,072 million compared to US\$ 6,177 million in 2007. This growth was primarily a result of an increase in sales prices by 30.7%. The price increase was driven by the general growth in world prices.

In 2007 the Company's revenues from export petroleum product sales slightly increased by 2.0% to US\$ 6,177 million compared to US\$ 6,055 million in 2006. This was due to an increase in sales prices by 9.2% accompanied by a slight decrease in sales volumes by 6.6%

Petroleum Products Sales to SIC

In 2008 our revenues from CIS petroleum product sales increased by 54.5% to US\$ 1,267 million compared to US\$ 820 million in 2007. This growth was primarily due to an increase in sales prices by 54.5%. The price increase was attributable to the growth in Urals price by 36.9%.

In 2007 the Company's revenues from CIS petroleum product sales slightly increased by 2.0% to US\$ 6,177 million compared to US\$ 6,055 million in 2006. This was due to an increase in sales prices by 9.2% accompanied by an increase in sales volumes by 46.2%

Petroleum Products Domestic Sales

In 2008 the Company's revenues from domestic petroleum product sales increased by 69.2% to US\$ 10,307 million compared to US\$ 6,093 million in 2007. This growth was primarily due to an increase in sales prices by 44.4% and a 17.2% increase in sales volumes. The price increase was driven by the general growth in world prices.

In 2007 the Company's revenues from domestic petroleum product sales increased by 31.8% to US\$ 6,093 million compared to US\$ 4,622 million in 2007. This growth was primarily due to an increase in sales prices by 17.1% and a 12.6% increase in sales volumes. The price increase was driven by the general growth in world prices.

Other Sales

Other revenues consist primarily of sales of services such as transportation, construction, utilities and other services and are recognized when goods are provided to customers and services are performed providing that the price for the service can be determined and no significant uncertainties regarding realization exist.

Other sales were US\$ 665 million in 2008 that is 27.9% higher compared to the same period of 2007 (520 US\$ million in 2007 which is 112.2% higher than in 2006). The increase was a result of the growth in other sales and services provided to third parties in Russia.

Costs and Other Deductions

Crude Oil, Petroleum and Other Products Purchased

In 2008 cost of purchased crude oil, gas and petroleum products increased by 111.2% to US\$ 8,296 million compared to US\$ 3,928 million in 2007. The growth was primarily due to the acquisition of our 50% interest in Tomskneft, which resulted in an increase in crude oil purchases in the domestic market by 42.7% (32.5 million barrels) in 2008.

In 2007 cost of purchased crude oil, gas and petroleum products slightly increased by 6.0% to US\$ 3,928 million compared to US\$ 3,705 million in 2006. The growth was primarily due to an increase in world prices for crude oil.

Operating Expenses

The following table comprises operating expenses for the periods indicated:

(in US\$ million)	Change %				
	2008	2007	2006	2008-2007	2007-2006
Hydrocarbon extraction expenses	1,416	1,408	1,215	0.6	15.9
Refining expenses at own refinery	310	282	226	9.9	24.8
Refining expenses at equity investee refineries	334	291	194	14.8	50.0
Total operating expenses	2,060	1,981	1,635	4.0	21.2

The main cost drivers of the Company's operating expenses are the growth of hydrocarbon extraction expenses and refining costs at own and equity investee refineries. The effective cost control policy implemented by the Company helped us to hold the level of operating costs growth in 2008 to 4.0% compared to 2007. In 2007 operating expenses increased by 21.2% compared to 2006.

Hydrocarbon Extraction Expenses

Our hydrocarbon extraction expenses include expenditures related to raw materials and supplies, maintenance and repairs of extraction equipment, labor costs, fuel and electricity costs, activities to enhance oil recovery and other similar costs at our extraction subsidiaries.

In 2008, the Company's extraction expenses increased by 0.6% to US\$ 1,416 million compared to US\$ 1,408 million in 2007. This was primarily due to an increase in expenses for energy supply, workovers, materials and labor. The Company's average hydrocarbon extraction cost per barrel of oil equivalent increased from US\$ 5.55 to US\$ 5.86, or by 5.6% compared to 2007.

In 2007, the Company's extraction expenses increased by 15.9% to US\$ 1,408 million compared to US\$ 1,215 million in 2006. This increase is primarily due to an increase in expenses for energy supply, workovers, materials and labor. The Company's average hydrocarbon extraction cost per barrel of oil equivalent increased from US\$ 4.75 to US\$ 5.55, or by 16.8% compared to 2006.

Own Refining Expenses

In 2008 the Company's refining expenses at our own refinery increased by US\$ 28 million, or 9.9%, compared to 2007. This resulted primarily from increase in expenses for electricity and other operating costs due to inflation and because of an increase in the refinery throughout 11.5 % in 2008. The Company's average refining expenses per barrel at own refinery decreased from US\$ 2.33 to US\$ 2.30, or by 1.3% in 2008 due to an increase in the volumes of petroleum products produced.

In 2007 the Company's refining expenses at our own refinery increased by US\$ 56 million, or 24.8%, compared to 2007. This was primarily due to an increase in expenses for electricity and other operating costs due to inflation and because of growth in production volumes of 1.2 % in 2007. The Company's average refining expenses per barrel at own refinery increased from US\$ 1.89 to US\$ 2.33, or by 23.3% in 2007.

Refining Expenses at Equity Investee Refineries

In 2008 the Company's refining expenses at equity investee refineries increased by US\$ 43 million, or 14.8%, compared to 2007. This resulted primarily from increased cost of processing services due to higher electricity costs. The Company's average refining expenses per barrel at equity investee refineries increased from US\$ 4.09 to US\$ 4.51 per barrel, or by 10.3%, compared to 2007.

In 2007 the Company's refining expenses at equity investee refineries increased by US\$ 97 million, or 50.0%, compared to 2006. This resulted primarily from increased cost of processing services due to higher electricity costs. The Company's average refining expenses per barrel at equity investee refineries increased from US\$ 3.27 to US\$ 4.09 per barrel, or by 25.1%, compared to 2006.

Selling, General and Administrative Expenses

Selling, general and administrative expenses include general business expenses, wages, salaries, social benefits (except for wages and salaries at our production and refining subsidiaries), insurance, banking commissions, legal fees, consulting and audit services, charity, allowances for doubtful accounts and other expenses.

In 2008 the Company's selling, general and administrative expenses increased by 23.3% to US\$ 1,078 million compared to US\$ 874 million in 2007. This growth was due to an increase in the Company's activities and overall increase in selling expenses.

In 2007 the Company's selling, general and administrative expenses increased by 55.2% to US\$ 874 million compared to US\$ 563 million in 2006. This growth was due to an increase in the Company's activities and overall increase in selling expenses.

Transportation Expenses

Transportation expenses consist of the costs of delivering crude oil to refineries and crude oil and petroleum products to final customers. These costs consist of pipeline transportation, sea freight, railway, shipping, handling and other costs.

In 2008 our transportation expenses increased by 29.9% to US\$ 1,661 million compared to US\$ 1,279 million in 2007. This growth was due to an increase in transportation tariffs, volumes of crude oil and petroleum products transported.

In 2007 our transportation expenses slightly decreased by 5.1% to US\$ 1,279 million compared to US\$ 1,348 million in 2006. This change was due to a decrease in sales volumes of crude oil by 8.1% accompanied by an increase in sales of petroleum products volumes by 5.1%

Depreciation, Depletion and Amortization

Depreciation, depletion and amortization expenses include depletion of oil and gas producing assets and depreciation of other fixed assets.

In 2008 our depreciation, depletion and amortization expense was US\$ 1,309 million compared to US\$ 929 million for 2007, an increase of US\$ 380 million, or 40.9%. The increase was a result of the growth in depreciable assets due to the Company's capital expenditure program.

In 2007 our depreciation, depletion and amortization expense was US\$ 929 million compared to US\$ 803 million for 2006, an increase of US\$ 126 million, or 15.7%. The increase was a result of the Company's capital expenditure program, acquisitions and significant increase in depreciable assets.

Export Duties

Export customs duties include duties related to the export of both crude oil and petroleum products.

The following table presents export customs duties for the periods analyzed:

(in US\$ million)	Change %				
	2008	2007	2006	2008-2007	2007-2006
Export customs duties for crude oil	4,876	2,348	3,371	107.7	(30.3)
Export customs duties for petroleum products	1,657	1,023	1,298	62.0	(21.2)
Total export customs duties	6,533	3,371	4,669	93.8	(27.8)

In 2008 export customs duties increased by 93.8% to US\$ 6,533 million compared to US\$ 3,371 million in 2007. The growth was due to an increase in export custom duty rate for crude oil by 68.3% and for petroleum products by 62.0%. The increase in export custom duty rate was attributable to the growth in Urals price by 36.9% and an increase in export and CIS volumes of crude oil by 8.0% and 31.9% due to the acquisition of 50% interest in Tomskneft.

In 2007 export customs duties decreased by 27.8% to US\$ 3,371 million compared to US\$ 4,669 million in 2006. The decline was due to a decrease in export and CIS sales volumes of crude oil by 17.1% and 3.7% which was offset by a slight increase in Urals price by 13.0%.

Taxes Other Than Income Taxes

The following table summarizes the Company's taxes other than income taxes for the periods indicated.

(in US\$ million)	Change %				
	2008	2007	2006	2008	2007
Mineral extraction taxes	4,202	3,139	2,719	33.9	15.4
Excise	828	681	138	21.6	393.5
Property tax	107	87	70	23.0	24.3
Other taxes	85	91	13	(6.6)	600.0
Total taxes other than income tax	5,222	3,998	2,940	30.6	36.0

In 2008 taxes other than income tax increased by 30.6% to US\$ 5,222 million compared to US\$ 3,998 million in 2007. This growth was a result of the increase in mineral extraction tax rate on crude oil by 38.5% and due to the increase in excise caused by increase in volumes of production of petroleum products by 8.5%.

In 2007 taxes other than income tax increased by 36.0% to US\$ 3,998 million compared to US\$ 2,940 million in 2006. This growth was a result of the increase in mineral extraction tax rate on crude oil by 16.0% and changes in the Russian tax legislation for excise on oil products.

Exploration expenses

Exploration expenses include seismic, geophysical and exploratory drilling costs (including costs associated with stratigraphic test wells). Exploration drilling costs are temporarily capitalized pending determination of whether proved oil and gas reserves have been found, which justify further commercial development. If such reserves are not found, the drilling costs are charged to exploration expenses in the period when a determination is made that such costs have not resulted in additional proved oil and gas reserves.

In 2008 and 2007 our exploration costs increased by 4.9% and 72.0% to US\$ 193 million and US\$ 184 million, respectively. The growth was due to increased volume of exploration services in order to expand the Company's reserve base.

Cost of other sales

Cost of other sales increased by 46.3% and 710.0% in 2008 and 2007, respectively, compared to the previous comparative periods. The increase was primarily due to a result of the growth in other sales and services provided.

Income from equity affiliates

The Company accounts its investments in Slavneft, Tomskneft, Moscow Refinery using the equity method. These companies are primarily engaged in crude oil exploration, production and refining in the Russian domestic market.

In 2008 income from equity affiliates reduced by 0.2% to US\$ 407 million compared to the corresponding period of 2007.

In 2007 income from equity affiliates decreased by 19.5% to US\$ 408 million compared to the corresponding period of 2006.

Interest income

In 2008 and 2007 interest income increased by 6.4% and 141.0% to US\$ 100 million and US\$ 94 million, respectively, compared to the previous comparative periods. This was due to an increase in cash and deposits placed in banks during the related periods.

Interest expense

In 2008 interest expense increased by 12.1% to US\$ 167 million compared to US\$ 149 million in 2007. The increase was attributable to obtaining a US\$ 1 billion syndicated loan in May and July of 2008.

In 2007 interest expense increased by 18.3% to US\$ 149 million compared to US\$ 126 million in 2006. The increase was attributable to obtaining US\$ 2.2 billion syndicated loan in September 2007.

Income tax expenses

In 2008, 2007 and 2006 effective income tax rate was 23.9%, 24.1% and 24.6. In 2008 effective income tax rate was slightly lower than a statutory tax rate in Russia due to the change in income tax rate from 24% to 20% and non-deductible permanent differences during the period indicated.

Reconciliation of Net income to EBITDA (Earnings before interest, income tax, depreciation and amortization)

(in US\$ million)	2008	2007	2006
Net income	4,658	4,143	3,661
Add back:			
Minority interest	39	-	-
Income tax expense	1,464	1,315	1,193
Depreciation, depletion and amortization	1,309	929	803
Interest income	(100)	(94)	(39)
Interest expense	167	149	126
Other income (expenses), net	(89)	(45)	6
Foreign exchange (loss) gain, net	517	(161)	(74)
EBITDA	7,965	6,236	5,676

EBITDA represents earnings before interest, income tax, depreciation and amortization. EBITDA is a supplemental non-GAAP financial measure used by management, as well as industry analysts, to evaluate operations. Management believes that EBITDA represents useful means of assessing the performance of the Company's ongoing operating activities, as it reflects the Company's earnings trends without showing the impact of certain charges. EBITDA is not used by management as an alternative to net income as an indicator of the Company's operating performance, as an alternative to any other measure of performance in conformity with US GAAP or as an alternative to cash flow from operating activities as a measure of liquidity. EBITDA does not have a standardized meaning prescribed by US GAAP.

Liquidity and Capital Resources

Cash Flows

(in US\$ million)	Change %				
	2008	2007	2006	2008-2007	2007-2006
Net cash provided by operating activities	5,444	5,316	3,320	2.4	60.1
Net cash used in investing activities	(3,463)	(5,636)	(1 864)	(38.6)	202.4
Net cash used in financing activities	(566)	(320)	(440)	76.9	(27.3)

Net Cash Provided by Operating Activities

In 2008 net cash provided by operating activities was US\$ 5,444 million as compared to US\$ 5,316 million in 2007. The increase of US\$ 128 million or 2.4% in net cash provided by operating activities is due to the following:

- a growth in net income of US\$ 515 million and depreciation, depletion and amortization increase of US\$ 380 million accompanied by an decrease in income from equity investees of US\$ 101 million resulted in higher operating cash flow in 2008 compared to 2007;
- a US\$ 265 million net decrease in accounts receivable and payable;
- an increase in inventory of US\$ 173 million was a result of the increase in balances of purchased and produced crude oil and petroleum products;
- a US\$ 901 million decrease in income and other taxes payable.

In 2007 net cash provided by operating activities was US\$ 5,316 million as compared to US\$ 3,320 million in 2006. The increase of US\$ 1,996 million or 60.1% increase in net cash provided by operating activities is due to the following:

- a growth in net income of US\$ 482 million and depreciation, depletion and amortization increase of US\$ 126 million and an increase in income from equity investees of US\$ 111 million resulted in higher operating cash flow in 2007 compared to 2006;
- a US\$ 1,026 million net decrease in accounts receivable and payable;
- a US\$ 360 million increase in income and other taxes payable.

Net Cash Used in Investing Activities

In 2008 net cash used in investing activities was US\$ 3,463 million compared to US\$ 5,636 million in 2007 (or 38.6% decrease). These changes in the net cash used in investing activities were due to an increase of capital expenditures by US\$ 1,115 million in 2008 compared to 2007, which was due to the necessity to maintain the Company's production on existing fields and development of the related infrastructure.

In 2007 net cash used in investing activities was US\$ 5,636 million against US\$ 1,864 million in 2006 (or three times increase). These changes in the net cash used in investing activities consist primarily of:

- an increase in purchase of investments during 2007 by US\$ 3,623 million of cash used primarily due to the acquisition of 50% interest in Tomskneft in December 2007;
- a significant increase of capital expenditures by US\$ 687 million in 2007 compared to 2006, which was due to necessity to maintain the Company's production on existing fields and development of the related infrastructure.

Net Cash Used in Financing Activities

In 2008 net cash used in financing activities was US\$ 566 million as compared to US\$ 320 million of net cash used in financing activities for the same period of 2007. The increase of US\$ 246 million or 76.9% was due to net loans proceeds and repayments (US\$ 271 million in 2008 as compared to US\$ 1,751 million in 2007), which is partially offset by amount of dividends paid (US\$ 1,279 million less in 2008 as compared to 2007).

In 2007 net cash used in financing activities decreased by US\$ 120 million as compared to US\$ 440 million in 2006. The decrease was due to the healthy increase of dividends paid - US\$ 2,071 million in 2007, which was partially offset by net loans proceeds and repayments (US\$ 1,751 million in 2007 as compared to US\$ 162 million in 2006).

Capital Expenditures

The following table represents the Company's capital expenditures:

(in US\$ million)	Change %				
	2008	2007	2006	2008-2007	2007-2006
Exploration and production	2,979	2,045	1,394	45.7	46.7
Refining	189	107	43	76.6	148.8
Marketing and distribution	159	60	88	163.3	(31.8)
Total capital expenditures	3,327	2,212	1,525	50.4	45.0

In 2008 the Company's capital expenditures increased by 50.4% to US\$ 3,327 million as compared to US\$ 2,212 million in 2007. The growth was primarily driven by the exploration and production and refining activities. Exploration and production increased by 45.7% to US\$ 2,979 million due to the rapid development of Priobskoe oilfield, refining - by 76.6% to US\$ 189 million in 2008 compared to 2007. The increase in refining segment was a result of the modernization program launched at the Omsk Refinery.

In 2007 the Company's capital expenditures increased by 45.0% to US\$ 2,212 million as compared to US\$ 1,525 million in 2006. The growth was primarily driven by the exploration and production and refining activities. Exploration and production increased by 46.7% to US\$ 2,045 million due to the rapid development of Priobskoe oilfield, refining - by 148.8% to US\$ 107 million in 2007 compared to 2006. The increase in refining segment was a result of the modernization program launched at the Omsk Refinery.

Recent Volatility in Global Financial Markets

The ongoing global liquidity crisis has resulted in, among other things, a lower level of capital market funding and lower liquidity levels across the Russian Federation. The uncertainties in the global financial market, has also led to bank failures and or bank rescues. While the Russian government has introduced a range of stabilization measures aimed at providing liquidity and supporting debt refinancing for Russian banks and companies, such circumstances could affect the ability of the Company to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. Additionally, the uncertainty in the global markets combined with other local factors has led to very high volatility in the Russian Stock Markets during 2008.

Management is unable to reliably determine the effects on the Company's future financial position, results of operations or cash flows as a result of the ongoing crisis. Management believes the Company's current and long-term investment and capital expenditures program can be funded through cash generated from existing operations. Management also believes the Company has the ability to obtain syndicated loans and other financings as needed to fund business acquisitions and other transactions that may arise in the future.

Credit ratings

Standard & Poor's Ratings Services

On January 9, 2008, Standard & Poor's Ratings Services raised its corporate credit rating on JSC Gazprom Neft to 'BBB-' from 'BB+'. The outlook is stable. At the same time, Standard & Poor's affirmed its 'ruAA+' Russia national scale rating on the company.

The stable outlook reflects S&P expectation that Gazprom Neft will maintain strong financial metrics given the continuing high oil price environment. Capital expenditures and investments are, however, likely to increase, reflecting the Company's need to invest in new fields to offset declines at other major fields.

An equalization of the ratings on Gazprom Neft with those on Gazprom may arise after Gazprom entered into an agreement to acquire an additional 20% interest in the Company in April 2009; if the Company's strategic importance to Gazprom is further strengthened or Gazprom Neft's operational and financial integration within the Gazprom group increases; or if there is parental support for future acquisitions, either directly or through dividend reductions.

Rating downside could emerge from sizeable debt-financed acquisitions if these are not offset by parental support.

On October 24, 2008, Standard & Poor's Ratings Services affirmed 'BBB-' long-term corporate credit rating and 'ruAA+' Russia national scale rating on JSC Gazprom Neft. The outlook is stable.

The rating on Gazprom Neft continues to be based on a bottom-up approach, with a one-notch uplift for potential support from JSC Gazprom, - the "S&P" statement says.

Under S&P release, the rating differential to Gazprom reflects Gazprom Neft's operating and financial autonomy relative to the Gazprom group, as well as the absence of parental guarantees on Gazprom Neft's debt.

The stable outlook reflects the agency's expectation that even if the rating on Gazprom were to be lowered by one notch, the rating on Gazprom Neft would likely be affirmed, in line with the bottom-up approach.

Moody's Investors Service

On July 4, 2008 Moody's Investors Service upgraded the senior unsecured ratings of JSC Gazprom Neft ("Gazprom Neft"), including the rating of Gazprom Neft's senior unsecured 10.75% US\$500 million notes (repaid in January 2009), to Baa3 from Ba1. As part of the upgrade of the ratings into investment grade, the Ba1 Corporate Family Rating and Probability of Default Rating have been withdrawn.

Gazprom Neft's ratings have a stable outlook which is based on expectation that the recently upgraded investment grade rating is not expected to move further over the immediate term due to the fundamental constraining factors described above. To maintain current rating Moody's expect the Company to continue delivering a robust operational and financial performance, while adhering to its financial policies and business plan targets.

Given the Company's strong performance on the majority of the methodological metrics, the key constraining factors relate to low diversification of Gazprom Neft's reserves base and exposure to the country and operational risks. Therefore significant improvements in the above factors could bring some upward pressure on the current rating. Additionally, Moody's would require evidence of continued strong operational and financial performance, production and reserves growth and successful execution on its investment program. Upward pressure could also increase if there was to be a commitment by Gazprom to either guarantee Gazprom Neft's debt.

Decision to raise substantial unsecured debt by Gazprom Neft could eliminate the group's financial flexibility and possibly put pressure on ratings (although there is financial headroom at present according to 2007 financial ratios). Any uncertainty related the shareholding structure, as well as a major acquisition which would alter the Company's business and credit risk profile, could also trigger the rating downgrade if not appropriately structured.

Debt obligations

As of December 31, 2008 The Company's long-term debt was US\$ 3,080 million as compared to US\$ 3,081 million as of December, 31 2007. The increase was due to the partial repayment US\$ 2.2 billion syndicated loan obtained from Calyon, ABN-AMRO, Commerzbank and Citibank which is partially offset by a US\$ 1 billion syndicated loan from BBVA Bank, BTMU Bank, Barclays Capital, Sumitomo Mutsui Banking Corporation and WestLB Bank obtained in 2008.

The following table shows maturities of long-term loans as of December 31, 2008 (in US\$ million):

<u>Year due</u>	<u>Amount due</u>
2009	\$ 1,472
2010	758
2011	529
2012	211
2013	110
	<u>\$ 3,080</u>