OPEN JOINT STOCK COMPANY

ROSNEFT OIL COMPANY

2006 ANNUAL REPORT
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Message from the chairman

Upstream, we will commission the massive Vankor field and expand oil and gas production in Western Siberia and on the Sakhalin shelf. Downstream, we will increase refining volumes and improve the quality of refined products.

We will also build on our history of mutually advantageous international cooperation by exchanging advanced scientific and technical know-how with foreign partners and working closely with them on major joint projects in Siberia and Russia’s Far East.

Russia’s energy potential is vast and contributes not only to the country’s increasing national wealth, but also to greater global energy security.

Rosneft’s new projects in Eastern Siberia, Timano-Pechora, Russia’s Far East, and on the shelves of the Caspian and Black Seas and the Sea of Azov will provide a significant and stable contribution to the world’s energy supply in both the medium and long term.

Meanwhile, we can take pride that Rosneft is already Russia’s largest oil company by market capitalization.

As Chairman of your Board of Directors, I can assure you that under the strong and effective leadership provided by our management team – and with the help of our highly skilled and dedicated employees – we will continue to pursue Rosneft’s successful growth strategy.

Igor Sechin
Chairman of the Board of Directors
Deputy Chief of Staff
Presidential Executive Office and Aide to the President of Russia

The market has spoken.

In 2006, Rosneft’s Initial Public Offering (IPO) raised USD 10.7 billion on stock exchanges in London and Moscow when investors purchased 15% of our Company’s shares.

Our IPO was a real milestone. It was the fifth largest in global financial history and the largest ever by an oil and gas major, attracting thousands of Russian and foreign investors who recognized the value of our long-term growth strategy and world-class production and financial results. High investor confidence in our management team enabled us to become a public company and join the ranks of the world’s foremost energy majors – leading the way with the highest production growth, lowest lifting costs and a reserves replacement ratio second to none.

By any standard, 2006 was a milestone for Rosneft, but we are firmly oriented toward the future.

As a result of our ongoing mergers and acquisitions program, in 2007, Rosneft became the world’s largest company in terms of reserves.
Rosneft can look back on 2006 with considerable pride.

One of the high points of the year was completion of our program to consolidate 12 of the Company’s upstream and downstream subsidiaries into a vertically integrated company with a single management and profit center in order to achieve greater shareholder value.

This new streamlined structure will result in greater management effectiveness, increasingly efficient capital investments, improved operational performance and better access to attractive financing, which is essential for pursuing capital-intensive projects.

The consolidation and our Initial Public Offering have positioned Rosneft superbly for the future, enabling us to build on our greatly improved operational and financial performance:

- In 2006, Rosneft increased average daily oil production by 8.3% to over 1.60 million barrels (annual production of 79.89 million tonnes), the fastest growth in operational performance not only in Russia’s oil sector, but in the world. We also achieved the lowest lifting costs and the best reserves replacement ratio of any major oil company.

- During the year, our proved oil and gas reserves increased by 6.1% to 20.089 billion barrels of oil equivalent. Our replacement ratio of proved reserves was 272.6%.

- In 2006, we exported 401.1 million barrels (54.8 million tonnes) of oil, nearly 22% more than in 2005. Marine terminals handled most of our total crude exports, pipelines and rail transport handling the remainder.

- Refining at Russian plants increased by 7.2% to reach 175.61 million barrels of crude oil, of which 45.4% was processed at our own refineries. Rosneft produced 22.65 million tonnes of petroleum products.

- As a result of increased production and high oil prices, Rosneft’s revenues increased by 39% compared to 2005, reaching a record USD 33.09 billion. Our net income was USD 3.53 billion.

Increasing our high-quality resource base

Last year, we significantly expanded and diversified Rosneft’s resource base, acquiring licenses through tenders to develop a series of promising new sectors in Siberia, European Russia and Russia’s Far East. As part of our mergers and acquisitions program, Rosneft gained partial control of Udmurtnefte. At the end of 2006, Rosneft’s oil reserves life amounted to 27 years.

Cost-efficient management

As part of our drive to reduce Rosneft’s costs and maximize profits, we are creating stronger links between our upstream and downstream operations. In 2006, we purchased Nakhdoka’s Oil Seatrade Port, the largest specialized commercial seaport on Russia’s Pacific coast. As part of the Sakhalin-1 project, in 2006 we completed the construction of the De-Kastri terminal. Our investment program also included the completion of the railway overpass to load and unload light petroleum products at Arkhangelsknefteprodukt. A similar overpass was commissioned at Tuapsenefteprodukt.
Continuous modernization

We are also currently modernizing the Komsomolsk Refinery and will begin reconstructing the Tuapse Refinery in 2007. These projects will further optimize our downstream business and allow us to sell more value-added products.

Last year, Rosneft continued to expand its cooperation and partnerships with the world’s leading oil and gas companies and signed major agreements with Sinopec, Gazprom, CNPC and BP, including exploration arrangements on the Sakhalin-4 and Sakhalin-5 projects and the Kurmangazy shelf structure in the Caspian Sea, which is being developed by Rosneft subsidiaries and KazMunayTeniz.

Ongoing improvements to corporate governance

Rosneft continued to improve corporate governance in 2006 to protect our shareholders’ interests.

In order to increase the Company’s transparency and investment attractiveness, the Board of Directors approved Rosneft’s new Code of Corporate Conduct last year, which provides for three independent non-executive directors on the nine-member Board. These directors chair the Board’s Audit Committee, the Strategic Planning Committee and the HR and Remuneration Committee.

The Board also approved new regulations on internal financial controls and monitoring.

Finally, we adopted new principles on releasing information to meet the strict standards of the stock exchanges in London and Moscow.

Professional and technology-driven solutions to operational challenges

The Company’s highly successful application of advanced technology has been one of the main drivers of our significant production growth in recent years.

We have accumulated unique experience in addressing the technical challenges arising in exploration and production at our continental and offshore oilfields, which are scattered across Russia’s highly diverse geographical and climatic zones.

Our research and development experts are carrying out a wide range of work, ranging from making cost estimates to developing special drilling techniques.

Rosneft also actively cooperates with leading research centers in the global oil industry, including those at Schlumberger, Halliburton and Baker Hughes. We also cooperate with universities in Russia and around the world, including Stanford University, the University of Tulsa and the Colorado School of Mines in the United Sates, Strathclyde and Heriot-Watt universities in Scotland, the Institut Français du Petrole in France and the University of Calgary in Canada.

These links demonstrate our interest in the entire spectrum of knowledge associated with the development and broad application of new technologies, as well as the experience in managing the process of innovation itself.

Positive commitments

We take very seriously our responsibilities to our employees and their families, to the regions where we operate and to society at large.

Rosneft’s people are a major driving force behind our growth and development and are therefore among our top priorities.

Our senior management devotes considerable attention to the Company’s employees and training to ensure we can meet our growing demand for qualified specialists at all levels.

As part of that effort, we have instituted a successful system of continuing education that provides pre-university training for talented students and continues their training in industry-related specializations.

The Company also actively supports mutually beneficial cooperation with leading educational institutions and offers jobs to the most talented students and graduates.

In 2006, approximately 21,000 employees of every category took part in corporate training designed to increase their motivation and efficiency.

I can say with conviction that we will maintain the momentum of Rosneft’s dynamic development.
That means continuing to increase our output, expand and diversify our resource base, and modernize and expand our downstream business. We will also further strengthen our international partnerships, which will not only develop our business for the benefit of our shareholders, but also enhance global energy security.

I would like to thank all our shareholders for the confidence they have shown in Rosneft and our 70,000 employees for their hard work, dedication and initiative.

Our management team will make every effort in the future to ensure the efficient development of Rosneft’s enormous potential.

Sergey Bogdanchikov
President of Rosneft
Key events in 2006

February
• Rosneft won tenders for exploration and production licenses to the Tukolandsky, Vadinsky and Pendomayakhsky oil and gas bearing blocks in the Krasnoyarsk Territory.
• Rosneft received recognition for its high level of corporate and social responsibility at a competition organized by the Russian government.

March
• Rosneft established a single service drilling company, RN-Drilling, optimizing the management of drilling services.

April
• The Board of Directors of Rosneft and its subsidiaries voted on a consolidation program for the Company.

May
• A reserves audit in accordance with the SPE methodology by the international company DeGolyer and MacNaughton set Rosneft’s net proved estimated reserves as of December 31, 2005 at 2.047 billion tonnes of oil and 691 billion cubic meters of gas.

June
• Rosneft, the Moscow State Institute of International Relations (University) and the International Institute of Energy Policy and Diplomacy (MIEP) MGIMO (University) signed a strategic partnership agreement.
• Rosneft acquired the Nakhodka Tanker Port (OJSC Nefteport)

July
• Rosneft held an Initial Public Offering (IPO) and sold 14.8% of its shares to raise USD 107 billion. On July 19, the Company’s securities were floated on the London Stock Exchange and the Russian stock market.

October
• Rosneft completed the consolidation of its principal subsidiaries, optimizing the Company’s organizational and management structure.
• Three months ahead of schedule, Groznneftegaz began industrial production of the first successfully completed production well drilled in Chechnya in the last 15 years.
• Rosneft and the Chinese National Petroleum Corporation (CNPC) agreed to establish a joint venture in Russia.
• The first crude oil tanker was loaded at the De-Kastri oil-loading terminal as part of the Sakhalin-1 project.

November
• Rosneft and BP signed an agreement to develop cooperation on the Sakhalin shelf.
• Rosneft and Gazprom signed an agreement on strategic cooperation.

December
• Rosneft and Sinopec completed the joint acquisition of OJSC Udmurtneft.
Structure of Rosneft

Rosneft is one of the largest vertically integrated oil and gas companies in Russia. Rosneft’s headquarters is in Moscow and its core assets are located in Western Siberia, the Timano-Pechora oil and gas province, Southern Russia and on Sakhalin Island.

At the end of 2006, the Company had two refineries, one in the Northern Caucasus, the second in Russia’s Far East, with a combined refining capacity of approximately 12 million tonnes of oil per annum, as well as a lubricants plant in Moscow, four marine terminals for the transshipment of crude oil and petroleum products and 684 proprietary service stations in various regions of Russia.
Rosneft at a glance

Rosneft is one of Russia’s leading energy companies — and the world’s

- We have proved reserves of over 20 billion barrels — equivalent to 30 years of production at current levels

- Our liquid reserves are the highest of any publicly traded company anywhere

- In 2006, through exploration and improved development technologies, we replaced our proved reserves by 224% — the highest replacement rate in the global industry

- Our daily oil production rose sixfold between 2000 and 2006 from 260,000 barrels to over 1.6 million barrels

- In 2006, our crude oil production growth was 7.8% — a rate five times the average of our Russian peers

- Our lifting cost is the lowest in the sector

- In July 2006, our IPO, one of the largest and most successful in financial history, raised USD 10.7 billion from the sale of 15% of our shares on stock markets in London and Moscow

- We follow international best practice in corporate governance, with a policy of transparency and adherence to internationally accepted accounting standards

- We proudly fulfill our social responsibilities to our 70,000 employees and their families, to the communities in which we operate, to wider society and to the environment as a whole
Regions where Rosneft operates
Operational results

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<th>2005</th>
<th>2006</th>
<th>Change in %</th>
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<td>Proved oil reserves (billion tonnes)</td>
<td>2.047</td>
<td>2.195</td>
<td>7.3%</td>
</tr>
<tr>
<td>Proved gas reserves (billion cubic meters)</td>
<td>690.5</td>
<td>701.1</td>
<td>1.5%</td>
</tr>
<tr>
<td>Reserves-to-production ratio (years)</td>
<td>27.4</td>
<td>27.2</td>
<td>-0.7%</td>
</tr>
<tr>
<td>Volume of oil production (million tonnes)</td>
<td>73.91</td>
<td>79.89</td>
<td>8.3%</td>
</tr>
<tr>
<td>Volume of gas production (billion cubic meters)</td>
<td>13.1</td>
<td>13.7</td>
<td>4.7%</td>
</tr>
<tr>
<td>Reserves-to-production ratio (years)</td>
<td>7.4</td>
<td>7.9</td>
<td>-0.7%</td>
</tr>
<tr>
<td>Overall refining (million tonnes)</td>
<td>22.2</td>
<td>24.0</td>
<td>8.1%</td>
</tr>
<tr>
<td>At Rosneft refineries, including mini-refineries (million tonnes)</td>
<td>10.6</td>
<td>10.9</td>
<td>2.8%</td>
</tr>
<tr>
<td>At third-party refineries (million tonnes)</td>
<td>11.6</td>
<td>13.1</td>
<td>12.7%</td>
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<td>Manufacture of oil products</td>
<td>21.3</td>
<td>22.7</td>
<td>6.5%</td>
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<tr>
<td>Oil product sales in Russia (million tonnes)</td>
<td>8.0</td>
<td>9.5</td>
<td>18.8%</td>
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Proved oil and gas reserves (SPE, billion boe)

Level of crude oil production (kbpd)
Separation unit at Central Treatment Facility – Yuganskneftegaz
## Financial performance

### Key financial ratios

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<th>2005</th>
<th>2006</th>
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<td>Revenue (USD million)</td>
<td>5,262</td>
<td>23,863</td>
<td>33,099</td>
</tr>
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<td>Adjusted EBITDA (USD, million) ¹</td>
<td>1,521</td>
<td>7,079</td>
<td>7,630</td>
</tr>
<tr>
<td>Adjusted EBITDA margin ²</td>
<td>28.9%</td>
<td>29.7%</td>
<td>21.9%</td>
</tr>
<tr>
<td>Net profit</td>
<td>837</td>
<td>4,159</td>
<td>3,533</td>
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<td>Return on average capital employed</td>
<td>7.5%</td>
<td>22.3%</td>
<td>18.1%</td>
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<td>Return on average equity</td>
<td>19.6%</td>
<td>49.2%</td>
<td>23.0%</td>
</tr>
<tr>
<td>Debt (USD, million)</td>
<td>13,742</td>
<td>12,203</td>
<td>13,829</td>
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<tr>
<td>Net debt (USD, million)</td>
<td>12,709</td>
<td>11,030</td>
<td>13,324</td>
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<td>Net debt to capital employed ratio</td>
<td>0.68</td>
<td>0.54</td>
<td>0.38</td>
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<tr>
<td>Debt to adjusted EBITDA ratio</td>
<td>9.03</td>
<td>1.72</td>
<td>1.90</td>
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<tr>
<td>Current ratio</td>
<td>0.89</td>
<td>0.72</td>
<td>0.87</td>
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<tr>
<td>Adjusted EBITDA/bbl (USD)</td>
<td>10.26</td>
<td>13.23</td>
<td>12.60</td>
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<td>Adjusted EBITDA/boe (USD)</td>
<td>7.48</td>
<td>11.57</td>
<td>11.07</td>
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<td>Upstream capital expenditures/bbl (USD)</td>
<td>3.83</td>
<td>3.00</td>
<td>4.85</td>
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<tr>
<td>Upstream capital expenditures/boe (USD)</td>
<td>2.79</td>
<td>2.63</td>
<td>4.26</td>
</tr>
<tr>
<td>Upstream operating expenses/bbl (USD)</td>
<td>2.32</td>
<td>2.49</td>
<td>2.83</td>
</tr>
<tr>
<td>Upstream operating expenses/boe (USD)</td>
<td>1.69</td>
<td>2.18</td>
<td>2.49</td>
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¹ Adjusted EBITDA, for any relevant period, is operating income for such period plus interest on taxes other than income tax accrued in relation to Yuganskneftegaz’s tax liabilities for 1999-2004 (see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations—Costs and Expenses—Taxes Other than Income Tax”), accretion expense related to the unwinding of asset retirement obligations and depreciation, depletion and amortization for such period.

² Adjusted EBITDA margin is adjusted EBITDA divided by total revenues for the relevant period.
International oil trends and global energy security

- Oil and gas currently meet 60% of the world’s energy needs, a dominance that will continue until at least 2030, despite developments in renewables and other alternative energy sources.

- Russia’s vast reserves mean it will remain one of the world’s largest producers of oil and gas during this period, when overall energy demand is forecast to increase by 60%.

- As a leading oil and gas company, Rosneft will continue to play an essential role in meeting the energy needs of Russia and the world.

A future that still relies on oil and gas

According to the International Energy Agency, the world will rely on oil and gas to fuel growing prosperity for decades to come. By 2030, hydrocarbons will account for 60% of total energy demand, the same figure as now.

However, oil and gas exploration will continue to become more challenging. New fields are likely to be found in ever more remote and difficult areas, making every aspect of operations more costly. This trend will increase the value of current reserves and lead to greater competition over access to hydrocarbon resources.

The result will be continuing market volatility driven by concerns over security of oil and gas supply. Compounding these technical concerns are the geopolitical issues that have a bearing on the investment needed to promote security of supply from major oil and gas producing regions such as the Middle East, Africa and Latin America.
Key issues in global energy security

- Energy security is a global problem and its resolution requires uniting all links in the global energy chain – from the production of crude oil to its refining and sale as an end product.

- Global energy security requires the participation of governments and international organizations such as the UN, OPEC, the International Energy Agency and the International Energy Forum.

- The task of international governments and organizations in establishing and maintaining a global system for energy security involves creating equal competitive conditions for companies and minimizing political and economic barriers.

- Strategic partnerships between international oil companies serve as effective market-based instruments for creating a global system of energy security and for solving the most important problems of energy supplies in the world economy.

- Led by Rosneft, Russian companies are increasing production and internationalizing their operations to ensure the stability of supplies and long-term contacts with clients abroad.

Tapping into Russia’s potential

Russia, on the other hand, can boast political stability and a dynamic economy that has been growing consistently at over 6% per annum since 2000.

Russia already supplies a considerable amount of the world’s oil and gas. Europe imports an even higher percentage of hydrocarbons from Russia.

This mutual dependence should serve as a solid basis for the further development of relations between Russia and the European Union, particularly on energy security.

Russian oil companies are also developing oil and gas fields in Siberia and Russia’s Far East to meet the rapidly rising demand in the United States and Asia, especially in China, Korea and India.

Russia is also therefore an important contributor to global energy security.

But despite strongly rising output in recent years, Russia has drawn on less than half of its reserves and has yet to reach peak production.

Various conservative estimates put Russia’s hydrocarbon reserves at 120-200 billion barrels.

Russia expects its reserves to continue increasing significantly. When current exploration projects and technological advances are taken into account, Russian reserves could increase to over 300 billion barrels of oil.

Bringing stability to global markets

Russian companies have initiated a series of new energy projects and long-term alliances that bring stability to global markets for oil and refined products.

These projects span the country’s newest oil and gas regions, as well as its traditional ones – Eastern Siberia, the Far East, Timano-Pechora and the shelves of the Caspian Sea, the Black Sea and the Sea of Azov.

Russia is also developing oil and gas export pipelines to both east and west. The completion of the East Siberia – Pacific Ocean pipeline will make for far more efficient deliveries of crude oil to Asia-Pacific markets, while the Burgas-Alexandroupolis pipeline will facilitate increased oil exports from Russia and Kazakhstan, relieve the current bottleneck of tankers in the narrow Bosphorus linking the Black and Mediterranean Seas, and allow the Caspian Pipeline Consortium (CPC) to increase its annual capacity to nearly 490 million barrels.

The construction of the Nord Stream gas pipeline across northern Europe represents yet another improvement in Russia’s export infrastructure.

A major player in Russia’s mega-projects

Virtually all of Rosneft’s projects contribute significantly to international energy security. The largest of these include the development of the Vankor field in Eastern Siberia, Sakhalin Island and West Kamchatka in the Far East, as well as various projects in Southern Russia on the Caspian Sea, the Black Sea and the Sea of Azov.

Major projects such as these create genuine mutual dependence among partners, thus fostering supply stability as well.

In recent years, Rosneft’s growth strategy and improved efficiency have transformed it into one of the world’s leading oil and gas companies.
Rosneft today

Rosneft is one of the leading oil and gas companies in Russia. Its priorities are to:

- increase oil and gas production;
- expand the resource base and improve its structure;
- increase scientific and technical capability;
- increase the efficiency of field development;
- upgrade refining capacity and increase the output of oil products that meet environmental requirements;
- expand and upgrade transport infrastructure;
- develop sales capacity for oil products;
- identify and access attractive markets;
- enhance the efficiency of its subsidiaries.

Rosneft is one of the three largest oil producers in Russia and a leader in the country’s oil and gas industry.

In 2006, Rosneft had the largest proved oil and gas condensate reserves among the world’s publicly traded oil companies.

The Company aims to achieve a balance between hydrocarbon production and reserves replacement. Last year, Rosneft was number one in the world in terms of reserves life and replacement ratio.

Rosneft has an extensive portfolio of projects at the exploration stage in parts of Russia and the CIS which could become important areas for oil and gas production in the near future.

As of December 31, 2006, aggregate resources of crude oil and gas condensate at Rosneft’s exploration projects amounted to 5.8 billion tonnes - these large resources form a solid basis for future increases in proved reserves from geological exploration.

In 2006, Rosneft was the second-largest producer of crude oil and gas condensate among Russian oil companies. Rosneft has licenses to develop new fields with high potential, where well stimulation programs result in high daily well flow rates.

The Company’s unique scientific capability also contributes to improved results in drilling and workover programs.
The combination of Rosneft’s highly productive assets and our application of optimal technology when developing fields allowed the Company to record the domestic industry’s highest rates of crude oil and gas condensate production growth in 2006.

Last year, Rosneft was the third-largest gas producer among Russia’s vertically integrated oil-producing companies. As of December 31, 2006, Rosneft’s proved gas reserves amounted to 701 billion cubic meters, with the potential of further increasing this figure due to probable reserves of 433 billion cubic meters and possible reserves of 439 billion cubic meters.

Increasing the utilization of associated gas is a priority for Rosneft. In 2006, the Company launched its Gas Program, which provides for the construction of collection systems for associated gas, booster compression stations and underground gas storage tanks.

The Company also plans to improve gas treatment and processing by constructing new facilities. In 2006, the Company continued the construction of a gas compressor station at the Priobskoye field of Yuganskneftegaz in order to reduce the flaring of associated gas. More gas compressor stations are due to be commissioned in the fourth quarter of 2007.

Rosneft has ample opportunities to export crude oil and petroleum products from its terminals in Arkhangelsk, Tuapse in the Krasnodar Territory, De-Kastri in the Khabarovsk Territory and Nakhodka in the Primorsky Territory.

The Company’s refineries are located in geographically advantageous regions. The Tuapse Refinery has direct access to oil product markets in the CIS and Europe and the Komsomolsk Refinery exports oil products to the Asia-Pacific region.

A favorable economic climate with high energy prices, i.e. both high prices for oil exports and the growing value of oil products on the Russian market, has allowed the Company to implement its strategic plans and allocate more resources to increasing the volume of refining and oil product sales on the domestic market as it moves up the value chain. This shift will represent a qualitative change for the Company.

Rosneft’s successful operational performance last year was also reflected in our financial and commercial indicators. In 2006, Rosneft demonstrated the lowest figures for production costs and administrative expenses per unit of actual production.

The Company’s production and financial performance improved not only due to the acquisition of new assets, but also because of its enhanced operational efficiency. Rosneft’s Business Plan provides for the rational use of production facilities, the reduction of production and non-sales costs, increased capital investment efficiency and the optimization of logistics.

Principal achievements in 2006

In 2006, Rosneft achieved impressive results in numerous areas:

- Highest reserves of liquid hydrocarbons among the world’s publicly traded energy companies
- Industry-leading figure for organic replacement of proved reserves
- Highest industry increase in proved reserves per exploration well
- Lowest replacement cost per tonne of reserves
- Fastest oil production growth rate in Russia
- Highest new well flow rates in Russia
- Lowest figure for production costs in Russia
- Lowest figure for refining costs in Russia
- Lowest administrative costs per unit of production in Russia
- Highest market capitalization among Russian oil companies
Rosneft’s strategic objective is to become Russia’s leading oil and gas company with the best production and financial indicators in the industry and to join the ranks of the world’s largest energy companies.

The Company’s management expects to achieve these objectives in the near future by increasing production, processing and sales of oil and gas products in Russia and abroad and by applying new technology.

Efficient management and tighter financial discipline are also crucial to this strategy, which will ensure dynamic growth in our production and financial indicators in the interests of our numerous shareholders.

The Company’s strategy, approved by the Board of Directors in 2002, sets our main priorities as follows:

**Further growth of liquid hydrocarbons and gas production**

The Company believes that if favorable economic conditions continue, it can increase annual oil production to at least 100 million tonnes in 2010, excluding new acquisitions, and up to 140 million tonnes in 2015.

In the short-term, growth will be driven primarily by further development at Yuganskneftegaz, Purneftegaz and Severnaya Neft.

Yuganskneftegaz is one of the largest oil producing enterprises in Russia. At the beginning of 2005, Yuganskneftegaz was integrated into the Company’s production system and now accounts for approxi-
mately 70% of Rosneft’s total oil production and proved oil reserves.

Purneftegaz is Rosneft’s second largest oil-producing company and also has extensive reserves of natural gas at the Kharampur field.

Severnaya Neft is Rosneft’s principal oil-producing company in Northwest Russia. The Company acquired Severnaya Neft in 2003 and since then it has increased oil production over 2.4 times. The subsequent acquisition of licenses in the Timano-Pechora oil province combined with the expansion of the Arkhangelsk terminal’s export capacity will provide substantial potential for future growth.

Rosneft plans to play a major role as a supplier to the energy markets in the Asia-Pacific region. The Company has a 20% stake in the international Sakhalin-1 project, where fields are being developed under a Production Sharing Agreement (PSA). Commercial production of oil and gas began at the end of 2005, with output expected to increase considerably within the next several years. The Sakhalin-1 project will play a key role in diversifying Rosneft’s export deliveries.

Eastern Siberia is crucial to the Company’s medium-term development. Rosneft has recently started development of the extensive Vankor field in the Krasnoyarsk Territory, and in cooperation with TNK-BP is also participating in the development of the Verkhnechonsk field in the north of the Irkutsk Region. According to DeGolyer and MacNaughton, proved reserves at the Vankor field amount to 165 million tonnes of oil according to the SPE classification. Production at the Vankor field is planned to begin in 2008, with the oil destined for export via the East Siberia - Pacific Ocean (ESPO) oil pipeline, which is currently under construction.

While the Sakhalin-1 project plays a key role in Rosneft’s short-term development, other offshore projects to develop the continental shelf represent some of the most promising sources for stable growth in the Company’s hydrocarbon production over the long term.

Exploration at Sakhalin-3, Sakhalin-4 and Sakhalin-5 is ongoing, but the substantial potential of these projects could turn Rosneft into the key player on the Far Eastern energy market.

All these projects are being implemented on the basis of joint financing agreements, thus minimizing the Company’s risks and capital expenditures.

Rosneft considers its exploration project on the West Kamchatka shelf, which it is implementing in cooperation with the Korean National Oil Company (KNOC), to be an important and integral part of its long-term development strategy. The project is based on an agreement to jointly finance geological exploration. The region’s potential resources may be comparable to the resources of the entire Sakhalin Shelf.

All of the above projects also have considerable gas resources and are designed to play a key role in Rosneft’s strategy to monetize its gas reserves.

Resources of the Vankor group of blocks also have substantial long-term development potential for the Company.

**Increasing the Company’s value by enhancing operating efficiency**

Rosneft aims to optimize important performance indicators, such as upstream costs per barrel of produced reserves, upstream capital expenses per tonne of production, return on average capital employed and return on equity.

The Company has introduced an advanced Total Production Management System, which is based on geological and simulation models of our key fields. In combination with Rosneft’s superior knowledge of the geological conditions at developed fields, these models enable the Company to achieve the maximum potential from each well and efficiently allocate our resources for the purpose of drilling, hydraulic fracturing and artificial lift.

Rosneft’s cooperation with leading service companies, such as Schlumberger, Halliburton and Baker Hughes, also facilitates the introduction of advanced drilling and well workover technology.

The attractiveness of Rosneft’s investment projects, which involve major capital expenditures, is based on an analysis of net present value, internal rates of return, payback period, the volume of hydrocarbon reserves and a discounted profitability index.

Rosneft’s measures to enhance operating efficiency, together with favorable geological conditions and the crude oil and gas properties at its major fields, help the Company to hold operating and capital expenses per barrel of produced oil below the industry average.
Increase in volumes and depth of crude oil refining

Rosneft plans to increase the volume and depth of oil refining and the quality of refined products. The Company is refurbishing and upgrading the Komsomolsk and Tuapse oil refineries in order to produce oil products that meet global standards. These upgrades will increase Rosneft’s profits and improve the balance between our production and refining operations.

We are also looking to acquire appropriate assets in Russia and abroad in order to further increase refining capacity. In addition, the Company has plans to expand and upgrade its network of service stations and facilities and thereby significantly increase its share of oil products on the retail market.

Commitment to the highest standards of corporate governance

Rosneft is committed to the highest standards of corporate governance.

The Company’s corporate governance code includes provisions for:
- at least three independent directors on the Board of Directors;
- committees of the Board of Directors, of which at least two (the Audit Committee and the HR and Remuneration Committee) are headed by independent directors;
- prohibiting the use of insider information;
- introducing internal control procedures.

In 2006, Rosneft completed its consolidation of a number of key subsidiaries, which resulted in a simplification of the Company’s corporate structure, making it easier to manage. In addition, the minority shareholders of affiliated subsidiary companies can now benefit from the success of a powerful and united company.

Rosneft’s management is currently drafting a new development strategy to be submitted for review to the Board of Directors at the end of 2007.

Sucker-rod pumps at the Mishkinskoye field of Udmurtneft
Performance review

Exploration

Rosneft conducts large-scale exploration operations in Russia’s traditional oil producing areas of Western Siberia, the Northern Caucasus and Timano-Pechora, as well as in new strategic areas of Eastern Siberia, Russia’s Far East and the shelf of the Caspian and Black Seas and the Sea of Azov.

Rosneft’s exploration replaces produced volumes with commercial reserves and prepares the resource base for faster production at the Company’s major projects.

Every year, the Company carries out extensive exploratory drilling and seismic surveys and conducts exploration in joint projects with Russian and foreign partners.

In 2006, Rosneft spent 6.3 billion rubles on exploration, 54% more than the 4.1 billion rubles spent in 2005. The Company carried out 82,480 meters of exploratory drilling, 10,727 linear kilometers of 2D and 3,016 square kilometers of 3D seismic surveys.

Reduced seismic exploration was due to the completion of exploration projects at Sakhalin-1 and the Tuapse Trough and the reallocation of capacity to the most promising regions of Eastern Siberia and the Far East. Seismic survey work is expected to increase in 2007.

In 2006, Rosneft maintained its leading positions in terms of increases in reserves per well and reserves replacement cost. Last year, the average increase in reserves per well was 1.4 million tonnes, while the reserves replacement cost did not exceed USD 16 per tonne of oil equivalent.

Industry-leading results were achieved by an optimal combination of sufficient volumes of 2D and 3D seismic surveys, professional processing, as well as the interpretation of seismic data and the proper location of exploration wells.
Rosneft’s exploration results indicate that the Company is capable of maintaining a high reserves replacement ratio. Taking acquisitions into account, the proved hydrocarbon reserves replacement ratio was 273%, while the organic reserves replacement ratio was 224%. The hydrocarbon reserves-to-production ratio amounted to 27 years for oil and 51 years for gas.

In 2006, proved reserves increased by 148.5 million tonnes according to SPE’s international classification and probable and possible oil reserves by 148.7 million tonnes. A major increase in proved reserves was achieved at the Vankor (29.5 million tonnes) and Yuganskneftegaz fields (59.2 million tonnes), as well by the purchase of an effective stake of 49.4% in Udmurtneft (45.9 million tonnes). Gas reserves increased by 10.6 billion cubic meters.
Proved oil reserves (million tonnes)

- 2005: 1900
- 2006: 2047
- Change: 7.3%

Proved gas reserves (billion cubic meters)

- 2005: 691
- 2006: 701
- Change: 1.5%

Probable oil reserves (million tonnes)

- 2005: 1143
- 2006: 1206

Probable gas reserves (billion cubic meters)

- 2005: 444
- 2006: 433
Possible oil reserves (million tonnes)

Possible gas reserves (billion cubic meters)

A drilling rig at a well cluster pad on the Priobskoye field at Yuganskneftegaz
Geographic distribution of Rosneft’s oil reserves

- **Central Russia**: 2.1% of 45.9 million tonnes
- **Timano-Pechora**: 3.1% of 68.4 million tonnes
- **Western Siberia**: 83.5% of 1832.3 million tonnes
- **Southern Russia**: 2.0% of 43.9 million tonnes
- **Eastern Siberia**: 8.0% of 176.0 million tonnes
- **Far East**: 1.3% of 29.0 million tonnes

Legend:
- Capital
- International border
- Production and development

28
Prospective projects

The Company expects its basic growth to come from the continued expansion of production at oilfields in Western Siberia, the further development of the Sakhalin-1 project, the commissioning of the highly promising Vankor field and the development of the Verkhnechonsk field.

Rosneft also believes further increases in commercial categories of reserves will come from exploration at several long-term projects on Sakhalin Island, the West Kamchatka shelf, in Southern Russia and Eastern Siberia.

Prospective resources may not be qualified as reserves due to the lack of commercial development or insufficient exploration. Assessing resources in promising areas takes into account the full range of geological, technological and commercial uncertainties, combined with the probabilities of geological and economic success.

Rosneft is the only company in Russia that performs an annual audit of prospective resources. DeGolyer and MacNaughton is the Company’s auditor.

Vankor field and adjacent blocks

The Vankor field is in the northeast of the Western Siberian oil and gas province in the Krasnoyarsk Territory. The field is divided administratively by the border between the Turukhansk Region in the Krasnoyarsk Territory and the Dudinsk Region in the Taymyr District.

The main efforts in 2006 concentrated on constructing the facilities required to begin commercial operations at the field in 2008. Rosneft plans to develop the field primarily by drilling horizontal wells, 75% of which will be bored using the smart completion method.

Due to the absence of developed infrastructure and the severe weather conditions at the field, the project elements at the Vankor field have been designed as modules using experience gained from similar infrastructure developments in Western Siberia, Sakhalin and Alaska.

Contractors are making rapid progress in building the 543-kilometer Vankor-Purpe pipeline, which will ship oil produced at the Vankor group of fields to the East Siberia - Pacific Ocean pipeline.

Proved reserves at the Vankor field (million tonnes)

<table>
<thead>
<tr>
<th>Year</th>
<th>Proved Reserves</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>135.5</td>
</tr>
<tr>
<td>2006</td>
<td>165.0</td>
</tr>
</tbody>
</table>

Proven reserves at the Vankor field (in million tonnes)

<table>
<thead>
<tr>
<th>Year</th>
<th>Proved Reserves</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>20.0</td>
</tr>
<tr>
<td>2006</td>
<td>60.0</td>
</tr>
</tbody>
</table>

Proven reserves at the Vankor field (in million tonnes, billion cubic meters)

<table>
<thead>
<tr>
<th>Year</th>
<th>Proved Reserves</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>0.0</td>
</tr>
<tr>
<td>2006</td>
<td>128.1</td>
</tr>
</tbody>
</table>

Prospective resources of Rosneft’s group of blocks surrounding the Vankor field (in million tonnes, billion cubic meters)

<table>
<thead>
<tr>
<th>Year</th>
<th>Prospective Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>581.4</td>
</tr>
<tr>
<td>2006</td>
<td>569.0</td>
</tr>
</tbody>
</table>
In developing the Vankor field, Rosneft is strictly adhering to rigorous standards of industrial safety and environmental protection in order to meet international standards and avoid adverse ecological effects.

As a result of exploration in 2006, the Company increased the proved reserves of the Vankor field by 29.5 million tonnes and probable and possible reserves by 95.8 million tonnes according to an assessment based on the SPE classification carried out by DeGolyer and MacNaughton.

The Vankor group of fields includes 14 licensed blocks located close to the Vankor field. They are Sovetsky, Lebyaziy, Western Lodochny, Eastern Lodochny, Nizhnebaikhsky, Polyarny, Samoedsky, Baikalovsky, Peschanoy, Protochny, Vadinsky, Tukolandsky, Pendomayakhsky and NorthernCharsky.

In addition to the proved, probable and possible reserves of the Vankor field itself, the total resource potential of the adjoining areas is assessed by DeGolyer and MacNaughton at 569 million tonnes.

In 2006, 2D seismic surveys of 2,600 linear kilometers and geochemical surveys were carried out in the Vankor blocks. In 2007, the Company plans to drill three exploratory wells. Rosneft expects to increase the resource base of the Vankor project by discovering commercial reserves in these blocks, which will enhance the efficiency of the entire transport and field infrastructure of the project.

Verkhnechonskneftegaz

OJSC Verkhnechonskneftegaz is carrying out exploration and development of the Verkhnechonsk field, one of the largest fields in Eastern Siberia.

Participating interests in the company are as follows:

- 25.94% - Rosneft;
- 62.71% - TNK-BP;
- 11.29% - East-Siberian Gas Company;
- 0.06% - minority shareholders.

The Verkhnechonsk oil and gas condensate field is in the Katanga district of the Irkutsk Region, approximately 420 kilometers northwest of Ust-Kut.

The Verkhnechonsk project is one of the priority areas for the Company in Eastern Siberia. Crude oil from the Verkhnechonsk project may be delivered into the East Siberia - Pacific Ocean pipeline system and thus meet the rapidly growing demand for energy in Asian markets. An alternative route provides for delivering crude feedstock to Russian oil refineries in Eastern Siberia.

Sakhalin-1

Participating interests in the project are as follows:

- 20% - Rosneft;
- 30% - Exxon Neftegaz Limited;
- 30% - Sodeco;
- 20% - ONGC Videsh Limited.

Sakhalin-1 is the first large-scale shelf project implemented in the Russian Federation on the basis of a Production Sharing Agreement, which was signed in 1996.

The project provides for the development of three fields - Chayvo, Odoptu and Arkutun-Dagi - which are on the northeastern shelf of Sakhalin Island in the Sea
of Okhotsk. Between 1996 and 2001, exploration was carried out and the structure of the fields and their reserves volumes were quantified. Based on DeGolyer and MacNaughton’s assessment, proved oil reserves at the Sakhalin-1 fields, including Rosneft’s stake, amount to 7.9 million tonnes, probable reserves to 5 million tonnes, and possible reserves to 20 million tonnes.

Installation of the necessary infrastructure and development of the fields began in 2002. The fields will be developed in several stages. The first stage includes full-scale oil production at Chayvo and Odoptu, as well as limited gas production for the domestic market and the project’s own requirements. The second stage envisions full-scale oil production at the Chayvo field, while the third stage includes the development of oil and gas on Arkutun-Dagi. In the fourth stage, the remaining reserves will be developed. The life cycle of the project will last through 2050-2060.

In 2006, the Company commissioned the Chayvo-De-Kastri pipeline, onshore oil treatment facilities and an export oil terminal at the De-Kastri port, which enabled the beginning of export deliveries to Japan and South Korea. In 2006, production amounted to 2.6 million tonnes of oil and 623 million cubic meters of gas. Rosneft’s share amounted to 500,000 tonnes of oil and 125 million cubic meters of gas.

**Sakhalin-3**

The Veninsky block of the Sakhalin-3 project is on the shelf of Sakhalin Island in the Sea of Okhotsk, where the depth varies from 25 meters to 150 meters. The Veninsky licensed block covers approximately 5,300 square kilometers.

Exploration has been underway in this area since the end of the 1960s, with seismic work going on since the mid-1990s. Rosneft obtained an exploration license to the Veninsky block in April 2003.

The project’s current plan provides for drilling onshore exploration wells of 5,000 meters to 8,500 meters using advanced technology similar to that used on the Sakhalin-1 project. If exploration proves successful, all the wells at the Veninsky block will be drilled using horizontal and controlled directional drilling from the coast and offshore platforms.

In 2006, the first exploratory well in the South-Ayashskaya area of the Veninsky block was drilled.

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**Proved reserves at the Sakhalin-1 project**

(Rosneft’s share, ml. tonnes, bln. cubic meters)

<table>
<thead>
<tr>
<th>Year</th>
<th>Oil</th>
<th>Gas</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>2.0</td>
<td>7.9</td>
</tr>
<tr>
<td>2006</td>
<td>12.2</td>
<td></td>
</tr>
</tbody>
</table>

In the first quarter of 2007, crude production at the Sakhalin-1 project reached design capacity. Output during the first three months was 2.7 million tonnes of oil and the demand for gas in the Khabarovsk Territory was met in full. Deliveries to regional consumers amounted to approximately 4.2 million cubic meters of gas every day.

**Prospective resources at the Sakhalin-3 project**

(mln. tonnes, bln. cubic meters)

<table>
<thead>
<tr>
<th>Year</th>
<th>Oil</th>
<th>Gas</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>84.3</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>234.1</td>
<td></td>
</tr>
</tbody>
</table>
tested and closed down. Prospective oil and gas-bearing formations were identified and tests confirmed the presence of hydrocarbons. Drilling was performed from the floating semi-submersible Kantan-3 drilling rig owned by the Shanghai Offshore Drilling Company. In the near future, the Company plans to drill a second exploratory well at the North-Veninskaya structure and a third exploratory well at one of the structures of the Ayashskaya group.

Sinopec is a partner in this project and has a stake of 25.1%.

**Sakhalin-4**

The West-Schmidtovsky block is in the north of the Sakhalin shelf, northwest of the Schmidt Peninsula. The area covers 11,840 square kilometers. The sea varies from a depth of 40 meters to 200 meters.

The prospects of the West-Schmidtovsky block result from a favorable combination of factors that have contributed to the formation and accumulation of hydrocarbons. Over 10 promising structures have been discovered within the block.

The Company has performed seismic surveys on a major part of the block in previous years, as well as environmental and engineering research. In 2007, the Company plans to drill exploratory wells on two structures.

Exploration at the Sakhalin-4 project is part of a single joint program with the Sakhalin-5 project (the Kaygansko-Vasyukansky and East-Schmidtovsky blocks). In the event of successful geological exploration, these blocks will be developed as a single project with common transport and oilfield infrastructure.

**Sakhalin-5**

The Sakhalin-5 project includes two licensed blocks: East-Schmidtovsky and Kaygansko-Vasyukansky.

The East-Schmidtovsky block of 9,400 square kilometers is located on the Sakhalin shelf to the north of the Schmidt Peninsula.

The prospects of the East-Schmidtovsky block are based on a favorable combination of factors which led to the formation and accumulation of hydrocarbons and the formation of oil and gas reserves.

Between 2004 and 2006, the Company conducted major 2D and 3D seismic surveys and a range of engineering and environmental studies.
The Kaygansko-Vasyukansky licensed block of 7,183 square kilometers is located in the northeastern part of the Sakhalin shelf. Within this area, the Company has discovered over 14 structures. In 2004, the Company drilled the first exploratory well, which tapped into the Pela Leich deposit. In 2005, the Company drilled the Udachnaya exploratory well, which also tapped a pay zone. The data obtained confirmed that exploration was going well and that the prospects for Kaygansko-Vasyukansky block were promising.

In 2006, the Company completed drilling an exploratory well at the structures of South Vasyukan- skaya and Savitskaya. A program is being implemented to further delineate discoveries.

In March 2007, Rosneft obtained a certificate confirming that a discovery had been made at the Kaygansko-Vasyukansky field. The Company is continuing a geological survey of the area and is designing a strategy for the joint development of the Sakhalin-4 and Sakhalin-5 projects.

This project is being implemented in cooperation with BP, which holds a stake of 49%.
West Kamchatka block

The licensed area of the West Kamchatka shelf is located in the Sea of Okhotsk near the western coast of the Kamchatka Peninsula. The total area is 62,680 square kilometers, where the depth of the sea varies from 40 meters to 2,200 meters, which is considered to be ultra-deep for offshore fields. Deep search and exploration drilling, as well as stratigraphic drilling, was performed in the adjacent blocks of West Kamchatka.

Exploration has now confirmed the existence of 30 potential anticline structures.

The Korean National Oil Company (KNOC) is a partner in this project and holds a 40.0% stake.

Tuapse trough

The Tuapse trough is located in the Russian part of the Black Sea shelf along the shore of Krasnodar Territory. It covers about 11,220 square kilometers, but the depth of the sea ranges from 50 to 2,200 meters, which is considered to be ultra-deep for offshore fields.

In August 2003, Rosneft obtained an exploration license to the Tuapse trough. The Company has since performed 21,000 linear kilometers of 2D seismic survey work.

In addition, Rosneft has carried out geological exploration on prospective blocks in close proximity to its existing operations, at licensed blocks in Eastern Siberia, as well as at the Aday block and the Kurman-gazy structure in Kazakhstan.

In August 2003, Rosneft obtained an exploration license to the Tuapse trough. The Company has since performed 21,000 linear kilometers of 2D seismic survey work.

In addition, Rosneft has carried out geological exploration on prospective blocks in close proximity to its existing operations, at licensed blocks in Eastern Siberia, as well as at the Aday block and the Kurman-gazy structure in Kazakhstan.
Distribution of hydrocarbon resources by region of operation for Rosneft

Legend

- Oil
- Gas

Source: Best estimate of prospective resources excluding geological risks according DeGolyer and MacNaughton, as of December 31, 2006
Licensing

As of December 31, 2006, Rosneft held 345 exploration and development licenses.

The majority of the Company’s production and development licenses are valid until 2013-2030. In accordance with Russia’s Law on Subsurface Resources, the licenses maybe extended at the initiative of the subsurface user provided there have been no violations of the license terms.

Rosneft strictly complies with its license obligations, and as of the end of 2006, the Company had no disagreements with the regulatory authorities.

Rosneft is constantly expanding its portfolio of geological exploration assets by acquiring licenses in strategically important regions where the Company operates.

In 2006, the Company acquired exploration and production licenses to the Tukolandsky, Vadinsky and Pendomayakshsky oil and gas blocks in the Krasnoyarsk Territory, as well as in the North Charskaya area on the border of Taymyr and the Yamalo-Nenets Autonomous Districts. These blocks are located in close proximity to the Vankor field.

The total resources of these blocks, including the resource potential of the Northern Vankor field, are estimated at 61 million tonnes by DeGolyer and MacNaughton. The license will expire in 2031.

In Eastern Siberia, where the Verkhnechonsk field is being developed, the Company acquired an exploration and production license in 2006 to the East-Sugdinsky, Mogdinsky, Sanarsky and Danilovsky blocks in the Irkutsk Region, as well as to the Kulindinsky block in Evenkia.

The total resources of these blocks are assessed at 317 million tonnes according to DeGolyer and MacNaughton. The license will expire in 2031.

The Company has also reinforced its position in the Timano-Pechora region by acquiring an exploration and production license to the Osoveysky block in the Nenets Autonomous District, which is in close proximity to the Val Gamburtseva group of fields already under development.

As of January 1, 2006, the reserves of the Osoveyskoye field were estimated at 4.6 million tonnes in the C1 category and 4.3 million tonnes in the C2 category according to the Russian classification system. DeGolyer and MacNaughton performed no audit for this field in 2006. The license will expire in 2026.
In 2006, Rosneft produced 79.89 million tonnes of oil and 13.7 billion cubic meters of natural and associated gas, exceeding the results for 2005 by 8.3% and 4.7%, respectively. In 2006, oil production, excluding the acquisition of a stake in Udmurtneft, increased by 8%.

In 2006, Rosneft actively began developing existing proved hydrocarbon reserves by commissioning new wells and expanding the current well stock, as well as by applying enhanced oil recovery techniques.

**Production of oil and gas condensate (mln. barrels, day)**

- 2004: 0.42
- 2005: 1.48
- 2006: 1.59

**Production of natural gas (bln. cubic meters)**

- 2004: 9.4
- 2005: 13.1
- 2006: 13.7

**Number of operating production wells**

- 2004: 8,247
- 2005: 15,003
- 2006: 15,362
The average oil and gas condensate flow rate was 109 barrels per day and increased by 7.7% compared to 2005, while the average flow rate of the new wells was 714 barrels per day, an increase of 21%.

Flow rates at new wells have increased more than the Company previously envisioned, which demonstrates the significant potential of Rosneft’s fields. Improved flow rates will not only contribute to production growth, but also reduce operating costs per unit of production.

In 2006, the drilling of production wells increased by one-third in comparison with 2005 and amounted to 1,417 thousand meters. As a result, 420 new wells were drilled in 2006, an increase of 25% over 2005.

Last year, Rosneft continued to improve the planning, construction and completion of wells, which enabled the Company to exploit the maximum potential of the oil-bearing strata.
Regions of oil production at Rosneft
Western Siberia

The Khanty-Mansiysk Autonomous District (KhMAD)

As of December 31, 2006, Rosneft had production licenses to 25 oil and gas fields in the Khanty-Mansiysk Autonomous District (KhMAD).

The KhMAD is Rosneft’s primary resource base. Our fields in the KhMAD include over 16% of the commercial oil reserves of the largest oil and gas province in Western Siberia. The Company’s reserves in the KhMAD are unique due to their very high concentration ratio, with up to 80% of reserves concentrated in the large Priobskoye, Mamontovskoye, Malobalykskoye and Prirazlomnoye fields.

In 2006, the Company drilled 1.2 million meters of production wells in the KhMAD, an increase of 47%. As a result, the Company commissioned 364 new production wells.

The average flow rate of the new wells in the KhMAD was 709 barrels per day, which exceeded the industry average figure by 2.3 times.

The average flow rate of Rosneft’s producing wells in the KhMAD is 156 barrels per day, which exceeds the average figures for the industry more than two-fold.

In 2006, Rosneft produced 56 million tonnes of oil and 1.5 billion cubic meters of associated gas from fields in the KhMAD, up by 9.3% and 5.4%, respectively, compared to 2005.

The Yamalo-Nenets Autonomous District (YaNAD)

The Company’s reserves in the Yamalo-Nenets Autonomous District are its second largest and have a high degree of concentration, with 71% of crude oil and gas condensate reserves concentrated in four fields: Komsomolskoye, North Komsomolskoye, Tarasovskoye and Barsukovskoye.

In 2006, the Company continued to optimize the location and completion of new wells and increase associated gas utilization. These measures were aimed at enhancing the exploitation of reserves in the YaNAD. As a result, the Company considerably increased the flow rates of new wells to 827 barrels of oil per day, which is 3.9 times more than the level of 2005.

Timano-Pechora

The Company produces oil in the Komi Republic and the Nenets Autonomous District (NAD), both of which are in the Timano-Pechora oil and gas province.

The Company’s reserves in the Timano-Pechora are highly productive and concentrated, with 86% of the Company’s proved reserves located at fields belonging to the Val Gamburtseva group (Khasireyskoye, Charpayu, and Nadeyu) and the Baganskaya group.

In 2006, the average flow rate of a producing well was 574 barrels of oil per day and the average flow rate of new wells 1,000 barrels of oil per day.

In 2006, the Company continued its dynamic production development in the region and increased oil output to 5.6 million tonnes, 15% more than in 2005.

In 2006, Rosneft won a tender to the Osorevsky licensed block, which is located in close proximity to the Val Gamburtseva group of fields and should therefore result in the expansion of the Company’s proved reserves in the region in the near future. As a result, Rosneft should be able to maintain production volumes at a stable level using existing infrastructure.

Sakhalin Island

Rosneft’s developments on Sakhalin Island benefit greatly from their proximity to the markets of the Asia-Pacific region and the use of the Komsomolsk Refinery’s existing capacity in Russia’s Far East.

In 2006, the Company produced 1.9 million tonnes of oil and 1.1 billion cubic meters of natural and associated gas, excluding its share in the Sakhalin-1 project.

Northern Caucasus

Russia’s oldest oil-producing region includes Chechnya and the Krasnodar and Stavropol Territories. As of December 31, 2006, the Company held development and production licenses to 155 oil and gas fields.
The region’s reserves enjoy a unique combination quality crude oil and proximity to primary export routes.

In 2006, the region produced 5.18 million tonnes of crude oil and gas condensate and 3.7 billion cubic meters of gas, exceeding the figures for 2005 by 3.4% and 7%, respectively.

**Polar Lights**

In the northern part of the Timano-Pechora oil and gas province, Polar Lights Company LLC, a joint venture between Rosneft and ConocoPhillips, is developing four oilfields of the Ardalinskaya group (Ardalinskoye, East Kolvinskoye, Oshkotynskoye and West Oshkotynskoye).

In 2006, the Company produced 1.2 million tonnes of oil. The wells at Polar Lights are highly efficient with an average daily flow rate in 2006 of 1,185 barrels.

Rosneft has a 50% stake in the joint venture.

**Udmurtneft**

OJSC Udmurtneft is the largest oil-producing company in the Udmurt Republic. In August 2006, the Chinese Petrochemical Corporation of Sinopec bought 96.86% of Udmurtneft’s shares from TNK-BP. On December 11, 2006, Rosneft exercised an option to purchase 51% of the stake from Sinopec.

Udmurtneft holds 57 subsurface licenses to blocks located in the Udmurt Republic. During the twenty days of December 2006 following Rosneft’s purchase of Udmurtneft, the joint venture produced 500,000 tonnes of crude oil.

Udmurtneft makes full use of most recent advances in technology, including enhanced oil recovery methods and horizontal drilling.
Competitive advantages in Upstream

A balanced asset portfolio – Our upstream assets are conveniently situated near attractive and diverse domestic and international markets. They are located in traditional oil and gas producing regions, as well as in promising new areas such as Eastern Siberia and Russia’s Far East. As global oil reserves mature and economic growth spurs demand, these new areas will become increasingly important.

Experienced and focused management – Rosneft’s management team has decades of experience working on geologically and technologically difficult projects in oil producing regions across Russia. We have become particularly adept at managing organic growth and acquiring promising assets in Russia and abroad.

Highly innovative research and development – Rosneft’s research staff, which is based at our main research facility in Moscow and its regional divisions, is responsible for identifying opportunities at new oil and gas fields and improving the efficiency and economics of production. State-of-the-art geological modeling technologies and real-time operations monitoring ensure continuous improvement across all of our upstream operations.

Dynamic domestic and international demand – The brisk growth of Russia’s economy since 1999 has stimulated increasing domestic demand for high quality energy products. The Russian government is promoting development of new large-scale infrastructure projects such as the East Siberia – Pacific Ocean pipeline, which will improve our export capabilities to diverse markets in Europe and Asia.

Access to attractive financing – Our successful USD 10.7 billion IPO in July 2006 and a USD 22 billion bridging loan in March 2007 demonstrate Rosneft’s ability to attract financing at the most favorable terms. Raising capital under such conditions greatly increases our scope for research and development and acquiring licenses in the future in ways that maximize long-term shareholder value.
Refining and marketing

Rosneft exports produced oil and oil purchased from third-party producers, and also sends crude to proprietary and third-party refineries for subsequent refining and sale to customers on the domestic market. Exports of oil and deliveries to refineries accounted for 97.9% of the total volume of crude oil sold.

Rosneft aims to maximize the profitability of crude deliveries to refineries or for export and therefore responds quickly to price fluctuations. The Company uses its proprietary facilities to sell crude oil and oil products via its own ports, terminals and service stations.

The convenient geographic location of the Company’s refineries, retail networks and facilities for oil and oil products transshipment allow Rosneft to optimize flows in a timely manner and redirect the oil and oil products it sells to enhance profitability.

Discrepancies between the figures for the initial resources and the amount of sales by destination are due to process losses within the approved limits, transport losses during crude oil pumping through the Transneft system, the use of resources for utility purposes and variations in the balances from previous periods. Oil resources available for distribution taking into account the above factors were 82.9 million tonnes.
Distribution of oil sales

Deliveries to third-party refineries 15.8%
Deliveries to proprietary refineries 13.2%
Deliveries to domestic market 2%
Exports to CIS countries 7.3%
Global exports 61.7%

Use of third-party capacity for oil deliveries

Large wholesale marketing in Russia 15.8%
Small wholesale marketing through oil deliveries 22.3%
Exports 56.8%
Sales at service stations 5.1%

Proprietary capacity
Third-party capacity
Refining

Rosneft owns two oil refineries, the Komsomolsk Refinery and the Tuapse Refinery, which have a total capacity of 10.8 million tonnes per annum. Both refineries are conveniently located, which enables the Company to sell oil products at a profit on both domestic and foreign markets. The Komsomolsk Refinery is close to the Pacific coast in Russia’s Far East, while the Tuapse Refinery is on the Black Sea coast.

Rosneft’s refining operations

Legend

- Capital
- International border
- Rosneft refineries
- Rosneft refineries acquired after accounting period
- Gasoline
- Diesel fuel
- Jet fuel
- Fuel oil
- Other
Rosneft also owns the Moscow Pilot Plant MZ Nefteprodukt, which produces specialty oils and lubricants. In 2006, MZ Nefteprodukt manufactured 4.8 tonnes of oils and 22 tonnes of lubricants.

In 2006, Rosneft refineries (including three mini-refineries) processed 10.9 million tonnes.

Rosneft also refines its own crude oil at refineries owned by other Russian companies. In 2006, the Company refined 13.1 million tonnes of oil at third-party refineries, 12.1% more than in 2005.

**Tuapse Refinery**

The Tuapse Refinery’s throughput in 2006 was 4.3 million tonnes, which resulted in the output of approximately 4.2 million tonnes of oil products, 5.8% more than in 2005. Capacity utilization at the Tuapse Refinery last year was 100%.

In 2006, the depth of oil refining at Tuapse was 56.4%, up from 55.8% in 2005. The greater refining depth was due to the new rectification columns at the primary processing facilities. Last year, production of top quality gasoline at the Tuapse Refinery increased by 8.9% and diesel fuel by 7.9% compared to 2005.

The Tuapse Refinery is located on the Black Sea coast in close proximity to another Rosneft subsidiary, Tuapsefteprodukt, which owns an oil-loading terminal. As a result, the Tuapse Refinery is able to export about 80% of its production, much more than would otherwise be the case.

**Production volume and refining depth at the Tuapse Refinery**

Petroleum products are sold on the domestic market through six marketing companies, including Kubanfteprodukt and Stavropolye, which own a network of filling stations in the region.

The principal suppliers of feedstock to the refineries are Rosneft’s oil-producing companies, Purneftegaz, Stavropolftegaz and Groznftegaz.

In 2006, capital investment at the Tuapse Refinery increased 2.4 times and amounted to 809 million rubles.

**Komsomolsk Refinery**

In 2006, the Komsomolsk Refinery’s throughput amounted to 6.5 million tonnes of oil, with the output of oil products amounting to approximately 6.1 million tonnes, 1% more than in 2005. Refining depth increased from 60.1% to 60.7% due to the increased volume of high quality oil feedstock from the Sakhalin-1 project.

The proportion of top quality gasoline produced increased from 46.4% to 52.2% following the commissioning of the first commercial hydrotreatment unit at the Komsomolsk Refinery in April 2006, which also produced 311,000 tonnes of diesel fuel.

In 2006, output of all basic oil products - gasoline, diesel fuel and fuel oil - increased over 2005.

Oil products are exported through the Vanino port in the Khabarovsk Territory and oil transshipment terminals.
at Nakhodkanefteprodukt, which belong to Rosneft. Japan, South Korea and Vietnam are the primary markets for these products. The refinery also has an extensive sales market in the Russian Far East owing to the successful development of Vostoknefteprodukt, a Rosneft subsidiary which handles wholesale and retail sales of oil products.

Part of the crude comes from Yuganskneftegaz and Purneftegaz and is transported to the refinery by an oil pipeline to Irkutsk and then by rail. Another part goes by Rosneft’s pipeline between Okha and Komsomolsk-on-Amur and includes the feedstock produced by Sakhalinmorneftegaz.

In 2006, capital investments at the Komsomolsk Refinery were 1.821 billion rubles, an increase of 34%.

Modernization of refineries

Since 1999, the Company has been implementing investment programs to upgrade the Komsomolsk and Tuapse refineries and increase their efficiency and refining depth.

Upon completion of the programs, the aggregate capacity of the Komsomolsk and Tuapse refineries will increase to 19 million tonnes per annum. The production process will meet the very latest international safety and environmental requirements.

After upgrading the Komsomolsk and Tuapse refineries, Rosneft’s manufactured products will comply with strict international standards, allowing the Company to increase the cost efficiency of oil product sales and strengthen its position on international markets.

By 2011, the total capacity of the Company’s refineries will nearly double.

Modernization of the Tuapse refinery

In 2006, the Company continued to upgrade the refinery in order to:

- increase oil throughput from 4.3 million tonnes to 12 million tonnes;
- increase oil refining depth from 56% to 95%;
- manufacture products meeting Euro-4 and Euro-5 standards;
- form a single technological and production process, thereby saving on capital expenses and power resources and reducing the production area;
- equip processing plants with control and management systems which meet the latest international safety and environmental requirements;
- create the flexibility to change the volumes and quality of manufactured oil products in response to changing market demand and seasonal fluctuations.

By upgrading the refinery, the Company will be able to provide Russia’s rapidly developing Southern Federal District with high quality fuel.

The Company will achieve a dominant position on the domestic market and a major increase in its export volumes of oil products after refurbishing the terminal owned by Tuapsenefteprodukt. Upon completion of the upgrade, the export transshipment of oil products through Tuapse port will increase from 10 million to 17 million tonnes. Other oil companies may use the refinery’s surplus capacity.

Modernization of the Komsomolsk refinery

The refinery is currently implementing a program that runs to 2011 to expand and upgrade production.

The upgrade of the refinery is meant to:

- increase oil throughput from 6.5 million tonnes to 7 million tonnes;
- increase oil refining depth from 61% to 95%;
- manufacture products meeting Euro-4 and Euro-5 standards;
- equip processing plants with control and management systems which meet the latest international safety and environmental protection requirements;
create the flexibility to change the volumes and quality of manufactured oil products in response to changing market demand and seasonal fluctuations.

In the first quarter of 2006, the Company commissioned a diesel hydrotreatment unit and for the first time in Russia produced diesel fuel meeting the Euro-5 standard set for sulfur content and other properties.

In 2007, the Company will continue to build a deep oil refining facility within the structure of the delayed coking, vacuum gas, hydrocracking and hydrogen generation units.
Export of crude oil and gas condensate

In 2006, Rosneft exported 57.2 million tonnes of crude oil and gas condensate, which includes 4 million tonnes of crude oil purchased from third parties. The geographical distribution of deliveries was as follows:

- 23.3 million tonnes (40.7%) were delivered to Western and Central Europe;
- 15.4 million tonnes (30%) were delivered to the Mediterranean;
- 11.1 million tonnes (19.4%) were delivered to the Asia-Pacific region;
- 6.2 million tonnes (10.8%) were delivered to CIS countries;
- 1.2 million tonnes (2.1%) were delivered to Baltic States.

China was the largest importer after purchasing 8.9 million tonnes of oil. China bought 15.5% of the total crude oil and gas condensate exported by the Company.

Export terminals at Rosneft
In 2006, export deliveries of crude oil and gas condensate were as follows:

- 34.9 million tonnes (61.1%) were delivered through marine terminals (Primorsk, Novorossiysk, Belokamenka floating storage and offloading facility, De-Kastri, Butinge, Yuzhny, Odessa);
- 9.7 million tonnes (17%) were delivered by rail to China and Belarus, including by combined transport using oil pipelines and rail;
- 12.5 million tonnes (21.9%) were delivered to Belarus, Poland, Lithuania, the Czech Republic, Slovakia, Kazakhstan and Ukraine by oil pipelines.

Rosneft exports 7.7% of its produced oil to the CIS and over 62% further abroad.

Export deliveries are made through Transneft’s facilities, including its network of export pipelines and ports such as Butinge, Novorossiysk and Tuapse.

Rosneft’s own export capacity includes, in particular, the transshipment terminal of its subsidiary Arkhangelsknefteprodukt, which exports the oil from Rosneft’s subsidiary Severnaya Neft. The Company also makes extensive use of the De-Kastri port to export oil from Sakhalinmorneftegaz and the Sakhalin-1 project in Russia’s Far East.

**De-Kastri**

De-Kastri in the Khabarovsk Territory exports crude oil from its two terminals, one of which belongs to Rosneft’s subsidiary Sakhalinmorneftegaz, while the Sakhalin-1 project consortium owns the second.

In 2006, 2.2 million tonnes of Rosneft’s oil were shipped through De-Kastri.

Due to production increases expected from Sakhalin-1 and other offshore projects around the island, we forecast a considerable rise in crude export deliveries, with De-Kastri becoming a link between the Company’s large production capacity in Russia’s Far East and the Asian crude oil market.

**Arkhangelsknefteprodukt and Belokamenka**

Rosneft’s crude oil produced in Timano-Pechora is exported via the transshipment facilities of our sub-
subsidiary Arkhangelsknefteprodukt on Russia’s north-western coast.

Oil produced by Severnaya Neft, our other subsidiary in Northern Russia, is transshipped via the railway oil loading complex at Privodino in Northwest Russia from the Transneft pipeline onto rail tankers and delivered to the Arkhangelsk tanker port, where it is re-loaded onto shuttle tankers.

The Belokamenka floating storage reservoir is the terminal point in the transport chain. Oil is trans-shipped from there onto tankers for export. Belokamenka is a stationary floating oil-loading storage tanker and is berthed in a cove in the ice-free Kola Bay. In 2006, the Company exported 2.8 million tonnes of oil through Belokamenka.

**Caspian Pipeline Consortium**

The Caspian Pipeline Consortium (CPC) was established in 1992 to build a pipeline to pump Kazakh oil through Russia. The pipeline is 1,510 kilometers long and runs from the Tengiz oilfield in Western Kazakhstan to the port of Novorossiysk.

Rosneft participates in the CPC project through the joint venture of Rosneft Shell Caspian Ventures Ltd., which holds a 7.5% stake in the project.

Rosneft holds a 51% stake in the joint venture, with Shell holding 49%.

**Distribution of oil product exports by product type (mln. tonnes)**

![Distribution of oil product exports by product type](image)

Rosneft has been delivering oil and gas condensate through the Caspian Pipeline Consortium since December 2004.

In 2006, the Company delivered 4.7 million tonnes of oil and 700,000 tonnes of gas condensate through the Caspian Pipeline Consortium.

**Export of oil products**

In 2006, Rosneft exported 13.3 million tonnes of oil products, including deliveries to global markets and the CIS.

The Company enjoys significant competitive advantages over other Russian oil companies in exporting oil and oil products given the proximity of its two major refineries to export markets.

The Tuapse Refinery is on the Black Sea coast, and the Komsomolsk Refinery is near Russia’s Pacific coast in the Far East.

Rosneft also has its own transshipment facilities in Tuapse and Nakhodka, thereby enabling the Company to export oil products almost directly from the production areas.

**Domestic sales of oil products**

Rosneft has developed a powerful infrastructure to sell oil products on the Russian domestic market. The Company has 15 regional marketing and sales companies involved in the wholesaling and retailing of oil products and their storage, transport and transshipment.

The Company’s retail business reaches right across Russia, from Murmansk in the north to the Northern Caucasus in the south, and from Smolensk in the west to Sakhalin Island in the Far East.

In 2006, the Company sold 9.5 million tonnes of oil products on the domestic market, including 6.4 million tonnes through sales subsidiaries, of which 1.2 million tonnes of oil products were sold through the Company’s own network of service stations, up 23.2% over 2005. Fuel sales per service station increased by 25.1% and reached 1,819 tonnes.

Major end consumers and independent distributors, as well as organizations in the public sector, including the Ministry of Defense, community services and agricultural enterprises, are wholesale purchasers of Rosneft’s oil products. For the most part, whole-
sale purchasers take delivery of heating fuel, diesel and jet fuel.

As of December 31, 2006, Rosneft’s marketing subsidiaries owned 98 operating tank farms with a total capacity of 1,952,000 cubic meters, including 511,000 cubic meters for storing light oil products.

As of December 31, 2006, Rosneft had a retail network consisting of 684 proprietary and leased service stations and 83 service stations operating as franchises under the Rosneft brand.

As of December 31, 2006, the Company’s proprietary and leased service stations operated 51 car washes, 105 stores (which also sold packed lubricants) and 42 cafes.

Eighty-two proprietary and leased service stations had garages for minor repairs and servicing of motor vehicles.
Rosneft plans to continue developing its chain of service stations in areas close to its refineries and tank farms.

In the Far East, these areas include the Khabarovsky Territory, Primorsky Territory and Sakhalin Island. In Southern Russia, they include the Krasnodar and Stavropol Territories.

The Company also plans to strengthen its presence on rapidly developing markets such as Moscow and St. Petersburg.

**Nakhodkanefteprodukt**

The Nakhodka oil-loading terminal in the Primorsky Territory is the largest oil exporting port in the Russian Far East. The facility is part of Nakhodkanefteprodukt, a Rosneft subsidiary.

In 2006, Rosneft exported 2.7 million tonnes of oil products through Nakhodkanefteprodukt, 20.3% of the Company’s total export deliveries.

**Tuapsenefteprodukt**

The Tuapse oil-loading terminal is in Krasnodar Territory and close to the Tuapse Refinery on the Black Sea coast. The terminal is a part of Tuapsenefteprodukt and the sales network of Rosneft.

The terminal’s annual capacity is 10.2 million tonnes. In 2006, Rosneft exported 5.36 million tonnes of oil products through Tuapsenefteprodukt, 40.5% of the Company’s total exports.

Tuapsenefteprodukt is being refurbished in line with the Company’s strategy of developing, expanding and upgrading its production capacity.

By 2010, its capacity will increase to 17 million tonnes, making it possible to service exports from the Tuapse Refinery, whose capacity will also increase considerably after its own upgrade.

![A Tuapsenefteprodukt service station](image-url)
Research and innovation

Among a company’s key competitive advantages are technological innovation, production efficiency and a highly professional workforce.

Rosneft is tightly focused on all these areas, quickly applying and implementing new technology, adopting global best practice and providing continuous training to our specialists and employees to ensure that they constantly develop their key competences. Only this approach can ensure the Company’s continuous development.

Rosneft’s technology development trends

Rosneft introduces new technology at each stage of the value chain: exploration, development and production.

**Exploration**

Rosneft has developed proprietary basin modeling techniques, which simulate the natural environment and the formation of hydrocarbons. Applying these methods enables the Company to minimize geological risks and determine more precisely the principal prospective structures in the studied regions.

In 2006, the Company’s enterprises used cutting edge technology to interpret data and make reliable studies of reservoir characteristics. As a result, the accuracy of geological models and well flow rates after drilling reached 96% - an excellent result both by Russian and international standards.

Rosneft also uses its own patented technology when interpreting seismic data.

**Development**

To introduce new technology at the field development stage, Rosneft established a Project Center, which employs specialists at the parent company and its subsidiaries and corporate institutes, as well as outside international experts. In 2006, the Project Center carried out a number of key field development projects at Rosneft: Vankor, Priobskoye, Val Gamburtseva, Odoptu-More, fields at other Sakhalin projects and at Kurmangazy.

Horizontal drilling at the Vankor field, for example, reduced the planned well stock more than threefold and simultaneously increased the forecast initial well flow rate more than sixfold.

The application of “smart well” systems in the zone under the gas cap, which comprises 30% of the well stock, will enable the Company to produce an additional 14 million tonnes of crude oil. Drilling costs at the Vankor field will be reduced by 40%, and the planned oil recovery factor (ORF) will increase from 0.34 to 0.41.

Yuganskneftegaz increased the ORF from 0.26 to 0.32 at its new Priobskoye field project by optimizing the water flood and changing the drilling strategy. This change equals an increase in recoverable reserves of 153.5 million tonnes of oil and resulted in a 13% rise in oil output in 2006.

To enhance drilling efficiency, Rosneft has developed Real-Time Drilling Monitoring. By applying this technology, the Company will be able to change the trajectory of horizontal wells in response to changes in geological conditions. The drilling process is managed in real-time from a remote support center, which can be several thousand kilometers away from the actual well.

Application of cutting edge drilling techniques considerably enhanced the operating efficiency of complex fields.

In 2006, for example, Purneftegaz switched from drilling traditional vertical wells to horizontal drilling. Between 600-700 meters of horizontal wells were drilled, which not only increased the average flow rate of new wells to over 700 barrels per day, but also brought the undeveloped formations of the Komsomolskoye field into production.

The average flow rate from horizontal wells drilled at the Leminskaya area of the Salymskoye field at Yuganskneftegaz was 2,300 barrels per day, ten times above the level of the current average well flow rates at this field.

The Company also achieved strong drilling results at its offshore projects last year. At the Odoptu-More field belonging to Sakhalinmorneftegaz, the Company drilled wells with a deviation of 5 kilometers from the vertical and over 500 meters long in formations less...
than 4 meters thick. The flow rate of the last such well amounted to 6,600 barrels, eight times higher than the flow rate of wells drilled previously.

**Production**

Rosneft has established Total Production Management (TPM), an electronic system for well and formation management which stores all information on the properties of the strata and the operation of all the Company’s wells.

This system is based on software developed at the Company’s research and technology divisions and enables specialists and managers at all levels to analyze the state of development and make optimal joint decisions on production rate increases and well efficiency.

In 2006, TPM was used at all our subsidiaries and increased the efficiency of workover programs by an average of 10% compared to 2005. An additional 9 million tonnes of reserves were brought to production due to application of TPM at the Priobskoye field.

TPM is also successfully being applied in the regions that have been under development for 50 years or more, for example, in Southern Russia and in Udmurtia. As a result, daily production increased by 9% at Krasnodarneftegaz and by 15% at Stavropolneftegaz in 2006.
Management of Rosneft’s scientific and technical development

Rosneft believes in the centralized management of its scientific and technical development at its scientific research institutes, successfully introducing new technology and best practices, thorough and ongoing training in technology for personnel and accumulating and disseminating knowledge throughout the Company.

In order to integrate science and production completely, ensure the successful introduction of new technology and facilitate the dissemination and accumulation of knowledge throughout the entire the Company, Rosneft has established the Corporate Scientific Research and Production Complex (CSRPC).

The CSRPC employs over 100 researchers with postgraduate degrees and comprises four scientific research institutes in various regions of Russia - Krasnodar, Ufa, Izhevsk and Sakhalin Island, thus covering every geographic region where Rosneft operates. It also includes the Corporate Scientific and Technical Center (CSTC), which manages these institutes.

In 2006, 1,500 employees were involved in scientific research and project development.

The New Technologies System (NTS) manages innovative development and is responsible for problem analysis, determining key areas for research, developing efficient solutions, testing and introducing new technology and disseminating new experience throughout the Company.

Working groups dedicated to identifying the most important areas in the short and long-term ensure the functioning of NTS.

Experts working at Rosneft and its oil producing subsidiaries, corporate scientific research and project...
institutes, as well as outside Russian and foreign experts, are all involved in this joint effort. All activities of the working groups are based on the project principle and are directed by CSTC managers.

Innovations are stored in the Technology Data Base, which is continuously updated and includes the Technology Matrix, a set of simple and clear guidelines establishing where and how any technology should be applied.

One of the priorities of the NTS is the introduction of new hydraulic fracturing technologies (HF). In 2006, pilot projects involving four new HF technologies were implemented under the management of an NTS working group: in conditions of thin shale barriers, HF in horizontal wells, selective HF in conditions of highly stratified reservoirs and complex studies of HF fracture geometry.

In 2006, NTS developments were applied at Yuganskneftegaz and Purneftegaz and led to the flow rate from horizontal wells drilled in severe geological conditions rising by a factor of three to five. The average period for HF payback in horizontal wells is 2.2 months. HF methods at new wells were optimized, which reduced related expenses by more than 1.5 billion at Yuganskneftegaz alone, with the growth of production capacity and flow rates at new wells standing at 5%.

Testing of OptiStim and IsoFrac HF technology was conducted at the Priobskoye field for highly stratified reservoirs. In the future, the Company will be able to reduce the HF time and cost by a factor of 1.5-2.

The optimal HF technology, which limits the vertical fracture length, was used at several fields at Purneftegaz and increased the average well flow rate from 11 tonnes per day in the first half of 2005 to 25-30 tonnes per day in 2006.

Significant improvements were made in cementing technology. Upon application, the average increase in the flow rate per well in 2006 rose from three to ten tonnes per day, but the potential production growth from this technology is 2,000 tonnes per day.

An NTS working group carries out tests on the unique AKM-80 pump. A unique program for the pump’s auto-adjustment was developed after successful cooperation with the manufacturers. The AKM-80 resulted in an average increase in the well flow rate of 15% in 2006. The large-scale use of these pumps will enable the Company to increase production by 365,000 tonnes per annum.

Fields at Purneftegaz are test sites for the development of artificial lift technology to increase flow rates at wells with a high gas factor.

In 2006, the Company tested high-tech pumping equipment capable of stable operation even with high gas content at pump intake.

Purneftegaz specialists were able to operate electric submersible pumps with a gas content of up to 55% at pump intake - much higher than the usual technology, which only achieves between 20-30% - and increase production per well by 10 tonnes per day. The potential increase in production due to application of this technology for the Company as a whole amounts to 2,500 tonnes per day.

Specialists involved in the work of the NTS gain valuable experience and rapid career development. They also represent the Company’s technological and management potential.

In 2006, Rosneft held two large seminars within the framework of NTS to exchange production experience and organized over 25 field visits for the Company’s specialists to various Russian and foreign companies.

Rosneft is also establishing an integrated information environment that includes the RN-Expert Knowledge Management System (KMS), which is intended to standardize and automate the collection, accumulation, storage and dissemination of knowledge and best practice throughout Rosneft.

KMS includes four blocks that represent the entire knowledge management cycle:

- Planning and managing research, development and new technology to accumulate knowledge;
- Project Zones for applying the knowledge obtained to particular projects, such as new technology systems, design and production documentation for field development, research and development activities;
- Exchange of knowledge to swap and disseminate the knowledge obtained to using the Expert System, Innovation Data Base and the Technology Data Base, which is updated in real time and includes the Technology Matrix that defines the procedures and areas for applying technology;
- Informational storage for the structured storage of knowledge.
KMS also provides access to electronic libraries, such as that of Society of Petroleum Engineers and ScienceDirect, Elsevier, DIGITAL ANALOGS Database.

In order to efficiently utilize the potential of new technology, Rosneft has established the System of Production Training to develop the key competences of Company specialists.

In 2006, Rosneft conducted 61 courses devoted to exploration, development and production, attracting the best lecturers from leading Russian and foreign universities, such as Moscow State University, Russian State University of Oil and Gas, Stanford University, the University of Tulsa, the Colorado School of Mines, Texas A&M University, the University of Calgary, the University of Houston, the Institut Francais du Petrole and the Ecole Nationale Superieure de Geologie.

The continuous flow of new technology is enhanced by cooperation with the world’s leading research centers.

Rosneft is interested in the whole range of knowledge and experience in developing and introducing new technology, as well as in managing the innovation process. Utilizing associated gas is one of the highest priorities in current research, while other promising areas of research include the development of difficult oil reserves, for example offshore fields and high viscosity oilfields.

Scientific exchange occurs through all forms of interaction. This includes inviting leading international specialists to give lectures and provide consulting services, as well as organizing academic and practical conferences with foreign experts on issues crucial to the Company.

One example of close cooperation is the introduction of a method to calculate the multiphase flow, which was developed by the TUFFP International Consortium at the University of Tulsa, Rosneft and others. This method is currently the most precise and universal means of making calculations for wells of any configuration, from vertical to horizontal. Rosneft was the first oil company in the world to apply (in its Production Management System) these developments for its calculations throughout the entire Company.

Based on the results of the University of Tulsa Consortium on Artificial Lift Performance (TUALP), the Company was able to analyze the operational efficiency of equipment on fields with a high gas factor and to develop recommendations for the use of loading equipment under conditions of high dissolved gas content.

As a result of its activities in innovation, Rosneft, its subsidiaries and scientific research institutes have registered 75 items of intellectual property.
Sustainable development

Personnel

In 2006, Rosneft employed an average of 74,200 people, including 57,600 at subsidiaries and 16,500 at companies controlled by subsidiaries.

Rosneft employees work in practically every region across Russia. Company subsidiaries employ 19,900 people in Western and Eastern Siberia, 8,800 in Russia’s Far East and 17,800 people in Southern Russia.

In 2006, the average age of employees was 46. The Company employs 6,800 in executive positions and hired 13,533 new staff in 2006.

The Future is Today

Rosneft seeks to attract talented young employees as it prepares for the future and is already now supporting the people who will join its ranks in five or ten years.

The Company has established a program of pre-higher education for future specialists at specialized Rosneft classes to give them a solid foundation in essential subjects and orient them toward future employment at the Company.

Students are offered vocation-oriented education, including visits to enterprises, meetings with well-known oilmen and young specialists. They also become familiar with the business processes used in oil production.

Rosneft’s carries out this work in regions of particular importance to the Company, in Western and Eastern Siberia, the Northern Caucasus and Central Russia, operating 13 classes which provide training to 320 stu-
In 2007, the Company plans to introduce five more classes.

The Company also collaborates with teachers and organizes training for teachers of specialized subjects and school psychologists working in Rosneft classes.

The knowledge obtained in these classes is subsequently reinforced at institutions of higher education.

Rosneft cooperates closely with the Gubkin Russian State University of Oil and Gas, Ufa State Oil Technical University, Tyumen State Oil and Gas University, St. Petersburg Mining University, Kuban State Technical University, Moscow State University, MFTI, MGIMO (University) and other leading educational institutions in Russia.

The Company is constantly improving the educational, methodical, material and technical equipment of its partners in accordance with modern requirements.

Rosneft also provides sponsorships, organizes training for partner institutions’ teaching staff at the Company’s enterprises and offers corporate grants to teachers on a competitive basis.

In 2006, Rosneft expanded its cooperation with MIEP MGIMO by establishing a Department for Global Energy Policy and Energy Security.

Practical training and internships, business games, master classes and presentations are organized for students.

Rosneft has developed a corporate and social scholarship program, which will ultimately provide a pool of future specialists. In 2006, 13 students received these scholarships. The most promising students and graduates are offered an internship and then the possibility of full-time employment.

The Company devotes special attention to young specialists. It has set up councils for the 1,113 young specialists it currently employs, as well as a mentoring system, which help them to adjust to work at the Company.

The Company has also organized training sessions and created the right conditions for career growth for its young specialists. In addition, it holds competitions and training sessions, as well as regional and inter-regional scientific research conferences.
Training and development of personnel

Rosneft offers equal opportunities to all of its employees to steadily improve their capabilities and skills. A key aspect of the Company’s policy regarding individual training and development is its personal growth strategy. Rosneft believes that it can reach a high level of personnel development by educating the best specialists and managers.

The growth strategy is based on corporate training programs aimed at increasing the educational level of employees and reinforcing their personal motivation.

In addition, the Company is constantly improving the system that assesses the potential and appropriate remuneration of its employees. Corporate training programs developed jointly with Russian and foreign institutes and business schools are open to all categories of employees.

In 2006, the Company successfully began an MBA program (International Business in the Oil and Gas Industry) organized in cooperation with Norway’s Bodo Graduate School of Business and MGIMO (University), nineteen employees took part, while four Rosneft managers underwent training in the MBA program at the Stockholm School of Economics (SSE).

In 2006, the Company successfully implemented development programs for its employees, including individual training and strategic management programs.

Rosneft is interested in the successful professional development of its employees and provides all the necessary conditions for managers and specialists to ensure their self-improvement.

Rosneft plans to achieve its strategic objectives by applying new technology in active cooperation with leading industry scientific research centers, including those at such companies as Schlumberger, Halliburton and Baker Hughes.

These measures enable the Company to motivate and retain professionals and help achieve maximum labor efficiency.

Health, safety and environmental protection

Rosneft adheres strictly to the highest international standards and the requirements of Russian and international legislation on labor safety, health and environmental protection.

In 2006, Rosneft adopted a Company-wide policy on industrial safety, labor and environmental protection which provides for:

• steadily improving industrial safety, labor and environmental protection; monitoring the performance of these obligations;
• gradually reducing industrial injuries, accidents and the adverse impact of production on the environment;
• improving industrial and environmental safety at the Company’s production facilities to levels matching those at global oil companies;
• establishing and maintaining an efficient corporate management system for industrial safety, labor and environmental protection;
• reducing industrial risks from newly commissioned facilities.

The Company has developed systems for environmental management, monitoring and audit in accordance with ISO 14000 standards. Currently, Rosneft and all of its subsidiaries are being certified in accordance with ISO 14000 and OHSAS 18000.

Since 2006, Rosneft has been operating an integrated management system for industrial safety, labor and environmental protection in accordance with ISO 14001:2004, OHSAS 18001:1999 and ISO 19011:2002.

Rosneft applies cutting edge technology and production methods to create a safe and healthy working environment for its employees and to minimize the risk of accidents and other emergency situations.

In 2006, spending on occupational and industrial safety at Rosneft and its subsidiaries amounted to 710 million rubles, an increase of 3% over 2005.

Employees at Rosneft regularly participate in training programs to exchange experience on labor safety and environmental protection.

The Company also develops complex programs of health protection. Rosneft’s social package includes
medical insurance, disease prevention and treatment at sanatoria.

In 2006, Rosneft spent 97 million rubles on medical insurance for over 21,000 employees. Subsidiaries of Rosneft also render assistance to employees and pay for their treatment at sanatoria. In 2006, 7,300 employees received health and resort treatment at a cost of 158 million rubles. In 2006, a program to reduce the sickness rate by at least 30% by 2011 was made a priority in the area of health care.

Rosneft pays considerable attention to reducing the rate of accidents and in 2006 reduced the overall accident rate per one million man-hours at the Company and its subsidiaries to 0.34, a drop of 32% compared to 2005.

In 2006, nine incidents occurred at production facilities, compared to 11 incidents and two accidents in 2005. The Company reduced the total number of incidents and breakdowns in 2006 by 30.8% compared to the previous year.

Level of workplace accident occurrence (per 1 million hours worked)

Level of fatal workplace accident occurrence (per 100 million hours worked)
In 2006, Rosneft developed a plan for environmental and labor protection programs to run until 2009. The Company’s units began implementing a Dedicated Environmental Program, which provides for the construction of landfills and sewage disposal plants and the establishment of posts for clean-up in case of accidental spills of oil or oil products, as well as for the equipment required by these units.

**Gross emission of harmful elements in the atmosphere (ths. tonnes)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Emission (ths. tonnes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>959.5</td>
</tr>
<tr>
<td>2006</td>
<td>1060.2</td>
</tr>
</tbody>
</table>

**Expenditures on environmental protection (mln. rubles)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenditures (mln. rubles)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>1387</td>
</tr>
<tr>
<td>2006</td>
<td>2000</td>
</tr>
</tbody>
</table>

Sucker-rod pump at a Krasnodarneftegaz field
Social responsibility

The Company’s well-being is not only a function of its solid production and financial performance, but also of its position in society and its contribution to the development and prosperity of the country. In the interests of its shareholders, Rosneft therefore pursues a policy of high social responsibility to its employees and their families, the people in the regions where it operates and to society at large.

Basic directions of our social policy

Rosneft’s social policy is part of its corporate strategy and is aimed at providing the most comfortable and safest labor conditions for its employees and improving the quality of life of their families.

The Company’s policy therefore envisions:

• housing assistance;
• optimal conditions for labor and recreation;
• protection of health and support for a healthy lifestyle;
• private pension insurance;
• maintenance of social infrastructure;
• participation in regional social and economic development;
• charitable contributions.

Expenditures on core social programs (mln. rubles)

Social programs and charity

Social programs are implemented by Rosneft in many areas and affect the interests of tens of thousands of people in various regions across the country. Rosneft is involved in extensive housing construction, mortgage lending, construction of educational and medical institutions, cultural centers and sports and other facilities, infrastructure development and the improvement of various population centers.
The Company also renders material assistance to educational institutions, creative and sports collectives, veterans and retirees.

In 2006, Rosneft and its subsidiaries were nominated in recognition of its achievements in several categories at the V All-Russian Competition of High Social Efficiency, which is sponsored by the Russian Government.

In 2006, the Company allocated 7.5 billion rubles to social programs which in terms of their scope are on par with those of the world’s largest corporations.

**Housing programs and mortgage lending**

Rosneft has developed housing construction and mortgage lending programs to improve its employees’ accommodation, especially where the Company operates.

In 2006, Rosneft provided its employees with 47,500 square meters of housing, twice the amount achieved in 2005.

A substantial proportion of the construction in which Rosneft is involved is in the remote regions of Siberia and the Far East, where 8,100 square meters of housing were built in 2006. The Company plans to build a further 32,500 square meters by 2009.

Rosneft is also actively involved in housing construction in Chechnya, Dagestan and the Stavropol Territory, where construction last year amounted to 6,600 square meters.

In 2006, Rosneft purchased 3,900 square meters of company apartments, 39% more than in 2005, for skilled specialists who came to the Company from all over Russia.

Last year, 645 employees took part in Rosneft’s long-term mortgage lending program, three times more than in 2005. Between 2007 and 2011, the Company plans to spend more than 4.5 billion rubles to purchase 171,000 square meters of housing. This program may improve the housing conditions of 3,111 employees.

The most promising long-term employees of the Company are granted interest-free loans to finance the down payments on their new apartments. A beneficial lending system is also offered to the youngest employees of the Company.
Support for education, culture and sports

Rosneft pays considerable attention to construction and renovation of schools and cultural institutions as part of its social programs.

In 2006, the Company participated in the construction and renovation of seven schools, four kindergartens, five sports facilities and four cultural centers.

Rosneft sponsors an annual Sports Tournament for its employees. Games include football, volleyball, basketball, table tennis, chess and many other sports.

In 2006, regional competitions were held in several cities. Over 1,000 people took part in the preliminary events. The finalists met in Krasnodar, where the winners were announced.

Last year, Rosneft spent a total of 78.1 million rubles on education, culture and sport, 27.6 million rubles more than in 2005.

Support for local infrastructure development

Rosneft subsidiaries are the dominant enterprises in many of Russia’s population centers, such as Nefteyugansk, Gubkinsky, Okha and Usinsk. The Company’s management has always paid special attention to the needs of these and many other cities.

In most regions where Rosneft operates, the Company supports the development of local infrastructure, including medical facilities, libraries, sports and health-improvement facilities, pharmacies and other establishments.

In 2006, Rosneft provided financial support to five hospitals and clinics that lacked medicines and equipment and built roads and overhead crossings in Stavropol. In Chechnya, the Company not only rebuilt the oil and gas industry, but also upgraded the water supply system in several communities.

In the Khanty-Mansiysk Autonomous District, the Company repaired a gas pipeline and heating systems.

Since 2006, the Company has been participating in a program to develop the social sphere of the Turukhan District as part of an agreement with the authorities of Krasnoyarsk Territory. Total spending during 2006 and 2007 will be 185 million rubles.

In 2006, Rosneft invested over 1.2 billion rubles in developing local infrastructure, which is 788.9 million rubles more than in 2005.
Private pension insurance

Private pension insurance programs and corporate pension reforms have been developed for the Company’s employees.

As part of the private pension insurance program, Rosneft pays out corporate pensions, which are subject to regular indexation. Retirees also receive state pensions.

Between 2007 and 2010, the Company plans to complete its corporate pension reform to provide additional pension support to every employee upon his or her retirement.

In the near future, an employee’s pension will consist of the following three complementary parts:

- state pension;
- corporate cumulative pension contributed by Rosneft;
- pension from employees’ voluntary contributions into a private pension fund managed by Neftegarant.

Rosneft believes that it has a duty to support veterans and retirees through supplementary private pensions and material aid as part of its policy of social responsibility.

In 2006, together with the funding of the supplementary pension insurance for veterans and pensioners, Rosneft allocated 66 million rubles to payments for medical aid and health resort vouchers.

Charities

Rosneft participates actively in charitable activities and supports regional projects through material funding.

The Company spent 924 million rubles in 2006 on charitable activities.
Corporate governance

Rosneft has developed a system of corporate governance to enhance the Company’s efficiency. Rosneft believes that this system ensures the transparency and investment attractiveness of the Company and protects the rights and interests of its shareholders.

In 2006, Rosneft’s Board of Directors voted to adopt a Company Code of Corporate Conduct, which was developed in accordance with the requirements of Russian legislation and best practice in the area of corporate governance.

In addition, three committees of the Board of Directors were established in 2006: the Audit Committee, the HR and Remuneration Committee and the Strategic Planning Committee. They were headed by the Board’s independent non-executive directors.
Board of Directors
The Board of Directors of Rosneft consists of nine members, three of whom are independent directors.

The Board of Directors as of December 31, 2006

Igor Sechin
Chairman of the Board of Directors of Rosneft Oil Company

Sergey Bogdanchikov
Member of the Board of Directors, President of Rosneft

Hans-Joerg Rudloff
Independent member of the Board of Directors of Rosneft, Chairman of the Audit Committee, member of the HR and Remuneration Committee.

Andrey Kostin
Independent member of the Board of Directors of Rosneft, Chairman of the HR and Remuneration Committee, member of the Audit Committee

Alexander Nekipelov
Independent member of the Board of Directors of Rosneft, Chairman of the Strategic Planning Committee
There were some changes in the composition of Rosneft’s Board of Directors in 2006. Igor Artemyev, Oleg Gordeev, Yuri Medvedev and Sergey Oganessyan terminated their tenure. Alexander Nekipelov, Gleb Nikitin, Andrey Kostin and Hans-Joerg Rudloff were elected to the Company’s new Board of Directors.

**Kirill Androsov**

**Member of the Board of Directors of Rosneft, member of the Audit Committee.**
In 2005, received an MBA from the University of Chicago.
From 2002 to 2004 – first deputy general director of Lenenergo.
From 2004 to 2005 – director of the department of state regulation of tariffs and infrastructure of reforms of Russia’s Ministry of Economic Development.
From 2005 – Deputy Minister of Economic Development and Trade of Russia.

**Sergey Naryshkin**

**Deputy Chairman of the Board of Directors of Rosneft, member of HR and Remuneration Committee**
Born in 1954. In 1978, graduated from the Leningrad Mechanical Institute. He received his second higher education at the St. Petersburg International Institute of Management (Economics). PhD (Economics).
From 2002 to 2004 - chairman of the Foreign Economic and International Relations Committee of the Leningrad Region government.
In 2004 – deputy chief of the President’s Economic Department
In 2004 – chief of staff for the Cabinet of Ministers.
From 2004 – member of the Board of Directors of Rosneft.
From 2007 – Deputy Prime Minister of Russia

**Gleb Nikitin**

**Deputy Chairman of the Board of Directors of Rosneft, member of the Strategic Planning Committee**
From 2002 to 2004 – head of the state property management division at the Department for the Management of State Property in St. Petersburg’s Municipal Property Management Committee.
From 2004 – head of the division for commercial sector property management of the Russian Agency for the Management of Federal Property
From 2006 – member of the Board of Directors of Rosneft.

**Andrey Reus**

**Member of the Board of Directors of Rosneft, member of the Strategic Planning Committee**
From 2002 to 2004 – chief of staff to the Deputy Prime Minister of the Russian Federation.
From 2004 – member of the Board of Directors of Rosneft.
The activity of the Board of Directors of Rosneft in 2006

Activity of the Board of Directors and committees of the Board of Directors

Attendance at meetings

<table>
<thead>
<tr>
<th>Name</th>
<th>Board of Directors</th>
<th>Audit Committee</th>
<th>HR and Remuneration Committee</th>
<th>Strategic Planning Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Igor Sechin</td>
<td>12/12</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sergey Oganuyan</td>
<td>5/6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oleg Gordeev</td>
<td>6/6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yuri Medvedev</td>
<td>6/6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Igor Artemyev</td>
<td>6/6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sergey Naryshkin</td>
<td>12/12</td>
<td>4/5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gleb Nikitin</td>
<td>6/6</td>
<td></td>
<td></td>
<td>3/3</td>
</tr>
<tr>
<td>Sergey Bogdanchikov</td>
<td>11/12</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hans-Joerg Rudloff</td>
<td>6/6</td>
<td>5/5</td>
<td>5/5</td>
<td></td>
</tr>
<tr>
<td>Andrey Kostin</td>
<td>6/6</td>
<td>4/5</td>
<td>5/5</td>
<td></td>
</tr>
<tr>
<td>Kirill Androsov</td>
<td>12/12</td>
<td>5/5</td>
<td></td>
<td>3/3</td>
</tr>
<tr>
<td>Alexander Nekipelov</td>
<td>4/6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Andrey Reus</td>
<td>12/12</td>
<td></td>
<td></td>
<td>3/3</td>
</tr>
</tbody>
</table>

Note: the first figure shows the number of meetings which the member of the Board of Directors attended; the second one shows the total number of meetings which he might have attended (from the date of appointment).

In 2006, the Board of Directors of Rosneft issued seven instructions to the Company’s Management Board. All of them were carried out.

In 2006, the Board of Directors held a total of 12 meetings during which the following key issues were considered and respective decisions made:

Improvement of the corporate governance system

The Board of Directors adopted the Code of Corporate Conduct and internal documents regulating the procedure to establish and operate the Committees of the Board of Directors, internal control as well as the dividend and information policies. The Board of Directors proposed to the General Meeting of Shareholders of Rosneft to adopt the new versions of the Charter and regulations on the General Meeting of Shareholders, on the Board of Directors, on the Management Board, the President and the Internal Audit Committee. A recommendation was made to the Board of Directors to decide upon remuneration of the independent members of the Company’s Board of Directors and compensation to the members of the Board of Directors for expenses incurred in relation to the performance of their functions as members of the Board of Directors.

Enhancement of subsidiaries’ management efficiency and establishment of an optimal institutional and management structure

In 2006, Rosneft completed a consolidation program, whereby 12 subsidiaries joined the Company. Within the framework of this activity, the Board of Directors made
decisions to validate the conditions and procedures of Rosneft’s restructuring and the adoption of the schedule for the Company’s consolidation.

**Financial and economic performance of Rosneft**

Rosneft’s Board of Directors adopted a business plan for 2007. In order to prepare the Initial Public Offering (IPO) of shares on the London Stock Exchange, the Board of Directors approved the Prospectus. The Board of Directors also confirmed the Company’s preliminarily production and economic performance results for the first quarter, first half of the year and nine months of 2006; submitted recommendations to the General Meeting of Shareholders on the amount of annual dividends to be paid on Rosneft shares and approved dividend payment procedures. In the process of organizing loans, the Board of Directors approved the respective transactions of Directors approved the Prospectus. The Board of Directors also confirmed the Company’s preliminarily production and economic performance results for the first quarter, first half of the year and nine months of 2006; submitted recommendations to the General Meeting of Shareholders on the amount of annual dividends to be paid on Rosneft shares and approved dividend payment procedures. In the process of organizing loans, the Board of Directors approved the respective transactions.
Management Board

The Management Board of Rosneft consists of eight members.

The Management Board as of 31.12.2006

Sergey Bogdanchikov

President of Rosneft, Chairman of Management Board of Rosneft
From 1993 – general director of Sakhalinmorneftegaz.
From 1997 – vice president of Rosneft.
On October 14, 1998, appointed president of Rosneft by Russian Government decree.
Doctor of Engineering Sciences and an author of several academic works.

Nikolay Borisenko

First Vice President, Deputy Chairman of the Management Board of Rosneft
From 2002 – first vice president of Rosneft, responsible for corporate affairs.

Sergey Kudryashov

First Vice President of Rosneft
In 2006, received an Executive MBA from the Stockholm School of Economics.
From 2002 to 2003 – deputy general director of Tomskneft VNK – head of oil and gas production department of Strezhevoineftegaz.
From 2003 to 2005 – general director of Yuganskneftegaz, vice president of YUKOS.
From 2005 - first vice president of Rosneft, supervises the Company’s production sector.

Anatoly Baranovsky

Vice President of Rosneft
From 2002 – vice president of Rosneft, responsible for treasury and budgetary issues, current assets and fiscal regulation.
There were some changes in the membership of Rosneft’s Management Board in 2006. Alexey Kuznetsov and Sergey Alexeev terminated their tenure. Peter O’Brien and Kim Sun Ne were elected to the Company’s new Management Board.

**Stepan Zemlyuk**

**Vice President of Rosneft**


**Sun Ne Kim**

**Chief Accountant of Rosneft**


**Peter O’Brien**

**Head of the Group of Financial Advisers to the President of Rosneft in the capacity of Vice President**


**Riso Tursunov**

**Vice President of Rosneft**

Information on the shares held by the members of the Board of Directors and the Management Board of Rosneft (as of December 31, 2006)

<table>
<thead>
<tr>
<th>Members of the Board of Directors and the Management Board of Rosneft</th>
<th>Number of ordinary shares</th>
<th>Share in authorized capital, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Igor Sechin</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Sergey Bordanchikov</td>
<td>126 672</td>
<td>0.0012%</td>
</tr>
<tr>
<td>Hans-Joerg Rudloff</td>
<td>662 500</td>
<td>0.0063%</td>
</tr>
<tr>
<td>Andrey Kostin</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Alexander Nekipelov</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Kirill Androsov</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Sergey Naryshkin</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Gleb Nikitin</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Andrey Reus</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Nikolay Borisenko</td>
<td>295 216</td>
<td>0.0028%</td>
</tr>
<tr>
<td>Sergey Kudryashov</td>
<td>132 847</td>
<td>0.0013%</td>
</tr>
<tr>
<td>Anatoly Baranovsky</td>
<td>265 695</td>
<td>0.0025%</td>
</tr>
<tr>
<td>Stepan Zemlyuk</td>
<td>137 768</td>
<td>0.0013%</td>
</tr>
<tr>
<td>Sun Ne Kim</td>
<td>66 423</td>
<td>0.0006%</td>
</tr>
<tr>
<td>Peter O’Brien</td>
<td>50 000 (Global Depositary Receipts)</td>
<td>—</td>
</tr>
<tr>
<td>Riso Tursunov</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>

Shares of Rosneft were purchased by the members of the Board of Directors and the Management Board in 2006 during the process of the Company’s Initial Public Offering (IPO).

Committees of Rosneft’s Board of Directors

Audit Committee of the Board of Directors

The Audit Committee was founded by order of the Board of Directors of Rosneft in June 2006 and is headed by an independent director. It comprises only non-executive members of the Board of Directors and the Committee.

Members of the Audit Committee:

Hans-Joerg Rudloff – Chairman of the Committee; Kirill Androsov; Andrey Kostin.

The Committee’s functions include the preparation of recommendations to the Board of Directors on exercising control over Rosneft’s financial and economic performance.

In addition, the Committee evaluates the performance of Rosneft’s nominee auditors, the audit report and the efficiency of internal control procedures. It also drafts proposals on their improvement.

The Audit Committee assists the Board of Directors in exercising control over the integrity and accuracy of fiscal and management accounting and financial
statements at the Company and makes recommendations on profit and loss distribution procedures at Rosneft, based on performance in the given fiscal year.

The Audit Committee also reviews the Company’s internal procedures in terms of risk management, as well as reviews and monitors the efficiency of such procedures and their implementation.

**HR and Remuneration Committee of the Board of Directors**

The HR and Remuneration Committee was founded in June 2006. It also consists of non-executive members of the Board of Directors and is headed by an independent director. The Committee members cannot take part in the evaluation of their own performance and decision-making regarding their remuneration.

**Members of the HR and Remuneration Committee:**

Andrey Kostin – Chairman of the Committee; Sergey Naryshkin; Hans-Joerg Rudloff.

The HR and Remuneration Committee helps attract qualified specialists to the Company’s management and ensures that the necessary incentives are available for their successful work.

The main functions of the HR and Remuneration Committee are the development of personnel strategy, resolving of issues linked to remuneration and incentives for the employees of Rosneft, development of principles and criteria of establishing the size of the remuneration and compensation to the members of the Board of Directors, the Management Board and management of Rosneft, and the development of long-term remuneration programs for the Company’s employees (bonuses and optional forms of remuneration).

**Strategic Planning Committee of the Board of Directors**

The Strategic Planning Committee was founded in June 2006 and consists only of non-executive members of the Board of Directors. It is headed by an independent director.

**Members of the Strategic Planning Committee:**

Alexander Nekipelov – Chairman of the Committee; Gleb Nikitin; Andrey Reus.

The Strategic Planning Committee determines the strategic objectives and goals for Rosneft.

The main functions of the Strategic Planning Committee are business planning and the development of budgets and plans for the Company’s short-term and long-term financial and economic performance.

The Strategic Planning Committee develops policies aimed at enhancing the Company’s capitalization, establishes its investment, dividend and credit policies and evaluates coordination between Rosneft and its investors.

**Activities of the Committees of the Board of Directors of Rosneft in 2006**

**Audit Committee**

The Audit Committee is operating according to a plan for 2006-2007.

In 2006, the Audit Committee held five meetings during which the following issues were discussed:

The Committee made recommendations on adopting the consolidated financial reports of Rosneft for 2006, prepared by Ernst & Young in accordance with US GAAP standards, as well as on the fee for the performed audit services. The Committee took actions aimed at improving cooperation with the Company’s external auditor; appointed Accenture as the principal consultant of Rosneft with respect to the project of “fast close” of consolidated financial reports under US GAAP. The Audit Committee also reviewed the Company’s internal control system.

**HR and Remuneration Committee**

The HR and Remuneration Committee operates according to a plan for the second half-year of 2006 and the first half-year of 2007.

In 2006, the HR and Remuneration Committee held five meetings during which the following issues were discussed: recommendations made to the Board of Directors to adopt remuneration procedures and compensation of expenses of the mem-
bers of the Board of Directors of Rosneft; approved the compensation package for the President, the First Vice Presidents and other top managers based on the Company’s performance in the first and second half-years of 2006 in accordance with the terms of individual contracts and in view of the successful completion of Rosneft’s IPO. The Committee also adopted a program to develop (corporate) retirement insurance for employees of Rosneft for 2006 and subsequent years.

**Strategic Planning Committee**

The Strategic Planning Committee operates in accordance with a plan for the second half-year of 2006 and the first half-year of 2007.

In 2006, the Strategic Planning Committee held three meetings. The key decision was to recommend that the Board of Directors adopts the business plan for 2007.

**Authorized capital**

The authorized capital of Rosneft as of December 31, 2006 is 105,981,778.17 rubles and it is divided into 10,598,177,817 ordinary shares with a nominal value of 0.01 rubles each.

The state registration number of issue of ordinary shares of the Company is: 1-02-00122-A. The date of state registration of issue of ordinary shares of the Company: September 29, 2005.

The number of shareholders registered in the register of shareholders of Rosneft as of December 31, 2006 is: 36,723 (including 20 nominal holders).

**Structure of Rosneft’s equity**

**List of Rosneft major shareholders**

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Number of shares</th>
<th>Share in the stock capital, %</th>
<th>Number of shares</th>
<th>Share in the stock capital, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>OJSC ROSNEFTEGAZ</td>
<td>9'092'173'999</td>
<td>99.999'999'999'898</td>
<td>7'965'816'383</td>
<td>75.16</td>
</tr>
<tr>
<td>OJSC YUKOS Oil Company</td>
<td>—</td>
<td>—</td>
<td>1'000'000'000</td>
<td>9.44</td>
</tr>
<tr>
<td>Sberbank of Russia (nominee shareholder)</td>
<td>—</td>
<td>—</td>
<td>1'034'133'827</td>
<td>9.76</td>
</tr>
<tr>
<td>Vneshekonombank (nominee shareholder)</td>
<td>—</td>
<td>—</td>
<td>332'119'664</td>
<td>3.13</td>
</tr>
<tr>
<td>Other entities holding less than 1% of shares</td>
<td>—</td>
<td>—</td>
<td>197'126'186</td>
<td>1.86</td>
</tr>
<tr>
<td>Individuals</td>
<td>—</td>
<td>—</td>
<td>68'981'757</td>
<td>0.65</td>
</tr>
</tbody>
</table>

In 2005-2006, the government’s direct share in the equity of Rosneft was 0.0000000011% and 0.000000009%, respectively.

In 2006, additional shares of Rosneft were issued and distributed:
Consolidation of Rosneft

Rosneft completed the consolidation of its subsidiaries on October 2, 2006. This program was aimed at establishing an optimal organizational and management structure for the Company.

As a result of this consolidation, 12 subsidiaries joined the Company:

**Seven oil-producing companies:**
- Rosneft-Krasnodarneftegaz
- Rosneft-Purneftegaz
- Rosneft-Sakhalinmorneftegaz
- Rosneft-Stavropolneftegaz
- Yuganskneftegaz
- Severnaya Neft
- Selkupneftegaz

**Two oil-refining companies:**
- Rosneft-Komsomolsk Refinery
- Rosneft-Tuapse Refinery

- through conversion of subsidiaries’ shares into shares of Rosneft.

In July 2006, the shares of Rosneft were floated on the NP Russian Trade System Stock Exchange, MICEX Stock Exchange and the London Stock Exchange.

**Dynamics of Rosneft share quotes during 2006 (USD per share)**

![Chart showing share price movements from July to December 2006]

**Three oil product companies:**
- Rosneft-Arkhangelsknefteprodukt
- Rosneft-Nakhodkanefteprodukt
- Rosneft-Tuapsenefteprodukt

Twelve enterprises, which are involved in hydrocarbon production, refining and oil product sales, were established in the regions where the Company’s affiliated subsidiaries operate. As a result of the consolidation, Rosneft’s corporate structure was streamlined and its administration was substantially improved. Its levels of responsibility were more clearly defined, and the accountability of its production units was enhanced. Additionally, the consolidation of Rosneft made it easier for the Company to gain access to capital markets, which enabled it to secure financing for new capital-intensive projects and simplify the process of loan structuring.

After converting their shares into securities of the parent company, minority shareholders in Rosneft’s subsidiaries became holders of highly liquid financial instruments, which are traded on leading stock exchanges in Russia and abroad.
D**ividend policy**

In May 2006, Rosneft’s Board of Directors voted to adopt a Dividend Policy Statute. This statute was developed in accordance with Russian legislation, the Company’s Charter and the Code of Corporate Conduct. The statute sets out the main principles of Rosneft’s dividend policy, decision-making on payment (announcement) of dividends and calculation of their amount.

Rosneft will pursue a strategy aimed at systematically increasing the absolute and relative values of its dividend payments.

When establishing the amount of dividend payments, the following should be taken into consideration: the size and of the investment program and current operations, the need to enhance the Company’s investment...
Attractiveness and increase capitalization and strict adherence to shareholders’ rights as specified in applicable legislation of the Russian Federation.

The Board of Directors recommends the amount of dividend payments to the General Meeting of Shareholders on the basis of Rosneft’s annual financial results and is calculated in accordance with Russian Accounting Standards (RAS).

Rosneft informs shareholders of its dividend policy by placing information for download on the Company’s website: www.rosneft.ru (Russian version) and www.rosneft.com (English version).

### Dividend history of Rosneft

<table>
<thead>
<tr>
<th>Year</th>
<th>Total dividends (announced and paid), million rubles</th>
<th>Dividends per share, rubles</th>
<th>Dividend payout ratio, RAS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>200</td>
<td>2.21</td>
<td>3.4%</td>
</tr>
<tr>
<td>2000</td>
<td>800</td>
<td>8.87</td>
<td>5.3%</td>
</tr>
<tr>
<td>2001</td>
<td>1 100</td>
<td>12.19</td>
<td>11.0%</td>
</tr>
<tr>
<td>2002</td>
<td>1 500</td>
<td>16.63</td>
<td>16.8%</td>
</tr>
<tr>
<td>2003</td>
<td>1 500</td>
<td>16.50</td>
<td>8.1%</td>
</tr>
<tr>
<td>2004</td>
<td>1 755</td>
<td>19.31</td>
<td>10.0%</td>
</tr>
<tr>
<td>2005</td>
<td>11 336</td>
<td>1.25</td>
<td>20.0%</td>
</tr>
</tbody>
</table>

### Information disclosure

With respect to information disclosure, Rosneft is governed by requirements of the Federal Law on Securities, the Federal Law on Joint Stock Companies, the regulation on information disclosure by issuers of securities as approved by the Order of the Federal Service for the Financial Markets (FSFM) dated October 10, 2006 No 06-117/pz-n and other statutory acts.

Rosneft’s policy regarding information disclosure is based on the principles of regularity, efficiency, accessibility, integrity and meaningfulness.

In May 2006, Rosneft’s Board of Directors adopted an Information Policy Statute, based on which information is accessible to shareholders and individuals concerned, regardless of the reasons for obtaining such information, by following a procedure guaranteeing that it is made available.

The main source for disclosure is Rosneft’s website, which contains relevant information on substantial facts, events, management structure and the Company’s financial and operational results.

Rosneft’s website contains the Company’s Charter and internal regulations, annual and quarterly reports, financial statements (consolidated and interim), information on affiliates and other data that may affect the value of the Company’s securities.

Rosneft also provides information in the form of brochures, booklets, press conferences, meetings with shareholders and other concerned individuals.

The company strictly complies with legislative requirements concerning shareholders’ access to necessary information.
Code of Corporate Conduct

In May 2006, Rosneft’s Board of Directors voted to adopt a Code of Corporate Conduct. It was developed in accordance with the Federal Law on Joint Stock Companies, the sample Code of Corporate Conduct recommended by the FSFM of Russia, the Principles of Corporate Governance of the Organization for Economic Cooperation and Development (OECD) and the Charter of Rosneft.

The Code determines the principles of the Company’s corporate governance system. Provisions of this document reflect the main principles of best practice in this area, including the protection of rights and equal treatment of all shareholders; timely disclosure of information, including the Company’s financial status, economic parameters, ownership structure and governance; strategic management of the Company and efficient control over the activity of the Company’s executive bodies and the accountability of the Board of Directors to the General Meeting of Shareholders.

Internal control

Control over Rosneft’s financial and economic performance is exercised by the Company’s organization departments – the Internal Audit Committee, the Audit Department and the Audit Committee.

Internal Audit Committee

Control over Rosneft’s financial and economic performance is exercised by the Internal Audit Committee, which is elected by the General Meeting of Shareholders for a period of one year. It consists of at least three members. Members of the Internal Audit Committee cannot be members of the Board of Directors at the same time and cannot hold other positions in the Company’s management bodies. The audit of Rosneft’s financial and economic performance is exercised on mandatory grounds, based on the results of its activity within the year and additionally, at the initiative of the Internal Audit Committee, by decision of the General Meeting of Shareholders, the Board of Directors or at the request of shareholders holding at least 10% of the voting shares. The authority of the Internal Audit Committee on the issues not stipulated by the Charter is determined by the Regulation on the Internal Audit Committee, which was approved by the General Meeting of Shareholders of Rosneft on June 7, 2006. The Internal Audit Committee shall exercise the annual audit of the Company’s operations within 60 days after the end of the fiscal year.

Audit Committee

The Audit Committee ensures the actual participation of the Board of Directors in exercising control over the financial and economic performance of Rosneft.

Within the authority delegated by the Board of Directors, the Audit Committee:

• ensures a permanent liaison of the Board of Directors with an auditor, an independent assessor, the Internal Audit Committee, the Audit Department, executive bodies and the financial management;
• determines the amount of payment for auditor’s services, evaluates the quality of the auditor’s services to be performed and compliance with the requirements of auditor independence;
• exercises control over the integrity and accuracy of fiscal, management accounting and financial statements of Rosneft;
• makes recommendations to the General Meeting of Shareholders with respect to the amount of dividends on shares and their payment procedures; distribution of profit and losses based on the results of the fiscal year;
• evaluates the property of Rosneft, distribution and repurchase of issued securities as provided by the Federal Law on Joint Stock Companies;
• approves material transactions as provided by Chapters X and XI of the Federal Law on Joint Stock Companies;
• develops and adopts internal control procedures along with executive bodies and organization departments exercising internal control functions;
• reviews results of comprehensive and thematic audits, inspections and examinations of the financial and economic performance of the Company;
• considers proposals and recommendations on management of crisis situations.

Audit Department

The Audit Department (AD) is responsible for:

• establishment of an integrated system of general control over the financial and economic activity of the Company’s subdivisions, offices and subsidiaries;
• performance of comprehensive and selective audits of production and financial activity of the Company’s subdivisions, offices and subsidiaries with the participation of relevant specialists, members of the Internal Audit Committees and audit subdivisions;
• quality and timely execution of decisions made by the Board of Directors, the Management Board and the President of the Company, review of applications from subsidiaries and organization departments on issues within the authority of the Audit Department and control over implementation of the decisions made;
• evaluation, classification and minimization of potential risks arising in the course of Rosneft’s operation;
• cooperation with the Audit Committee and procurement of information on the state of the Company’s internal control;
• methodological support of the Internal Audit Committees and the activities of subsidiaries’ audit subdivisions.

The Audit Department reports to the Audit Committee of the Board of Directors of Rosneft. It allows the Audit Department to ensure its independence for execution of assigned tasks.
Contact information

Full name:

Open joint stock company Rosneft Oil Company

Abbreviated name:

OJSC Rosneft Oil Company

Registered address:

115035, Sophiyskaya naberezhnaya, 26/1, Moscow, Russia

Information service:

telephone: +7 (495) 777-44-22
fax: +7 (495) 777-44-44
telex: 1 4405 DISVO.RU
E mail: postman@rosneft.ru

Investor relations:

Investor Relations, Department of Assets, Economics and Business Planning, OJSC Rosneft Oil Company
telephone: + 7 (495) 221-35-55
fax: + 7 (495) 225-97-24
E mail: ir@rosneft.ru

Company auditor:

CJSC Audit firm “Centre of Accountant and Auditor”
Address: 19071, Ordjonikidze St., 10, Moscow, Russia
telephone: +7 (495) 955-16-00
fax: +7 (495) 955-16-00

Company registrar:

OOO Reestr-RN
Address: 15035, Pyatnitskaya st., 2 , building 2 , Moscow, Russia
telephone: +7 (495) 411-83-11
fax: +7 (495) 411-83-12

GDR Depositary:

J.P.Morgan Europe Limited
Address: 125 London Wall, London EC4Y 5AJ
telephone: +44 2 0 7777-2000

Company website:

Information on the Company and the results of its activity on the website:
Russian version: www.rosneft.ru
English version: www.rosneft.com
CONSOLIDATED FINANCIAL STATEMENTS

WITH REPORT OF INDEPENDENT AUDITORS

MANAGEMENT DISCUSSION AND ANALYSIS (MD&A)

FOR 2006
Report of Independent Auditors

Shareholders and the Board of Directors of OJSC Rosneft Oil Company

We have audited the accompanying consolidated balance sheets of OJSC Rosneft Oil Company, an open joint stock company ("the Company"), as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. We were not engaged to perform an audit of the Company’s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our report dated May 15, 2006, we expressed an opinion that the 2005 consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company, consolidated results of its operations and its cash flows in conformity with accounting principles generally accepted in the United States of America except for three departures from such principles, including the classification of certain debt in default as non-current. As described in Note 17 to the consolidated financial statements, the Company has subsequently obtained satisfactory waivers and/or amended loan agreements to support non-current clas-
sification of such debt as of December 31, 2005. Accordingly, our present opinion on the 2005 financial statements, as presented herein, is not qualified related to this matter, but remains qualified related to the other matters described below.

As discussed in Note 3 to the consolidated financial statements, the Company has not presented pro-forma results of operations for the year 2004 as though its OJSC Yuganskneftegaz acquisition had been completed as of January 1, 2004. These disclosures are required by SFAS No. 141 "Business Combinations".

As discussed in Note 3 to the consolidated financial statements, as of December 31, 2005 the value of property, plant and equipment pertaining to non-controlling shareholders in the accounting for minority interests resulting from acquisition of OJSC Yuganskneftegaz has been recorded at appraised values rather than at historical cost as required by SFAS No. 141 "Business Combinations".

In our opinion, except for the effects of the matters described in the preceding paragraphs, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

Ernst & Young LLC

May 3, 2007
# Consolidated Financial Statements

## Consolidated Balance Sheets

(in millions of US dollars, except share amounts)

<table>
<thead>
<tr>
<th>Notes</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>4</td>
<td>$505</td>
</tr>
<tr>
<td>Restricted cash</td>
<td>4</td>
<td>29</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>5</td>
<td>460</td>
</tr>
<tr>
<td>Accounts receivable, net</td>
<td>6</td>
<td>4,839</td>
</tr>
<tr>
<td>Inventories</td>
<td>7</td>
<td>905</td>
</tr>
<tr>
<td>Deferred tax assets</td>
<td>22</td>
<td>1,135</td>
</tr>
<tr>
<td>Prepayments and other current assets</td>
<td>8</td>
<td>1,589</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td></td>
<td>9,462</td>
</tr>
<tr>
<td><strong>Non-current assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term investments</td>
<td>9</td>
<td>568</td>
</tr>
<tr>
<td>Long-term bank loans granted, net of allowance of US$ 6 and US$ 12, respectively</td>
<td></td>
<td>110</td>
</tr>
<tr>
<td>Oil and gas properties, net</td>
<td>10, 13</td>
<td>32,959</td>
</tr>
<tr>
<td>Property, plant and equipment, net</td>
<td>11, 13</td>
<td>2,598</td>
</tr>
<tr>
<td>Construction-in-progress</td>
<td>12</td>
<td>388</td>
</tr>
<tr>
<td>Goodwill</td>
<td>14</td>
<td>161</td>
</tr>
<tr>
<td>Deferred tax assets</td>
<td>22</td>
<td>110</td>
</tr>
<tr>
<td>Other non-current assets</td>
<td>15</td>
<td>434</td>
</tr>
<tr>
<td><strong>Total non-current assets</strong></td>
<td></td>
<td>37,328</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td></td>
<td>46,790</td>
</tr>
</tbody>
</table>

| **LIABILITIES AND SHAREHOLDERS’ EQUITY** | | |
| **Current liabilities:** | | |
| Accounts payable and accrued liabilities | 16 | 1,998 | 1,358 |
### Consolidated Statements of Income

(in millions of US dollars, except earnings per share data)

<table>
<thead>
<tr>
<th>Notes</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil and gas sales</td>
<td>26</td>
<td>$23,499</td>
<td>16,152</td>
</tr>
<tr>
<td>Petroleum products and processing fees</td>
<td>26</td>
<td>9,250</td>
<td>7,374</td>
</tr>
<tr>
<td>Support services and other revenues</td>
<td>850</td>
<td>337</td>
<td>294</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>33,099</td>
<td>23,863</td>
<td>5,262</td>
</tr>
<tr>
<td><strong>Costs and expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Production and operating expenses</td>
<td>2,197</td>
<td>1,623</td>
<td>595</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Notes</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Consolidated Statements of Income</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Notes</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes</td>
<td>2006</td>
<td>2005</td>
<td>2004</td>
</tr>
<tr>
<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
</tr>
<tr>
<td>Cost of purchased oil, petroleum products and refining costs</td>
<td>1,320</td>
<td>637</td>
<td>547</td>
</tr>
<tr>
<td>Selling, general and administrative expenses</td>
<td>757</td>
<td>589</td>
<td>257</td>
</tr>
<tr>
<td>Pipeline tariffs and transportation costs</td>
<td>3,226</td>
<td>2,231</td>
<td>574</td>
</tr>
<tr>
<td>Exploration expenses</td>
<td>193</td>
<td>164</td>
<td>51</td>
</tr>
<tr>
<td>Depreciation, depletion and amortization</td>
<td>1,638</td>
<td>1,472</td>
<td>307</td>
</tr>
<tr>
<td>Accretion expense</td>
<td>23</td>
<td>34</td>
<td>8</td>
</tr>
<tr>
<td>Taxes other than income tax</td>
<td>22</td>
<td>6,990</td>
<td>5,326</td>
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<tr>
<td>Export customs duty</td>
<td>31</td>
<td>11,140</td>
<td>6,264</td>
</tr>
<tr>
<td>Total</td>
<td>27,495</td>
<td>18,341</td>
<td>4,056</td>
</tr>
<tr>
<td>Operating income</td>
<td>5,604</td>
<td>5,522</td>
<td>1,206</td>
</tr>
<tr>
<td>Other income/(expenses)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income</td>
<td>135</td>
<td>81</td>
<td>65</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(724)</td>
<td>(775)</td>
<td>(159)</td>
</tr>
<tr>
<td>(Loss)/gain on disposal of property, plant and equipment</td>
<td>(95)</td>
<td>(74)</td>
<td>121</td>
</tr>
<tr>
<td>Gain/(loss) on disposal of investments</td>
<td>3</td>
<td>(13)</td>
<td>(30)</td>
</tr>
<tr>
<td>Gain on sale of shares in CJSC Sevmorneftegaz</td>
<td>–</td>
<td>1,303</td>
<td>–</td>
</tr>
<tr>
<td>Equity share in affiliates’ profits</td>
<td>9</td>
<td>17</td>
<td>51</td>
</tr>
<tr>
<td>Dividends and income from joint ventures</td>
<td>15</td>
<td>10</td>
<td>46</td>
</tr>
<tr>
<td>Other expenses, net</td>
<td>(320)</td>
<td>(136)</td>
<td>(196)</td>
</tr>
<tr>
<td>Foreign exchange (loss)/gain</td>
<td>(470)</td>
<td>245</td>
<td>96</td>
</tr>
<tr>
<td>Total other (expenses)/income</td>
<td>(1,439)</td>
<td>692</td>
<td>(5)</td>
</tr>
<tr>
<td>Income before income tax and minority interest</td>
<td>4,165</td>
<td>6,214</td>
<td>1,201</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>22</td>
<td>(540)</td>
<td>(1,609)</td>
</tr>
<tr>
<td>Income before minority interest</td>
<td>3,625</td>
<td>4,605</td>
<td>903</td>
</tr>
<tr>
<td>Minority interest in subsidiaries’ earnings</td>
<td>20</td>
<td>(92)</td>
<td>(446)</td>
</tr>
<tr>
<td>Net income</td>
<td>3,533</td>
<td>4,159</td>
<td>837</td>
</tr>
<tr>
<td>Earnings per share (in US$) – basic and diluted</td>
<td>0.37</td>
<td>0.46</td>
<td>0.09</td>
</tr>
<tr>
<td>Weighted average number of shares outstanding (millions)</td>
<td>18</td>
<td>9,527</td>
<td>9,092</td>
</tr>
</tbody>
</table>
Consolidated Statements of Changes in Shareholders’ Equity for the years ended December 31, 2006, 2005 and 2004 (in millions of US dollars, except share amounts)

<table>
<thead>
<tr>
<th></th>
<th>Number of shares (millions)</th>
<th>Common stock</th>
<th>Additional paid-in capital</th>
<th>Accumulated other comprehensive income</th>
<th>Retained earnings</th>
<th>Shareholder’s equity</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance at December 31, 2003</strong></td>
<td>9,092</td>
<td>20</td>
<td>19</td>
<td>$13</td>
<td>2,510</td>
<td>2,562</td>
</tr>
<tr>
<td><strong>Realized gains on available-for-sale securities</strong></td>
<td></td>
<td></td>
<td></td>
<td>(13)</td>
<td></td>
<td>(13)</td>
</tr>
<tr>
<td><strong>Net Income for the year</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>837</td>
</tr>
<tr>
<td><strong>Comprehensive income for the year</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>824</td>
</tr>
<tr>
<td><strong>Dividends declared on common stock</strong></td>
<td></td>
<td></td>
<td></td>
<td>(51)</td>
<td>(51)</td>
<td></td>
</tr>
<tr>
<td><strong>Balance at December 31, 2004</strong></td>
<td>9,092</td>
<td>20</td>
<td>19</td>
<td></td>
<td>3,296</td>
<td>3,335</td>
</tr>
<tr>
<td><strong>Net and comprehensive income for the year</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4,159</td>
<td>4,159</td>
</tr>
<tr>
<td><strong>Dividends declared on common stock</strong></td>
<td></td>
<td></td>
<td></td>
<td>(61)</td>
<td>(61)</td>
<td></td>
</tr>
<tr>
<td><strong>Balance at December 31, 2005</strong></td>
<td>9,092</td>
<td>20</td>
<td>19</td>
<td></td>
<td>7,394</td>
<td>7,433</td>
</tr>
<tr>
<td><strong>Net and comprehensive income for the year</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3,533</td>
<td>3,533</td>
</tr>
<tr>
<td><strong>Ordinary shares issued during Initial Public Offering (see Note 1)</strong></td>
<td>285</td>
<td></td>
<td>2,115</td>
<td></td>
<td></td>
<td>2,115</td>
</tr>
<tr>
<td><strong>Ordinary shares issued during Share Swap (see Note 1)</strong></td>
<td>1,221</td>
<td></td>
<td>9,218</td>
<td></td>
<td></td>
<td>9,218</td>
</tr>
<tr>
<td><strong>Dividends declared on common stock</strong></td>
<td></td>
<td></td>
<td></td>
<td>(424)</td>
<td>(424)</td>
<td></td>
</tr>
<tr>
<td><strong>Balance at December 31, 2006</strong></td>
<td>10,598</td>
<td>20</td>
<td>11,352</td>
<td></td>
<td>10,503</td>
<td>21,875</td>
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</table>
Consolidated Statements of Cash Flows
(in millions of US dollars)

<table>
<thead>
<tr>
<th>Notes</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income</td>
<td>3,533</td>
<td>4,159</td>
<td>837</td>
</tr>
<tr>
<td>Reconciliation of net income to net cash provided by operating activities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effect of foreign exchange</td>
<td>392</td>
<td>(115)</td>
<td>(24)</td>
</tr>
<tr>
<td>Gain on sale of shares in CJSC Sevmorneftegaz</td>
<td>–</td>
<td>(1,303)</td>
<td>–</td>
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<tr>
<td>Depreciation, depletion and amortization</td>
<td>1,638</td>
<td>1,472</td>
<td>307</td>
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<tr>
<td>Dry well expenses</td>
<td>20</td>
<td>17</td>
<td>7</td>
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<tr>
<td>Loss/(gain) on disposal of property, plant and equipment</td>
<td>95</td>
<td>74</td>
<td>(121)</td>
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<tr>
<td>Deferred income tax</td>
<td>22</td>
<td>(1,845)</td>
<td>(79)</td>
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<tr>
<td>Accretion expense</td>
<td>23</td>
<td>34</td>
<td>35</td>
</tr>
<tr>
<td>Equity share in affiliates’ profits</td>
<td>9</td>
<td>(17)</td>
<td>(51)</td>
</tr>
<tr>
<td>(Decrease)/increase in allowance for doubtful accounts and bank loans granted</td>
<td>(10)</td>
<td>4</td>
<td>11</td>
</tr>
<tr>
<td>Minority interests in subsidiaries’ earnings</td>
<td>92</td>
<td>446</td>
<td>66</td>
</tr>
<tr>
<td>Acquisition of trading securities</td>
<td>(181)</td>
<td>(71)</td>
<td>(27)</td>
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<tr>
<td>Proceeds from sale of trading securities</td>
<td>9</td>
<td>75</td>
<td>44</td>
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<tr>
<td>Changes in operating assets and liabilities net of acquisitions:</td>
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<td></td>
<td></td>
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<tr>
<td>Increase in accounts receivable</td>
<td>(1,181)</td>
<td>(1,353)</td>
<td>(146)</td>
</tr>
<tr>
<td>Increase in inventories</td>
<td>(91)</td>
<td>(297)</td>
<td>(92)</td>
</tr>
<tr>
<td>(Increase)/decrease in restricted cash</td>
<td>(6)</td>
<td>2</td>
<td>(4)</td>
</tr>
<tr>
<td>Increase in prepayments and other current assets</td>
<td>(231)</td>
<td>(626)</td>
<td>(90)</td>
</tr>
<tr>
<td>(Increase)/decrease in other non-current assets</td>
<td>(124)</td>
<td>6</td>
<td>(60)</td>
</tr>
<tr>
<td>Increase in long-term bank loans granted</td>
<td>(41)</td>
<td>(23)</td>
<td>(16)</td>
</tr>
<tr>
<td>Increase in interest payable</td>
<td>36</td>
<td>158</td>
<td>35</td>
</tr>
<tr>
<td>Increase/(decrease) in accounts payable and accrued liabilities</td>
<td>678</td>
<td>(8)</td>
<td>(44)</td>
</tr>
<tr>
<td>(Decrease)/increase in income and other tax liabilities</td>
<td>(338)</td>
<td>414</td>
<td>34</td>
</tr>
<tr>
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<td>2005</td>
<td>2004</td>
</tr>
<tr>
<td>----------------------------------------------------------------------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
</tr>
<tr>
<td>Increase in other current and non-current liabilities</td>
<td>131</td>
<td>5</td>
<td>38</td>
</tr>
<tr>
<td><strong>Net cash provided by operating activities</strong></td>
<td>2,593</td>
<td>2,941</td>
<td>700</td>
</tr>
<tr>
<td><strong>Cash flows from investing activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>(3,462)</td>
<td>(1,944)</td>
<td>(829)</td>
</tr>
<tr>
<td>Acquisition of licences</td>
<td>(916)</td>
<td>(146)</td>
<td>–</td>
</tr>
<tr>
<td>Repayment of Sakhalin-1 carried costs</td>
<td>10</td>
<td>(1,339)</td>
<td>–</td>
</tr>
<tr>
<td>Proceeds from disposals of property, plant and equipment</td>
<td>27</td>
<td>30</td>
<td>206</td>
</tr>
<tr>
<td>Acquisition of short-term investments</td>
<td>(277)</td>
<td>(622)</td>
<td>(61)</td>
</tr>
<tr>
<td>Proceeds from sale of short-term investments</td>
<td>136</td>
<td>632</td>
<td>209</td>
</tr>
<tr>
<td>Acquisition of entities and additional shares in subsidiaries, net of cash acquired</td>
<td>(194)</td>
<td>(366)</td>
<td>(270)</td>
</tr>
<tr>
<td>Acquisition of OJSC Yuganskneftegaz</td>
<td>3</td>
<td>–</td>
<td>(9,398)</td>
</tr>
<tr>
<td>Proceeds from sale of long-term investments</td>
<td>33</td>
<td>147</td>
<td>248</td>
</tr>
<tr>
<td>Acquisition of debt receivable</td>
<td>5</td>
<td>(463)</td>
<td>(20)</td>
</tr>
<tr>
<td>Acquisition of long-term investments</td>
<td>(61)</td>
<td>(33)</td>
<td>(267)</td>
</tr>
<tr>
<td><strong>Net cash used in investing activities</strong></td>
<td>(6,516)</td>
<td>(2,322)</td>
<td>(10,162)</td>
</tr>
<tr>
<td><strong>Cash flows from financing activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds from short-term debt</td>
<td>2,768</td>
<td>977</td>
<td>3,211</td>
</tr>
<tr>
<td>Repayment of short-term debt</td>
<td>(796)</td>
<td>(2,018)</td>
<td>(132)</td>
</tr>
<tr>
<td>Proceeds from long-term debt</td>
<td>2,887</td>
<td>2,547</td>
<td>8,092</td>
</tr>
<tr>
<td>Repayment of long-term debt</td>
<td>(3,250)</td>
<td>(1,829)</td>
<td>(867)</td>
</tr>
<tr>
<td>Proceeds from share issue, net of commission</td>
<td>18</td>
<td>2,115</td>
<td>–</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>(424)</td>
<td>(61)</td>
<td>(51)</td>
</tr>
<tr>
<td>Dividends paid to minority shareholders in subsidiaries</td>
<td>(75)</td>
<td>(74)</td>
<td>(10)</td>
</tr>
<tr>
<td><strong>Net cash, provided by/(used in) financing activities</strong></td>
<td>3,225</td>
<td>(458)</td>
<td>10,243</td>
</tr>
<tr>
<td>(Decrease)/increase in cash and cash equivalents</td>
<td>(698)</td>
<td>161</td>
<td>781</td>
</tr>
<tr>
<td>Cash and cash equivalents at beginning of year</td>
<td>1,173</td>
<td>1,033</td>
<td>228</td>
</tr>
<tr>
<td>Effect of foreign exchange on cash and cash equivalents</td>
<td>30</td>
<td>(21)</td>
<td>24</td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at end of year</strong></td>
<td>505</td>
<td>1,173</td>
<td>1,033</td>
</tr>
</tbody>
</table>
### Supplementary disclosures of cash flow information

<table>
<thead>
<tr>
<th>Notes</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash paid for interest (net of amount capitalized)</td>
<td>610</td>
<td>617</td>
<td>124</td>
</tr>
<tr>
<td>Cash paid for income taxes</td>
<td>2,157</td>
<td>1,636</td>
<td>309</td>
</tr>
</tbody>
</table>

### Supplementary disclosure of non-cash activities

<table>
<thead>
<tr>
<th>Notes</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net assets of subsidiaries contributed by minority shareholders in exchange for shares issued by Rosneft</td>
<td>3</td>
<td>9,218</td>
<td>–</td>
</tr>
<tr>
<td>Income tax offsets</td>
<td>1</td>
<td>41</td>
<td>6</td>
</tr>
<tr>
<td>Non-cash capital expenditures</td>
<td>–</td>
<td>(32)</td>
<td>(50)</td>
</tr>
</tbody>
</table>

The accompanying notes to the consolidated financial statements are an integral part of these statements.
Notes to Consolidated Financial Statements

as of December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004 (all amounts in tables are in millions of US dollars, except as noted otherwise)

1. GENERAL

Nature of Operations

Open Joint Stock Company (“OJSC”) Rosneft Oil Company (“Rosneft”) and its subsidiaries, (collectively the “Company” or the “Group”), are principally engaged in exploration, development, production and sale of crude oil and gas and refining, transportation and sale of petroleum products in the Russian Federation and in certain international markets.

Rosneft State Enterprise was incorporated as an open joint stock company on December 7, 1995. All assets and liabilities previously managed by Rosneft State Enterprise were transferred to the Company at their book value effective on that date together with the Government of the Russian Federation (“State”) ownership in other privatized oil and gas companies. The transfer of assets and liabilities was made in accordance with Resolution No. 971, “On the Transformation of Rosneft State Enterprise into an Open Joint Stock Company ‘Rosneft Oil Company’”, dated September 29, 1995. Such transfers represented a reorganization of assets under the common control of the State and, accordingly, were accounted for at their book value. In 2005, the State contributed the shares of Rosneft to the share capital of OJSC Rosneftegaz (see Note 18). As of December 31, 2005, 100% of the shares of Rosneft less one share were owned by OJSC Rosneftegaz and one share was owned by the Russian Federation Federal Agency for the Management of Federal Property. As of December 31, 2006, OJSC Rosneftegaz maintains a 75.16% interest in Rosneft. The decrease in interest is attributable to sales of shares during Initial Public Offering (“IPO”) in Russia, sales of Global Depository Receipts (“GDR”) for the shares on London Stock Exchange and share swap realized during the merger of Rosneft and certain subsidiaries (see Note 1, Note 3 and Note 18).

Under Russian legislation, natural resources, including oil, gas, precious metals and minerals and other commercial minerals situated within the territory of the Russian Federation are the property of the State until they are extracted. The Law of the Russian Federation No. 2395-1, On Subsurface Resources, regulates relations arising in connection with the geological study, use and protection of subsurface resources within the territory of the Russian Federation. Pursuant to the Law, subsurface resources may be developed only on the basis of a licence. The licence is issued by the regional governmental body and contains information on the site to be developed, the period of activity, financial and other conditions. The Company holds licences issued by regional authorities for geological studies, exploration and development of oil and gas blocks and fields in areas where its subsidiaries are located.

Due to the limited capacity of OJSC Transneft’s pipeline system, the State Pipeline Commission sets export quotas for each oil company based on the legislation on equal access to the oil pipeline system. In addition, the Company exports certain quantities of crude oil bypassing the Transneft system thus enabling it to increase its export capacities. In 2006, 2005 and 2004, the Company’s export sales were approximately 70%, 62% and 57% of produced crude oil, respectively. The remaining production was processed at the Company’s refineries and other Russian refineries for further sales on domestic and international markets. Generally, export crude oil sales result in a higher netback than Russian domestic sales after considering related transportation and export duties and other charges.

On October 1, 2006, the Company undertook a legal reorganization whereby a number of subsidiaries were merged with OJSC Rosneft Oil Company via an exchange of shares, as approved by the respective shareholders (“Share Swap”) of: OJSC Yuganskneftegaz, OJSC Rosneft-Purneftegaz, OJSC Selkupneftegaz, OJSC Severnaya Neft (Northern Oil), OJSC Rosneft-Krasnodarneftegaz, OJSC Rosneft-Stavropolneftegaz, OJSC Rosneft-Sakhalmorneftegaz, OJSC Rosneft-Komsomolsky Refinery, OJSC Rosneft-Tuapse Refinery, OJSC Rosneft-Arkhangelsknefteproduct, OJSC Rosneft-Nakhodkanefteproduct, and OJSC Rosneft-Tuapsenefteproduct (each, a “Merging Subsidiary” and collectively, the “Merging Subsidiaries”). The primary purpose of the merger was to create a more efficient corporate and management structure with a single profit center. The Merging Subsidiaries were delisted from Unified State Register of Legal Entities from October 1, 2006. As a result of the Share Swap, OJSC Rosneft Oil Company issued its ordinary shares to the minority shareholders of
the Merging Subsidiaries in exchange for ordinary and preferred shares owned by them. The shares of each Merging Subsidiary were exchanged at an agreed conversion ratio (see Note 3).

In December 2006, the Federal Tax Agency of the Russian Federation registered the increase in the Company’s Share Capital resulting from the Share Swap.

Principal subsidiary companies included in the consolidated financial statements and respective ownership interests of the Company as of December 31, 2006 are as follows:

<table>
<thead>
<tr>
<th>Name</th>
<th>Nature of Business</th>
<th>Preferred and Common Shares</th>
<th>Voting Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exploration and production</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RN-Yuganskneftegaz LLC</td>
<td>Oil and gas production operator services</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td>RN-Purneftegaz LLC</td>
<td>Oil and gas production operator services</td>
<td>100.00</td>
<td>100.00</td>
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<tr>
<td>RN-Sakhalinmorneftegaz LLC</td>
<td>Oil and gas production operator services</td>
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<td>100.00</td>
</tr>
<tr>
<td>RN-Krasnodarneftegaz LLC</td>
<td>Oil and gas production operator services</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td>RN-Stavropolneftegaz LLC</td>
<td>Oil and gas production operator services</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td>Rosneft Severnaya Neft LLC (Northern Oil)</td>
<td>Oil and gas production operator services</td>
<td>100.00</td>
<td>100.00</td>
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<tr>
<td>CJSC RN-Astra</td>
<td>Oil and gas development and production</td>
<td>100.00</td>
<td>100.00</td>
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<tr>
<td>CJSC Sakhalinmorneftegaz Shelf</td>
<td>Oil and gas development and production</td>
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<td>100.00</td>
</tr>
<tr>
<td>CJSC Komsomolskneft</td>
<td>Oil and gas development and production</td>
<td>100.00</td>
<td>100.00</td>
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<tr>
<td>OJSC Dagneftegaz</td>
<td>Oil and gas development and production</td>
<td>81.22</td>
<td>94.96</td>
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<td>OJSC Rosneft-Dagneft</td>
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<td>OJSC Groznneftegaz</td>
<td>Oil and gas production operator services</td>
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<td>51.00</td>
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<td>Caspoil LLC</td>
<td>Oil and gas development and production</td>
<td>75.10</td>
<td>75.10</td>
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<td>CJSC Vostokshelf</td>
<td>Field survey and exploration</td>
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<td>100.00</td>
</tr>
<tr>
<td>RN-Kazakhstan LLC</td>
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<td>100.00</td>
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<td>RN-Kaiganneftegaz LLC</td>
<td>Field survey and exploration</td>
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<tr>
<td>CJSC Vostok-Smidt Neftegaz</td>
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<tr>
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<td>Field survey and exploration</td>
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<tr>
<td>Veninneft LLC</td>
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<td>100.00</td>
</tr>
<tr>
<td>Name</td>
<td>Nature of Business</td>
<td>Preferred and Common Shares</td>
<td>Voting Shares</td>
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<td>-------------------------------------</td>
<td>-----------------------------</td>
<td>--------------</td>
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<td>CJSC Vankorneft</td>
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<td>Taymyrneft LLC</td>
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<td>Holding company</td>
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<tr>
<td>Zapad Smidt Invest LLC</td>
<td>Investment activities</td>
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</tr>
<tr>
<td>Vostok-Energy LLC</td>
<td>Investment activities</td>
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<td>51.00</td>
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**Refining, marketing and distribution**

<table>
<thead>
<tr>
<th>Name</th>
<th>Nature of Business</th>
<th>Preferred and Common Shares</th>
<th>Voting Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>RN-Tuapse Refinery LLC</td>
<td>Petroleum refining</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td>RN-Komsomolsky Refinery LLC</td>
<td>Petroleum refining</td>
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<tr>
<td>OJSC Rosneft-MZ Nefteproduct</td>
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<td>Marketing and distribution</td>
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<td>Marketing and distribution</td>
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<td>RN-Arkhangelsknefteproduct LLC</td>
<td>Marketing and distribution</td>
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<tr>
<td>OJSC Rosneft-Kabardino-Balkarskaya Toplivnaya Company</td>
<td>Marketing and distribution</td>
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<td>92.91</td>
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<tr>
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<td>Marketing and distribution</td>
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<tr>
<td>OJSC Rosneft-Murmansknefteproduct</td>
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<td>60.51</td>
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<td>RN-Nakhodikanefteproduct LLC</td>
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<tr>
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<tr>
<td>RN-Tuapsenefteproduct LLC</td>
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<tr>
<td>OJSC Rosneft-Yamalnefteproduct</td>
<td>Marketing and distribution</td>
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<td>66.03</td>
</tr>
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<td>RN-Vostoknefteproduct LLC</td>
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<td>Transhipment</td>
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<td>CJSC Exponeft</td>
<td>Marketing and distribution</td>
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<td>60.51</td>
</tr>
</tbody>
</table>
All of the above subsidiaries, except for Rosneft International Ltd. and Anglo-Siberian Oil Company Limited, are incorporated in the Russian Federation. Rosneft International Ltd. is registered in Ireland, and Anglo-Siberian Oil Company Limited is registered in Cyprus.

Currency Exchange and Control

Foreign currencies, in particular the US dollar and the Euro, play a significant role in the underlying economics of many business transactions in Russia. For the oil and gas sector in particular, substantial export arrangements as well as investing and financing activities are conducted in foreign currencies, primarily the US dollar.

2. SIGNIFICANT ACCOUNTING POLICIES

Form and Content of the Consolidated Financial Statements

The Company maintains its books and records in accordance with accounting and taxation principles and practices mandated by the Russian legislation. The accompanying consolidated financial statements were derived from the Company’s Russian statutory books and records with adjustments made to present them in accordance with accounting principles generally accepted in the United States of America (“US GAAP”).

The accompanying consolidated financial statements differ from the financial statements issued for statutory purposes in Russia in that they reflect certain adjustments, not recorded in the Company’s statutory books, which are appropriate to present the financial position, results of operations and cash flows in accordance with US GAAP. The principal adjustments relate to:

1. recognition of certain expenses;
2. valuation and depreciation of property, plant and equipment;
3. foreign currency translation;
4. deferred income taxes;
5. valuation allowances for unrecoverable assets;
6. accounting for the time value of money;
7. accounting for investments in oil and gas property and conveysances;
8. consolidation principles;
9. recognition and disclosure of guarantees, contingencies, commitments and certain assets and liabilities;
10. accounting for asset retirement obligations; and
11. business combinations and goodwill/negative goodwill.

Certain items in consolidated statements of income and cash flows for 2005 and 2004 were reclassified to conform to the current year presentation.

As discussed in the Note 3 below, the Company acquired OJSC Yuganskneftegaz on December 31, 2004, thus the results of operations of OJSC Yuganskneftegaz are included in consolidated statements of income starting January 1, 2005. As a result, the results of operations of the Company for 2004 are not comparable with the results for 2006 and 2005 without considering this matter. The share of sales of oil, extracted from OJSC Yuganskneftegaz’s oil fields, and petroleum products...
produced from this oil for 2006 and 2005 in the total revenue of the Company is approximately 70% and 69%, respectively.

Management Estimates

The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheet as well as the amounts of revenues and expenses recognized during the reporting periods. Certain significant estimates and assumptions for the Company include: estimation of economically recoverable oil and gas reserves; rights to and recoverability and useful lives of long-term assets and investments; impairment of goodwill; allowances for doubtful accounts receivable; asset retirement obligations; legal and tax contingencies; environmental remediation obligations; recognition and disclosure of guarantees and other commitments; fair value measurements; ability to renew operating leases and to enter into new lease agreements; classification of certain debt amounts. Some of the most significant estimates were made in connection with the acquisition of OJSC Yuganskneftegaz. Management believes it has a reasonable and appropriate basis for its judgment pertaining to its estimates and assumptions. However, actual results could differ from those estimates.

Foreign Currency Translation

The management of the Company has determined the US Dollar as the functional and reporting currency for the purpose of financial reporting under US GAAP. Monetary assets and liabilities have been translated into US dollars using the official exchange rate as of the balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows are translated into US dollars at average exchange rates for the period or exchange rates prevailing on transaction dates where practicable.

Gains and losses resulting from the re-measurement into US dollars are included in the "Foreign exchange (loss)/gain" in the consolidated statements of income. As of December 31, 2006 and 2005, the Central Bank of the Russian Federation ("CBR") official rates of exchange were 26.33 rubles and 28.78 rubles per US dollar, respectively. As of May 3, 2007, the official rate of exchange was 25.76 rubles ("RUB") per US dollar.

The translation of local currency denominated assets and liabilities into US dollars for the purposes of these financial statements does not indicate that the Company could realize or settle, in US dollars, the reported values of these assets and liabilities. Likewise, it does not indicate that the Company could return or distribute the reported US dollar value of capital to its shareholders.

Principles of Consolidation

The consolidated financial statements include the accounts of majority-owned, controlled subsidiaries and variable interest entities where the Company is a primary beneficiary. All intercompany transactions and balances have been eliminated. The equity method is used to account for investments in affiliates in which the Company has the ability to exert significant influence over the affiliates' operating and financial policies. The investments in entities where the Company holds the majority of shares, but the minority shareholders have significant influence, are also accounted for using the equity method. The Company's share in net profit or loss of equity investees also includes any other-than-temporary declines in fair value recognized during the period. Investments in other companies are accounted for at cost and adjusted for estimated impairment.

Minority Interest

Minority interests in the net assets and net results of consolidated subsidiaries are shown under "Minority interest" in the accompanying consolidated balance sheets and statements of income. For majority-owned subsidiaries that incur losses, the Company recognizes 100% of the losses, after first reducing the related minority interests' balances to zero, unless minority shareholders committed to fund the losses. Further, when a majority-owned subsidiary becomes profitable, the Company recognizes 100% of profits until such time as the excess losses previously recorded have been recovered. Thereafter, the Company recognizes profits in accordance with the underlying ownership percentage. The actual ruble-denominated balances attributable to minority interests may differ from these amounts presented in these consolidated financial statements.

Cash and Cash Equivalents

Cash represents cash on hand and in the Company's bank accounts and interest bearing deposits which can
be effectively withdrawn at any time without prior notice or penalties reducing the principal amount of the deposit. Cash equivalents are highly liquid, short-term investments that are readily convertible to known amounts of cash and have original maturities of three months or less from their date of purchase. They are carried at cost plus accrued interest, which approximates fair value.

Accounts Receivable

Trade accounts receivable are stated at their principal amounts outstanding net of allowances for doubtful debts. Specific allowances are recorded against trade receivables whose recovery or collection has been identified as doubtful. Estimates of allowances require the exercise of judgment and the use of assumptions.

Earnings per Share

Basic earnings per share is calculated by dividing net earnings attributable to common shares by the weighted average number of common shares outstanding during the corresponding period. In the absence of any securities-to-shares conversion transactions, the amount of basic earnings per share stated in these financial statements is equal to the amount of diluted earnings per share.

Inventories

Inventories, consisting primarily of crude oil, petroleum products and materials and supplies, are stated at the lower of weighted average cost of acquisition or market value. Market value shall not exceed net realizable value (i.e. the price at which inventories can be sold after allowing for the cost of completion and sale), and shall not be lower than net realizable values less the amount of margin.

Financial Investments

All debt and equity securities held by the Company are classified into one of the following three categories: trading securities; available-for-sale securities; held-to-maturity securities.

Trading securities are purchased and held principally for the purpose of sale in the nearest future. Held-to-maturity securities represent financial instruments that the Company has both the intent and the ability to hold to maturity.

All other securities, which do not fall into these two categories, are classified as available-for-sale securities.

Trading securities and available-for-sale securities are carried at fair (market) value. Held-to-maturity securities are stated at amortized cost. Unrealized gains or losses on trading securities are included in the consolidated statements of income. Unrealized gains and losses on available-for-sale securities less related tax effects are recorded as a separate component of comprehensive income until the date of disposal.

Realized gains and losses from the sale of available-for-sale securities are reported separately for each type of security. Dividends and interest income are recognized in the consolidated statements of income on an accrual basis.

 Investments in shares or interests of companies where the Company has less than 20% equity interest and no significant influence, which are not publicly traded, and whose market value is not readily available, are carried at cost.

If the decline in fair value of an investment below its carrying value is other than temporary, the carrying value of the investment is reduced and a loss in the amount of any such decline is recorded. Cost method investments are evaluated for impairment when events or changes in circumstances occur which may have a significant effect on the fair value of these investments.

Sale and Repurchase Agreements and Securities Lending

Sale and repurchase agreements are treated as secured financing transactions. Securities sold under sale and repurchase agreements are included in trading securities. The corresponding liability is presented within short-term debt. The difference between the sale and repurchase price is treated as interest and is accrued over the life of repurchased agreements using the effective interest method.

Oil and Gas Properties

In accordance with Statement of Financial Accounting Standard ("SFAS") 19, Financial Accounting and Reporting by Oil and Gas Producing Companies, oil and gas properties and the related expenses are recognized under the successful efforts method. This method prescribes that exploration costs, including geological and geophysical costs and the costs of dry holes, are charged to expense when incurred.
Exploratory well costs (including costs associated with stratigraphic test wells) are temporarily capitalized pending determination of whether commercial oil and gas reserves have been discovered by the drilling effort. The length of time necessary for this determination depends on the specific technical or economic difficulties in assessing the recoverability of the reserves. If a determination is made that the well did not encounter oil and gas in economically viable quantities, the well costs are expensed and are reported in "exploration expenses".

Exploratory drilling costs are temporarily capitalized pending determination of whether the well has found proved reserves if both of the following conditions are met:

- The well has found a sufficient quantity of reserves to justify, if appropriate, its completion as a producing well, assuming that the required capital expenditure is made; and

- Satisfactory progress toward ultimate development of the reserves is being achieved, with the Company making sufficient progress assessing the reserves and the economic and operating viability of the project.

The Company evaluates the progress made on the basis of regular project reviews which take into account the following factors:

- First, if additional exploratory drilling or other exploratory activities (such as seismic work or other significant studies) are either underway or firmly planned, the Company deems there to be satisfactory progress. For these purposes, exploratory activities are considered firmly planned only if they are included in the Company’s three-year exploration plan/budget. At December 31, 2006, exploratory drilling costs capitalized on this basis were not material.

- In cases where exploratory activity has been completed, the evaluation of satisfactory progress takes into account indicators such as the fact that costs for development studies are incurred in the current period, or that governmental or other third-party authorizations are pending or that the availability of capacity on an existing transport or processing facility awaits confirmation. At December 31, 2006, exploratory drilling costs capitalized on this basis were not material.

Should the project be deemed commercially viable, it is then transferred to the development stage, otherwise the costs are expensed.

Costs, including "internal" costs relating to drilling and equipping of development wells, including development dry holes, as well as costs required for drilling and equipping of injection wells in the process of oil and gas reserves development, are capitalized. These costs are included in oil and gas properties in the consolidated balance sheet.

Property, Plant and Equipment

Property, plant and equipment are stated at historical cost, net of accumulated depreciation. The cost of maintenance, repairs, and replacement of minor items of property is charged to operating expenses. Renewals and betterments of assets are capitalized.

Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are included in the statement of income.

Depreciation, Depletion and Amortization

Depreciation expense of acquisition costs of proved oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalized costs related to oil and gas production is calculated using the unit-of-production method based on proved developed reserves. Management of the Company considers each extraction division as the appropriate level for these calculations.

Acquisition costs of unproved properties are not amortized. These costs are reclassified as proved properties when the relevant reserve reclassification is made. Acquisition costs of unproved properties are reviewed for impairment. In case of impairment these costs are expensed when incurred.

Depreciation and amortization charges with respect to property, plant and equipment other than oil and gas properties is computed using the straight-line method and based on their useful lives.

Depreciation rates are applied to similar types of buildings, machinery and equipment having similar economic characteristics, as shown below:
Interests in Joint Operations

A joint operation is a contractual arrangement whereby two or more parties (participants) undertake an economic activity that is subject to joint control. Joint control is only exercised when strategic, financial and operating decisions relating to the joint activity are made unanimously by all the parties. A joint venture is a registered company, partnership or any other legal form for the purposes of handling joint operations.

Financial results, assets and liabilities arising from interests in incorporated joint ventures are recognized in these consolidated financial statements using the equity method of accounting. Under the equity method, investments in joint ventures are recognized at the cost of financial investments increased by any change to the share of net assets from the date of inception of a joint venture, less distributed earnings and impairment of financial investments. The consolidated statements of income include the Company’s share in gains and losses arising from joint ventures.

The Company discontinues the use of the equity method of accounting from the date on which it ceases to have joint control over, or have significant influence in, a jointly-controlled entity, or when its interest in a jointly-controlled entity is reclassified to assets held for sale.

Undivided interests in unincorporated oil and gas joint ventures are consolidated on a proportionate basis.

A part of an interest in a jointly-controlled oil and gas exploration and production entity may be assigned to other participants or third parties. In which case, in accordance with SFAS 19, such assignment is performed and accounted for under an arrangement called a "carried interest" whereby the assignee agrees to carry all costs of drilling, developing, and operating the property. The assignee is also entitled to all of the revenue from hydrocarbon production from the property, excluding any third party interest, until all of the assignee’s costs, including the contractual rate of return, have been recovered, at such time the assignor will resume its participation in operating expenses and income.

Impairment of Long-Lived Assets

Long-lived assets, including blocks with proved oil and gas reserves, are assessed for potential impairment in accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

Oil and gas properties are assessed whenever events or circumstances indicate potential impairment. If the carrying value of oil and gas properties is not recoverable through undiscounted cash flows, an impairment is recognized. The impairment is determined on the basis of the estimated fair value of oil and gas properties which, in turn, is measured by discounting future net cash flows or with reference to current market prices of oil and gas properties, if available. Discounted future cash flows from oil and gas fields are based on the most reliable management estimates of future prices that rely on recent actual prices and published prices for forward transactions; such prices are applied to forecast production volumes at particular fields with further discounting for the expected risk level.

Forecast production volumes shall be understood as reserves, including probable reserves that are proposed to be extracted using a known amount of capital expenditures. Production volumes and prices correspond to the internal plans and forecasts, as well as other data in the published financial statements. Assumptions regarding future prices and costs used to assess oil and gas properties for impairment differ from those used in the standard procedure for discounting net cash flows from proved oil and gas reserves.

Grouping of assets for the purpose of depreciation is performed on the basis of the lowest level of identifiable cash flows that are largely independent of the cash flows from other groups of assets – as a rule, for oil and gas properties such level is represented by the field, for refining assets – by the whole refining unit, for service stations – by the facilities. Long-lived assets intended by management for use during a period not exceeding one year are recorded at the lower of depreciated value or fair value, less selling expenses.
Acquisition costs of unproved oil and gas properties are assessed for impairment on a regular basis and any estimated impairment is charged to expenses.

Recoverability of oil and gas properties attributable to the refining, marketing and distribution segment is generally assessed on the basis of expected future cash flows from key operating units, usually entire legal entities. Since assets of this segment (particularly refining units) represent an integrated set of operations, this condition is taken into account in measuring the value of particular units or the extent of their utilization to generate other cash flows.

Business Combinations

The Company accounts for its business acquisitions under the purchase method of accounting. The total cost of acquisitions is allocated to the underlying assets, including intangible assets, and liabilities based on their respective estimated fair values. Determining the fair value of assets acquired and liabilities assumed requires management’s judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, licence and other asset lives and market multiples, among other items.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the acquisition cost over the fair value of net assets acquired. The excess of the fair value of the acquired share of net assets over their acquisition cost represents negative goodwill and is allocated among the non-current assets acquired, excluding investments and deferred tax assets, which may result in their value being reduced to zero.

For investees accounted for under the equity method, the excess of the cost to acquire a share in those entities over the fair value of the acquired share of net assets as of the acquisition date is treated as embedded goodwill and is considered in computing the Company’s equity share in income/loss of equity investees.

In accordance with requirements of SFAS 142, Goodwill and Other Intangible Assets, goodwill and intangible assets with indefinite useful lives are not amortized. Instead, they are tested at least annually for impairment.

Intangible assets that have a finite useful life are amortized using the straight-line method over the shorter of their useful life or the term established by legislation.

Capitalized Interest

Interest expense related to the use of borrowed funds used for capital construction projects and acquisition of properties, plant and equipment is capitalized provided such interest expense could have been avoided if the Company had not made capital investments. Interest is capitalized only during the period when construction activities are actually in progress and until the resulting properties are put into operation. The Company capitalized US$ 109 million, US$ 79 million and US$ 22 million of interest expenses on loans and borrowings in 2006, 2005 and 2004, respectively.

Leasing Agreements

Capital leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the interest charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liabilities. Interest charges are charged directly to the consolidated statements of income.

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term unless leased assets are capitalized because the terms of the lease agreement grant the Company ownership rights over the leased assets by the end of the lease term or containing a bargain purchase option. In the latter cases capitalized assets are depreciated over the estimated useful life of the asset regardless of the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statements of income on a straight-line basis over the lease term.

Asset Retirement Obligations

The Company has asset retirement obligations as associated with its core business activities. The nature of the assets and potential obligations are as follows:

Exploration and Production – The Company’s exploration, development and production activities involve the use of the following assets: wells, re-
lated equipment and operating sites, oil gathering and treatment facilities, tank farms and in-field pipelines. Generally, licences and other regulatory acts require that such assets be decommissioned upon the completion of production. According to these requirements, the Company is obliged to decommission wells, dismantle equipment, restore the sites and perform other related activities. The Company’s estimates of these obligations are based on current regulatory or licence requirements, as well as actual dismantling and other related costs. Asset retirement obligations are calculated in accordance with the provisions of SFAS 143, Accounting for Asset Retirement Obligations.

Refining, Marketing and Distribution – This business segment covers refining operations, marine and other distribution terminals, and retail sales. The Company’s refining operations consist of major petrochemical operations and industrial complexes. These industrial complexes have been in operation for several decades. The Company’s management believes that given the nature of the operations, the useful lives of these industrial complexes are indeterminable, while certain of their operating components and equipment have definite useful lives. Legal or contractual asset retirement obligations related to petrochemical, oil refining, marketing and distribution activities are not recognized due to the limited history of such activities in these segments, the lack of clear legal requirements as to the recognition of obligations, as well as the fact that useful lives of such assets are not determinable.

The Company’s marine and other distribution terminals, including its retail network, operate under the regulatory requirements of local authorities and lease arrangements. These requirements generally provide for elimination of the consequences of the use of those assets, including dismantling of equipment, restoration of land, etc. The Company’s estimate of asset retirement obligations takes into account the above requirements.

SFAS 143 calls for measurements of asset retirement obligations to include, as a component of expected costs, an estimate of the price that a third party would demand, and could expect to receive, for bearing the uncertainties and unforeseeable circumstances inherent in the obligations, sometimes referred to as a market-risk premium.

To date, the oil and gas industry has few examples of credit-worthy third parties which are willing to assume this type of risk, for a determinable price, on major oil and gas production facilities and pipelines. Therefore, because determining such a market-risk premium would be an arbitrary process, it has been excluded from the SFAS 143 estimates.

Due to continuous changes in the Russian regulatory and legal environment, there could be future changes to the requirements and contingencies associated with the retirement of long-lived assets.

Fair Value of Financial Instruments

SFAS 107, Disclosures about Fair Value of Financial Instruments, defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Financial assets and financial liabilities recognized in the accompanying consolidated balance sheets include cash and cash equivalents, short-term and long-term investments, accounts receivable and payable, short-term and long-term debt and other current and non-current assets and liabilities.

The Company, using available market information, management’s estimates and appropriate valuation methodologies, has determined the approximate fair values of financial instruments.

Income Taxes

Russian legislation does not contain the concept of a ‘consolidated tax payer’ and, accordingly, the Company is not subject to Russian taxation on a consolidated basis but rather on an individual company basis. Income taxes are provided on taxable profit as determined under the Russian Federation Tax Code. Deferred income tax assets and liabilities are recognized in the accompanying consolidated financial statements in the amount determined by the Company using the liability method in accordance with SFAS 109, Accounting for Income Taxes. This method takes into account future tax consequences, based on the effective tax rate, associated with differences between the carrying values of assets and liabilities and their taxable base, which gives immediate income statement effect to changes in income tax laws, including changes in the tax rates. A valuation allowance for a deferred tax asset is recorded when management believes
that it is more likely than not that this tax asset will not be realized.

Recognition of Revenues

Revenues are recognized when title passes from the seller to the customer, the contract price is fixed or determinable and collectability of the receivable is reasonably assured. Specifically, domestic sales of crude oil and gas, as well as petroleum products and materials are recognized when title passes. For export sales, title generally passes at the border of the Russian Federation and the Company covers transportation expenses (except freight), duties and taxes on those sales. Revenues include excise taxes and custom duties (see Note 21).

Sales of support services are recognized as services are performed provided that the service price can be determined and no significant uncertainties regarding the receipt of revenues exist.

Transportation Expenses

Transportation expenses recognized in the consolidated statements of income represent all expenses incurred in the transportation of crude oil and petroleum products via the Transneft pipeline network, as well as by railway and other transport means. Transportation expenses also include all other shipping and handling costs.

Refinery Maintenance Costs

The Company recognizes the costs of overhauls and preventive maintenance performed with respect to oil refining assets as expenses when incurred.

Environmental Liabilities

Environmental expenditures are expensed or capitalized, depending upon their future economic benefit. Expenditures that relate to an existing condition caused by past operations, and do not have a future economic benefit, are expensed. Liabilities for these expenditures are recorded on an undiscounted basis when environmental assessments or clean-ups are probable and the costs can be reasonably estimated.

Guarantees

The fair value of a guarantee is determined and recorded as a liability at the time when the guarantee is issued. The initial guarantee amount is subsequently remeasured to reflect the changes in the underlying liability. The expense is included in the related line items of the consolidated statements of income, based on the nature of the guarantee. When the likelihood of performing on a guarantee becomes probable, a liability is accrued, provided it is reasonably determinable on the basis of the facts and circumstances at that time.

Comprehensive Income

The Company applies SFAS 130, Reporting Comprehensive Income, which establishes standards for the calculation and reporting of the Company’s comprehensive income (net income plus all other changes in net assets from non-owner sources) and its components in consolidated financial statements.

As of December 31, 2006, 2005 and 2004, there are no material comprehensive income items and, therefore, comprehensive income for 2006, 2005 and 2004 equals net income.

Accounting for Contingencies

Certain conditions may exist as of the date of these consolidated financial statements which may further result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company’s management makes an assessment of such contingent liabilities which is based on assumptions and is a matter of opinion. In assessing loss contingencies relating to legal or tax proceedings that involve the Company or unasserted claims that may result in such proceedings, the Company, after consultation with legal or tax advisors, evaluates the perceived merits of any legal or tax proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a loss will be incurred and the amount of the liability can be estimated, then the estimated liability is accrued in the Company’s consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.
Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed. However, in some instances in which disclosure is not otherwise required, the Company may disclose contingent liabilities or other uncertainties of an unusual nature which, in the judgment of management after consultation with its legal or tax counsel, may be of interest to shareholders or others.

Taxes Collected from Customers and Remitted to Governmental Authorities

Excise taxes are reported gross within sales and other operating revenues and taxes other than income taxes, while other sales and value-added taxes are recorded net in taxes other than income taxes.

Recent Accounting Standards

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation ("FIN") 48, Accounting for Uncertainty in Income Taxes, an interpretation of SFAS 109. FIN 48, which is the most significant change to accounting for income taxes since the adoption of the liability approach, creates a single model to address uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The interpretation also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 clearly scopes out income taxes from SFAS 5, Accounting for Contingencies.

FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the consolidated balance sheets prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The cumulative effect adjustment would not apply to those items that would not have been recognized in earnings, such as the effect of adopting FIN 48 on tax positions related to business combinations. The Company evaluated the impact of FIN 48 on the Company’s financial statements and concluded that it would not be significant.

In September 2006, the FASB issued SFAS 157, Fair Value Measurements. The standard defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, this standard does not require any new fair value measurements. The guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company will apply this standard for financial statements issued for fiscal year beginning from January 1, 2008. The Company has not identified the impact this standard will have on the Company’s financial position and results of operations.

In September 2006, the FASB issued SFAS 158, Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans. The standard will require employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. The standard will make it easier for investors, employees, retirees and others to understand and assess an employer’s financial position and its ability to fulfill the obligations under its benefit plans. SFAS 158 applies to plan sponsors that are public and private companies and nongovernmental not-for-profit organizations. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006, for entities with publicly traded equity securities. The requirement to measure plan assets and benefit obligations as of the date of the employer’s fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Since the Company has no defined benefit pension plans, this standard will have no impact to the Company’s financial position and results of operations.

In June 2006, the FASB Emerging Issues Task Force ("EITF") ratified EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation). Issue No. 06-3 requires disclosure of either the gross or net method of presentation for taxes assessed by a governmental authority resulting from specific revenue-producing transactions between a customer and a seller. For any such taxes reported on a gross basis, the entity must also disclose the amount of the tax reported in revenue in the interim and annual financial statements. The Company adopted the Issue effective December 31, 2006. See Note 2, Summary of Significant Accounting Policies (Taxes Collected from Customers and Remitted to Governmental Authorities) for additional information.
The Company expects that EITF 06-3 will not have a material impact to the Company’s financial statements.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. The standard permits all entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. This Statement is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. The Company will apply this standard for financial statements issued for fiscal year beginning from January 1, 2008. The Company has not identified the impact this standard will have on the Company’s financial position and results of operations.

3. SIGNIFICANT ACQUISITIONS

Share Swap

In June 2006, the shareholders of Rosneft and of the Merging Subsidiaries (see Note 1) approved the conversion of their shares into the Company’s shares at an agreed conversion ratio. Subsequent to this, the Merging Subsidiaries were merged with the Company. 1,220,939,458 shares of Rosneft were issued to acquire the shares of minority shareholders of these subsidiaries (11.52% of the Rosneft’s share capital).

This acquisition of minority interest was accounted for as a purchase, in accordance with SFAS 141, Business Combinations. The fair value of purchase consideration, that is Rosneft shares, issued for the Share Swap, was determined based on the market value of the shares as of the date nearest to the date of all the terms of the deal were agreed to and amounted to US$ 9,218 million. The excess of the fair value of the shares issued over the fair value of minority interests acquired in the amount of US$ 69 million has been reflected as goodwill and relates to refining and marketing segment. The Company attributes this goodwill to the synergy effects from the merger. The majority of the purchase price was allocated to oil and gas properties, property, plant and equipment and mineral rights. Where the fair value of the net assets acquired exceeded the purchase price, negative goodwill existed which has reduced, on a pro rata basis, amounts assigned to the long-term assets acquired.

OJSC Yuganskneftegaz

In late December 2004, the Company acquired a 76.79% interest in OJSC Yuganskneftegaz, which represented 100% of the common shares of OJSC Yuganskneftegaz. The purpose of the transaction was to acquire the oil and gas properties held by OJSC Yuganskneftegaz and the purchase price was RUR 260,782 million (US$ 9,398 million at the CBR exchange rate in effect on the settlement date).

As discussed in Note 25 the Company’s acquisition of OJSC Yuganskneftegaz is currently subject to court challenges in the Russian Federation and in the USA.

The Company consolidated the balance sheet of OJSC Yuganskneftegaz as of December 31, 2004 and the results of operations of OJSC Yuganskneftegaz from January 1, 2005. No results of operations are consolidated during the year ended December 31, 2004 given that the acquisition occurred on December 31, 2004.

Because the fair value of the net assets acquired exceeded the purchase price, negative goodwill existed which has reduced, on a pro rata basis, amounts assigned to the long-term assets acquired.

The following table summarizes the Company’s allocation of the assets acquired and liabilities assumed:

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets:</td>
<td></td>
</tr>
<tr>
<td>Restricted cash</td>
<td>14</td>
</tr>
<tr>
<td>Short–term investments</td>
<td>22</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>606</td>
</tr>
<tr>
<td>Inventories</td>
<td>94</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>1</td>
</tr>
<tr>
<td>Total current assets</td>
<td>737</td>
</tr>
<tr>
<td>Oil and gas properties, net</td>
<td>7,276</td>
</tr>
<tr>
<td>Mineral rights</td>
<td>9,786</td>
</tr>
<tr>
<td>Property, plant and equipment, net</td>
<td>370</td>
</tr>
<tr>
<td>Construction–in–progress</td>
<td>41</td>
</tr>
<tr>
<td>Deferred tax assets</td>
<td>3</td>
</tr>
<tr>
<td>Leased equipment</td>
<td>175</td>
</tr>
<tr>
<td>Other non–current assets</td>
<td>4</td>
</tr>
</tbody>
</table>
Pro forma financial information assuming that the acquisition of OJSC Yuganskneftegaz had occurred as of the beginning of 2004 has not been presented herein as is required by SFAS 141. This information is not presented as the Company does not have access to reliable US GAAP financial information for OJSC Yuganskneftegaz for periods prior to acquisition.

For the purposes of valuation of oil and gas properties, property, plant and equipment, and construction-in-progress which relate to minority interest in OJSC Yuganskneftegaz, the Company used their appraised fair values as the previous controlling shareholder did not provide the records of the historical cost of these non-current assets. Minority interest which relates to other assets and liabilities was determined on the basis of historical cost.

**CJSC Exponeft**

In December 2006, the Company, through one of its subsidiaries, acquired a 100% equity interest in CJSC Exponeft, which owns a network of gasoline stations in the Murmansk region. The purchase price amounted to US$ 12.5 million and was paid in cash. The excess of the purchase price over the fair value of the net assets acquired was US$ 14 million and is accounted for as goodwill. The Company explains the existence of the goodwill by the potential increase in the market volume in the Murmansk region.

**OJSC Nakhodka Oil Seatrade Port**

In June 2006, the Company acquired 97.51% equity interest in OJSC Nakhodka Oil Seatrade Port. The purchase price amounted to US$ 19.5 million and was paid in cash. The purchase price was allocated to the fair value of assets acquired and liabilities assumed, the resulting goodwill amounted to US$ 9.5 million, which the Company attributes to synergy effect from the future integration with the operations of the Company’s subsidiary LLC Rosneft-Nakhodkanefteprodukt.

The results of operations of the two aforementioned acquisitions are not significant and therefore do not warrant pro-forma presentation.

**OJSC Daltransgaz**

In February 2006, the Company purchased 25% of the additional issue of shares by OJSC Daltransgaz, an equity investee, for RUB 722 million (US$ 26 million at the CBR exchange rate as of date of settlement).

In August 2006, the Company again purchased 25% of the additional issue of shares by OJSC Daltransgaz for RUB 525 million (US$ 19 million at the CBR exchange rate as of the date of settlement). Through these purchases the Company maintained and continues to maintain its interest in OJSC Daltransgaz of 25% plus one share.

**Taihu Ltd/OJSC Udmurtneft**

In November 2006, the Company acquired a 51% equity share in Taihu Ltd, a joint venture created with the intention of managing the activity of OJSC Udmurtneft. The Company paid 5,100 Cyprus Pounds (approximately US$ 11 thousand) for this investment and is included within equity method investments - Other. The other party to the joint venture is China Petrochemical Corporation ("Sinopec") with a respective share of 49%. The Shareholder Agreement in respect of this joint venture stipulates that key decisions regarding its business shall be subject to unanimous approval by both participants and none of the participants has
a preferential voting right. The Company accounts for this investment using the equity method of accounting (see Note 9).

In December 2006, Taihu Ltd, through its wholly owned subsidiary, acquired a 96.86% equity interest in OJSC Udmurtneft for US$ 3,541 million. The credit facility for financing the purchase of 96.86% shares of OJSC Udmurtneft was provided to Taihu Ltd by Bank of China and principally secured by OJSC Udmurtneft’s shares, without recourse to the Company.

OJSC Udmurtneft is located in the Volga-Ural region of the Russian Federation and holds the licences for the development of 24 productive oil and gas condensate deposits. OJSC Udmurtneft is a group of 21 companies.

OJSC Verkhnechonskneftegaz

In the fourth quarter of 2005, the Company acquired 7,781,449 common shares (25.94% of the total number of common shares) of OJSC Verkhnechonskneftegaz. OJSC Verkhnechonskneftegaz holds the licence for the development of the Verkhnechonskoye oil and gas condensate deposit, which is the largest oil deposit in the Irkutsk region.

The purchase price amounted to US$ 230 million (RUB 6,637 million at the CBR exchange rate as at the date of the transaction) and was paid in cash. The acquisition price was fully allocated to the fair values of the acquired assets and liabilities. In these consolidated financial statements, the Company’s interest in OJSC Verkhnechonskneftegaz shares is accounted for using the equity method (see Note 9).

Other Acquisitions of Additional Interests

OJSC Vserossiysky Bank Razvitiya Regionov

In July 2006, the Company won an auction and purchased 25.49% ordinary shares of OJSC Vserossiysky Bank Razvitiya Regionov ("VBRR") for RUB 333 million (US$ 12 million at the CBR exchange rate as of the date of settlement), thus increasing its interest in VBRR to 76.47%. The settlement was made in cash. The purchase price was fully allocated to the fair value of assets acquired and liabilities assumed.

OJSC Rosneft – Tuapsenefteprodukt (a Merging Subsidiary)

In January 2006, the Company, through one of its subsidiaries, purchased an additional 39.26% of the voting stock (30.24% of the share capital) of OJSC Rosneft – Tuapsenefteprodukt, a consolidated subsidiary. The purchase price amounted to US$ 100 million and was paid in cash. After the purchase, the Company’s share in OJSC Rosneft – Tuapsenefteprodukt increased from 50.67% to 89.93% of voting shares (from 38.00% to 68.24% of the share capital).

The excess of purchase price over the fair value of the net assets acquired was US$ 34 million and is accounted for as goodwill. The Company explains the existence of the goodwill by expected additional positive effects arising from risk optimization which became possible after obtaining more than 75% of voting power.

OJSC Rosneft-Krasnodarneftegaz (a Merging Subsidiary)

In the first half of 2005, the Company acquired 33,337,187 common shares (38.66% of the total number of common shares) and 17,633,509 preferred shares (61.63% of the total number of preferred shares) in OJSC Rosneft-Krasnodarneftegaz, thus increasing its share in the share capital of OJSC Rosneft-Krasnodarneftegaz to 95.46%. The purchase price of the above shares amounted to US$ 110 million and was paid in cash.

The preliminary evaluation of the fair value of net assets acquired amounted to US$ 239 million based on a report of an independent appraiser. Because the fair value of the net assets acquired exceeded the purchase price, negative goodwill reduced, on a pro rata basis, amounts assigned to the long-term assets acquired, primarily oil and gas properties and mineral rights. The final purchase price allocation did not have a material effect on the carrying values of assets acquired and liabilities assumed.

OJSC Selkupneftegaz (a Merging Subsidiary)

In July 2005, the Company acquired 34 common shares (34% of the total number of common shares) in OJSC Selkupneftegaz, thus increasing its share in the share capital of OJSC Selkupneftegaz to 100%. The purchase price of the above shares amounted to US$ 20 million and was paid in cash.
The preliminary evaluation of the fair value of net assets acquired amounted to US$ 215 million based on a report of an independent appraiser. Because the fair value of the net assets acquired exceeded the purchase price, negative goodwill reduced, on a pro rata basis, amounts assigned to the long-term assets acquired, primarily mineral rights. The final purchase price allocation did not have a material effect on the carrying values of assets acquired and liabilities assumed.

4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at hand and cash in bank in RUB</td>
<td>244</td>
<td>414</td>
</tr>
<tr>
<td>Cash at hand and cash in bank – foreign currencies</td>
<td>192</td>
<td>394</td>
</tr>
<tr>
<td>Deposits and cash in transit</td>
<td>69</td>
<td>365</td>
</tr>
<tr>
<td>Total cash and cash equivalents</td>
<td>505</td>
<td>1,173</td>
</tr>
</tbody>
</table>

Restricted cash as of December 31 comprises the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obligatory reserve with the CBR</td>
<td>18</td>
<td>13</td>
</tr>
<tr>
<td>Other restricted cash</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>Total restricted cash</td>
<td>29</td>
<td>23</td>
</tr>
</tbody>
</table>

The obligatory reserve with the CBR represents the amounts deposited by the Company’s subsidiary bank, VBRR with the CBR for securing the current operating activity of the bank. Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBR, the amount of which depends on the level of funds attracted by the credit institution and this amount has certain restrictions for use.

Cash accounts denominated in foreign currencies represent primarily cash in US$.

Deposits and other represent primarily bank deposits denominated in RUB that may be readily convertible into cash and may be withdrawn by the Company at any time without prior notice or penalties.

As part of its cash management and credit risk function, the Company regularly evaluates the creditworthiness of financial and banking institutions where it deposits cash. Banking relationships are primarily with Russian subsidiaries of international banking institutions and certain large Russian banks.

5. SHORT-TERM INVESTMENTS

Short-term investments as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term loans granted</td>
<td>2</td>
<td>27</td>
</tr>
<tr>
<td>Loans to related parties</td>
<td>34</td>
<td>32</td>
</tr>
<tr>
<td>Trading securities</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Promissory notes</td>
<td>91</td>
<td>7</td>
</tr>
<tr>
<td>Corporate and state bonds</td>
<td>170</td>
<td>74</td>
</tr>
<tr>
<td>Other</td>
<td>39</td>
<td>10</td>
</tr>
<tr>
<td>Available-for-sale securities</td>
<td>120</td>
<td>–</td>
</tr>
<tr>
<td>Other</td>
<td>4</td>
<td>15</td>
</tr>
<tr>
<td>Total short-term investments</td>
<td>460</td>
<td>165</td>
</tr>
</tbody>
</table>

State bonds primarily represent federal loan bonds issued by the Ministry of Finance of the Russian Federation with maturities ranging from June 2007 to February 2036, coupon yields in 2006 ranging from 3.0% to 12.5% p.a. and yields to maturity ranging from 5.0% to 6.8% p.a., depending on the issue.

Corporate bonds represent bonds issued by large Russian corporations with maturities ranging from May 2008 to July 2014 and interest rates ranging from 7.4% to 13.8% p.a.

Short-term promissory notes mature in March and October 2007 and are interest free.

Available-for-sale securities represent promissory notes and loans maturing in March and December 2007 and bear interest rates of 7.14%.

Unrealized gains and losses on available-for-sale securities are not significant.
6. ACCOUNTS RECEIVABLE, NET

Accounts receivable as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade receivables</td>
<td>1,176</td>
<td>935</td>
</tr>
<tr>
<td>Value added tax receivable</td>
<td>2,092</td>
<td>1,536</td>
</tr>
<tr>
<td>Other taxes</td>
<td>117</td>
<td>88</td>
</tr>
<tr>
<td>Banking loans to customers</td>
<td>580</td>
<td>305</td>
</tr>
<tr>
<td>Accounts receivable from Yukos Oil Company</td>
<td>810</td>
<td>–</td>
</tr>
<tr>
<td>Other</td>
<td>129</td>
<td>63</td>
</tr>
<tr>
<td>Less: allowance for doubtful accounts</td>
<td>(65)</td>
<td>(69)</td>
</tr>
<tr>
<td><strong>Total accounts receivable, net</strong></td>
<td><strong>4,839</strong></td>
<td><strong>2,858</strong></td>
</tr>
</tbody>
</table>

The Company’s trade accounts receivable are denominated primarily in US dollars. Credit risk is managed through the use of letters of credit, and requesting advance payments from customers for the majority of sales.

Value added tax receivable (VAT) primarily includes input VAT associated with export sales, which is reimbursed from the budget in accordance with Russian tax legislation.

Accounts receivable from Yukos Oil Company represent the fair value of 23.21% of the trade receivables of OJSC Yuganskneftegas which are due from the Yukos Oil Company, and were acquired as part of the Share Swap (see Note 3). The total value of the receivables (US$ 3,430 million at 100%) has been included in Yukos Oil Company’s creditors register. The Company believes that US$ 3,430 million will be fully recovered as part of the ongoing Yukos Oil Company bankruptcy proceedings.

7. INVENTORIES

Inventories as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Materials and supplies</td>
<td>348</td>
<td>332</td>
</tr>
<tr>
<td>Crude oil and gas</td>
<td>329</td>
<td>300</td>
</tr>
<tr>
<td>Petroleum products</td>
<td>228</td>
<td>182</td>
</tr>
<tr>
<td><strong>Total inventories</strong></td>
<td><strong>905</strong></td>
<td><strong>814</strong></td>
</tr>
</tbody>
</table>

Materials and supplies mostly include spare parts. Petroleum products also include those designated for sale as well as for own use.

8. PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepayments to suppliers</td>
<td>599</td>
<td>366</td>
</tr>
<tr>
<td>Insurance prepayments</td>
<td>27</td>
<td>46</td>
</tr>
<tr>
<td>Customs</td>
<td>442</td>
<td>451</td>
</tr>
<tr>
<td>Acquired debt receivable</td>
<td>483</td>
<td>–</td>
</tr>
<tr>
<td>Other</td>
<td>38</td>
<td>19</td>
</tr>
<tr>
<td><strong>Total prepayments and other current assets</strong></td>
<td><strong>1,589</strong></td>
<td><strong>882</strong></td>
</tr>
</tbody>
</table>

Customs primarily represent export duty prepayments related to the export of crude oil and petroleum products (see Note 21).

The Company and a group of banks led by Societe Generale S.A. entered into an agreement granting the Company the right to claim the outstanding balance due from Yukos Oil Company under a syndicated loan of US$ 1,000 million. Under this agreement, the right to claim the debt and other rights and benefits per the original loan agreement between the bank syndicate and Yukos Oil Company were transferred from the banks to the Company in March 2006 upon the payment of the outstanding loan principal, accumulated interest (up to the date of repayment), legal and other fees in the amount of US$ 483 million, of which US$ 20 million was advanced in 2005.

The amount of the debt has been included in Yukos Oil Company’s creditors register. No interest is being accrued on this balance. As of December 31, 2006, the amount due from Yukos Oil Company is recognized as a current asset since it is anticipated that it will be recovered in full during the bankruptcy proceedings of Yukos Oil Company in 2007.

9. LONG-TERM INVESTMENTS

Long-term investments as of December 31 comprise the following:
Company. PLC is primarily engaged in the development of the Ardalin and satellite fields in the Timan-Pechora Basin located 125 kilometers south of the Barents Sea above the Arctic Circle. Development of the Ardalin field commenced in late 1992 and the first oil was produced in 1994.

**CJSC Kaspiy-1**

In 1997, a subsidiary of the Company made a contribution to the share capital of CJSC Kaspiy-1 which was founded to construct an oil refinery in Makhachkala (Dagestan Republic). The refinery has been commissioned. Due to significant and continuous capacity underutilization, the Company considered that decline in fair value is other-than temporary and the carrying amount of this investment was fully written-down in the amount of US$ 29 million.

**JV Rosneft–Shell Caspian Ventures Limited**

JV Rosneft–Shell Caspian Ventures Limited ("JV") is a joint venture in which the Company holds a 51% interest. The Articles of Incorporation of this joint venture stipulate, however, that key decisions regarding its business shall be subject to unanimous approval by both participants and none of the participants has a preferential voting right.

On February 6, 1997, the Company, through the JV, signed an agreement with eight oil and gas companies and government agencies of the Russian Federation and the Republic of Kazakhstan for the establishment of Caspian Pipeline Consortium ("CPC"). The purpose of the consortium is to design, finance,
construct and operate a pipeline from the oil fields located in Western Kazakhstan through Russia to the port of Novorossiysk. The interest of the JV in the CPC is 7.5%. In October 2001, the CPC pipeline was put in operation.

**OJSC Daltransgaz**

OJSC Daltransgaz is an operator for the program to supply gas to the Sakhalin Region and the Khabarovsk and Primorye Territories. See also Note 3.

**OJSC Verkhnechonskneftegaz**

OJSC Verkhnechonskneftegaz holds the licence for the development of the Verkhnechonskoye oil and gas condensate deposit, which is the largest oil deposit in the Irkutsk region.

**Oil Terminal (OT) Belokamenka LLC**

OT Belokamenka LLC is a floating storage facility constructed in 2004 in the nearby ice-free Kola Bay.

**10. OIL AND GAS PROPERTIES, NET**

Oil and gas properties as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wells and related</td>
<td></td>
<td></td>
</tr>
<tr>
<td>facilities</td>
<td>17,128</td>
<td>12,606</td>
</tr>
<tr>
<td>Mineral rights</td>
<td>19,356</td>
<td>10,723</td>
</tr>
<tr>
<td>Pipelines</td>
<td>1,627</td>
<td>1,057</td>
</tr>
<tr>
<td>Equipment under capital</td>
<td>26</td>
<td>214</td>
</tr>
<tr>
<td>lease (Note 13)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total cost</td>
<td>38,137</td>
<td>24,600</td>
</tr>
<tr>
<td>Less: accumulated</td>
<td></td>
<td></td>
</tr>
<tr>
<td>depletion</td>
<td>(5,178)</td>
<td>(3,661)</td>
</tr>
<tr>
<td>Total oil and gas</td>
<td></td>
<td></td>
</tr>
<tr>
<td>properties, net</td>
<td>32,959</td>
<td>20,939</td>
</tr>
</tbody>
</table>

Mineral rights include costs to acquire unproved properties in the amount of US$ 3,878 million as of December 31, 2006, and US$ 1,382 million as of December 31, 2005. The Company plans to explore and develop the respective fields. The Company’s management believes these costs are recoverable.

For the purposes of evaluation of the reserves as of December 31, 2006 and 2005 the Company used oil and gas reserves data prepared by DeGolyer and MacNaughton, independent reservoir engineers. The Company used the reserve report to calculate depreciation, depletion and amortization relating to oil and gas properties for 2006 and 2005. The reserve report was also used for the assessment of impairment of oil and gas assets and for the required supplemental disclosure for oil and gas activities (see supplementary oil and gas disclosure).

As described in the "Depreciation, depletion and amortization" section of Note 2, the Company calculates depletion using the unit-of-production method over proved or proved developed oil and gas reserves depending on the nature of the costs involved. The proved or proved developed reserves used in the unit of production method assume the extension of the Company’s production licences beyond their current expiration dates until the end of the economic lives of the fields as discussed below in further detail.

The Company’s oil and gas fields are located principally in the territory of the Russian Federation. The Company obtains licences from the governmental authorities to explore and produce oil and gas from these fields. The Company’s existing production licences generally expire during the period 2009 to 2031. Expiration dates of licences for the most significant fields are between 2013 and 2019, and the licence for the largest field, Priobskoye, expires in 2019. The economic lives of the major licenced fields extend significantly beyond these dates. Under Russian law, the Company is entitled to renew the licences to the end of the economic lives of the fields, provided certain conditions are met. Article 10 of the Subsoil Law, Concerning Subsurface Resources, provides that a licence to use a field “shall be” extended at its scheduled termination at the initiative of the subsoil user if necessary to finish production of the field, provided that there are no violations of the conditions of the licence.

The legislative history of Article 10 indicates that the term "shall" replaced the term "may" in August 2004, clarifying that the subsoil user has an absolute right to extend the licence term so long as it has not violated the conditions of the licence. In 2006, no licences came up for renewal. In 2005, the Company extended the terms of 39 of its production licences for the period equivalent to the expected life of the
fields. There were no unsuccessful licence renewal applications.

The Company’s current production plans are based on the assumption, which management considers to be reasonably certain, that the Company will be able to extend all other existing licences. These plans have been designed on the basis that the Company will be producing crude oil through the economic lives of the fields and not with a view to exploiting the Company’s reserves to maximum effect only through the licence expiration dates. Accordingly, management has included in proved reserves in the supplementary information on oil and gas exploration and production activities of the consolidated financial statements as of and for the year ended December 31, 2006 all reserves that otherwise meet the standards for being characterized as “proved” and that the Company estimates the Company can produce through the economic lives of Company’s licensed fields.

Proved reserves should generally be limited to those that can be produced through the licence expiration date unless there is a long and clear track record which supports the conclusion that extension of the licence will be granted as a matter of course. The Company believes that extension of the licences will occur as a matter of course as fully described above.

RN-Yuganskneftegaz LLC (previously OJSC Yuganskneftegaz) in its operating activities enters into short-term lease contracts for a significant number of wells and related equipment and facilities. These agreements are entered into with the owners of the wells, equipment and facilities, which are certain subsidiaries of Yukos Oil Company. All of the lease agreements are cancellable in nature and most expire within one year. During 2005 and 2006, all the expired lease contracts were extended for a period of up to one year. The Company’s management plans to attempt to further extend the above leases. Following a claim brought by OJSC Yuganskneftegaz in March 2006, the Moscow Arbitration Court ruled that the 100% ownership interest in one of the subsidiaries, which is by far the most significant lessor, should be transferred from Yukos Oil Company to OJSC Yuganskneftegaz (and following the Share Swap described in Note 3, was transferred directly to Rosneft). This ruling was upheld in the appeal hearings on June 1, 2006, which made it legally binding and enforceable. This ruling was also upheld in cassational hearing on July 26, 2006. Transfer of the ownership interest was made in the beginning of April, 2007 (see Note 28).

Sakhalin-1

The Company’s primary investment in production sharing agreements (“PSA”) is through the Sakhalin-1 project (PSA 1), which is operated by ExxonMobil, one of the PSA participants. In February 2001, the Company signed an agreement with Oil and Natural Gas Corporation (“ONGC”) in relation to its interest in the PSA 1 which reduced the Company’s interest to 20%. The Company recorded the investment in its retained share under the “carried interest” method. Commercial hydrocarbon production under PSA 1 commenced in October 2005. Accordingly, the Company’s share in hydrocarbon reserves was reclassified as proved developed reserves.

On July 31, 2006, the Company repaid US$ 1.34 billion (including accumulated interest) to ONGC with respect to the costs of the Company carried by ONGC in previous years. Following this settlement the Company recovered the right to receive the income equivalent to its interest in the project. As of December 31, 2006, US$ 1.33 billion of the US$ 1.34 billion paid was recorded as oil and gas properties and the remaining amount was reflected in the appropriate lines of the balance sheet and the statements of income based on the nature of the cost originally incurred.

Sakhalin-5

The participants of the project are subsidiaries of the Company and BP p.l.c. In March 2004, the licence for geological study of the Kaigansko-Vasyukansky block held by the Company was transferred to CJSC Elvari Neftegaz, which is a 100% subsidiary of Elvary Neftegaz Holdings B.V., an entity jointly established by the participants of the project.

The Shareholders and Operating Agreement was signed between the participants and the operator in June 2004. In accordance with the terms of the agreement, during the exploration stage project funding will be fully provided by BP p.l.c., while during the development stage BP p.l.c. will carry a portion of payments due from the Company and will provide credit support to obtain project funding.

The Company recognizes this investment as an equity interest in a related company under the equity method of accounting.

Other Projects

The Company is a party to other projects associated with the development of the Sakhalin shelf (Zapadno-Shmidtovsky and Vostochno-Shmidtovsky blocks). Under
those arrangements, the other participant (BP p.l.c.) has agreed to pay for exploration costs on behalf of the Company. Exploration and development of these projects is at an early stage. The Company’s costs (currently insignificant) associated with these projects were capitalized.

In July 2005, the Company entered into a PSA agreement with the Kazakhstan Government for the joint development of the Kurmangazy oil and gas field. The participants of the project are a subsidiary of the Company, RN Kazakhstan LLC, and a subsidiary of Kazakhstan State JSC KazMunaiGaz, JSC “NK KazMunaiGaz – KazMunaiTeniz” (“KazMunaiTeniz”), with equal shares of 50%. The agreement provided for a signing bonus in the amount of US$ 50 million. The Company’s share of US$ 25 million is recognized within mineral rights. In accordance with the terms of the agreement, upon a commercial discovery the Russian Federation has an option to buy a 25% share in the project at a future market price, by reducing the share of RN-Kazakhstan LLC in the project. If the Russian Federation does not exercise its option, this share shall be sold to third parties at a market price or redistributed between the participants in equal parts. If the share is sold, the proceeds from the sale shall cover the expenses already incurred, including those suffered by RN Kazakhstan LLC and related to the sold share. Any excess of the proceeds from the sale of share over the expenses shall be equally distributed between RN Kazakhstan LLC and KazMunaiTeniz.

11. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings and constr.</td>
<td>2,293</td>
<td>1,941</td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>1,214</td>
<td>1,096</td>
</tr>
<tr>
<td>Vehicles and other eq.</td>
<td>430</td>
<td>356</td>
</tr>
<tr>
<td>Service vessels</td>
<td>101</td>
<td>8</td>
</tr>
<tr>
<td>Assets under capital lease (Note 13)</td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>4,044</td>
<td>3,413</td>
</tr>
<tr>
<td>Less: accumulated deprecation</td>
<td>(1,448)</td>
<td>(1,383)</td>
</tr>
<tr>
<td><strong>Property, plant and equipment, net</strong></td>
<td>2,598</td>
<td>2,030</td>
</tr>
</tbody>
</table>

12. CONSTRUCTION-IN-PROGRESS

Construction-in-progress as of December 31 comprises the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment to be installed</td>
<td>98</td>
<td>100</td>
</tr>
<tr>
<td>Buildings and constr.</td>
<td>225</td>
<td>303</td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>65</td>
<td>106</td>
</tr>
<tr>
<td><strong>Total construction-in-progress</strong></td>
<td>388</td>
<td>509</td>
</tr>
</tbody>
</table>

Construction-in-progress includes various construction projects as well as machinery and equipment delivered but not yet installed.

13. LEASED PROPERTY, PLANT AND EQUIPMENT

The following is the analysis of the property, plant and equipment under capital leases as of December 31:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and gas properties</td>
<td>26</td>
<td>214</td>
</tr>
<tr>
<td>Less: accumulated depletion</td>
<td>(1)</td>
<td>(10)</td>
</tr>
<tr>
<td>Oil and gas properties, net</td>
<td>25</td>
<td>204</td>
</tr>
<tr>
<td>Other property, plant and equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings and constructions</td>
<td>–</td>
<td>1</td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Vehicles</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td>Less: accumulated depreciation</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>Property, plant and equipment, net</td>
<td>4</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total net book value of leased assets</strong></td>
<td>29</td>
<td>213</td>
</tr>
</tbody>
</table>

Below is the analysis of the repayment of capital lease obligations as of December 31:
Operating Lease

The Company has obligations which are primarily related to the operating lease for oil and gas facilities in the amount of US$ 62 million for 2007.

The total amount of operating lease expenses was as follows:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total lease expenses</td>
<td>115</td>
<td>120</td>
<td>16</td>
</tr>
<tr>
<td>Total sublease revenues</td>
<td>15</td>
<td>3</td>
<td>–</td>
</tr>
</tbody>
</table>

14. GOODWILL

Goodwill in the amount of US$ 161 million represents the excess of the purchase price of additional shares in various entities in the refining, marketing and distribution segment acquired during 2005 and 2006, over the fair value of the corresponding share in net assets (See Note 3). As of December 31, 2006 and 2005, no impairment of goodwill was identified.

15. OTHER NON–CURRENT ASSETS

Other non-current assets consist of advances given to Factorias Vulcano S.A for construction of three twin-hull shuttle oil tankers. As of December 31, 2006 the vessels were in the early stage of construction. The amount of the advance paid is US$ 145 million; the remaining part of the advance to be paid in 2007 is approximately US$ 95 million.

Advances paid for capital construction in the amount of US$ 142 million and US$ 15 million as of December 31, 2006 and 2005, respectively, are also included in other non-current assets.

16. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade accounts payable</td>
<td>851</td>
<td>649</td>
</tr>
<tr>
<td>Salary and other benefits payable</td>
<td>130</td>
<td>157</td>
</tr>
<tr>
<td>Advances received</td>
<td>350</td>
<td>192</td>
</tr>
<tr>
<td>Dividends payable</td>
<td>2</td>
<td>60</td>
</tr>
<tr>
<td>Banking customer accounts</td>
<td>386</td>
<td>252</td>
</tr>
<tr>
<td>Promissory notes payable</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Obligations under Total E&amp;P Vankor claim (Note 25)</td>
<td>134</td>
<td>–</td>
</tr>
<tr>
<td>Other</td>
<td>143</td>
<td>46</td>
</tr>
<tr>
<td>Total Accounts payable and accrued liabilities</td>
<td>1,998</td>
<td>1,358</td>
</tr>
</tbody>
</table>

The Company’s accounts payable are denominated primarily in RUB.

17. SHORT–TERM LOANS AND LONG–TERM DEBT

Short-term loans and borrowings as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank loans – US$ denominated</td>
<td>79</td>
<td>794</td>
</tr>
<tr>
<td>Bank loans – RUB denominated</td>
<td>2,517</td>
<td>9</td>
</tr>
<tr>
<td>Customer deposits – US$ denominated</td>
<td>29</td>
<td>42</td>
</tr>
<tr>
<td>Customer deposits – RUB denominated</td>
<td>164</td>
<td>96</td>
</tr>
<tr>
<td>Promissory notes payable</td>
<td>771</td>
<td>657</td>
</tr>
<tr>
<td>Other</td>
<td>505</td>
<td>456</td>
</tr>
<tr>
<td>Current portion of long-term debt</td>
<td>4,065</td>
<td>2,054</td>
</tr>
<tr>
<td></td>
<td>2,362</td>
<td>1,951</td>
</tr>
</tbody>
</table>
US$ denominated bank loans bear interest rates from LIBOR plus 0.75% p.a. to LIBOR plus 3.02% p.a., mostly represent interbank loans raised by the Company’s subsidiary bank. The RUB denominated loans generally bear an annual interest rate ranging from 4% to 8% p.a.

In December 2006, the Company opened a short-term credit line in Russian rubles with a state owned bank with a variable interest rate, dependent on the timing of the repayment period, ranging from 6.0% to 6.8% p.a.

Customer deposits represent fixed-term deposits placed by customers with the Company’s subsidiary bank, denominated in RUB and foreign currencies. Customer deposits denominated in RUB bear an interest rate ranging from 3% to 12.6% p.a. Customer deposits denominated in foreign currencies bear an interest rate ranging from 1.75% to 8% p.a.

Promissory notes are primarily payable on demand with interest rates ranging from 0% to 18% p.a. The promissory notes are recorded at amortized cost.

Other borrowings primarily include four RUB-denominated loans provided to OJSC Yuganskneftegaz by Yukos Capital S.a.r.l., which bear interest of 9% p.a. and mature in 2007. As of December 31, 2006 and December 31, 2005, these loans are classified as current since the creditor demanded early repayment of these loans due to non-compliance with the terms of the loan agreements.

Long-term debt as of December 31 comprises the following:

<table>
<thead>
<tr>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total short-term loans and current portion of long-term debt</strong></td>
<td><strong>Total short-term loans and current portion of long-term debt</strong></td>
</tr>
<tr>
<td>6,427</td>
<td>4,005</td>
</tr>
<tr>
<td><strong>Customer deposits – foreign currencies</strong></td>
<td><strong>Customer deposits – foreign currencies</strong></td>
</tr>
<tr>
<td>15</td>
<td>8</td>
</tr>
<tr>
<td><strong>Borrowings – RUB denominated</strong></td>
<td><strong>Borrowings – RUB denominated</strong></td>
</tr>
<tr>
<td>2</td>
<td>9</td>
</tr>
<tr>
<td><strong>Customer deposits – RUB denominated</strong></td>
<td><strong>Customer deposits – RUB denominated</strong></td>
</tr>
<tr>
<td>85</td>
<td>60</td>
</tr>
<tr>
<td><strong>Bonds of the subsidiary bank – RUB denominated</strong></td>
<td><strong>Bonds of the subsidiary bank – RUB denominated</strong></td>
</tr>
<tr>
<td>4</td>
<td>20</td>
</tr>
<tr>
<td><strong>Other long-term liabilities – RUB denominated</strong></td>
<td><strong>Other long-term liabilities – RUB denominated</strong></td>
</tr>
<tr>
<td>22</td>
<td>40</td>
</tr>
<tr>
<td><strong>Current portion of long-term debt</strong></td>
<td><strong>Current portion of long-term debt</strong></td>
</tr>
<tr>
<td>(2,362)</td>
<td>(1,951)</td>
</tr>
<tr>
<td><strong>Total long-term debt</strong></td>
<td><strong>Total long-term debt</strong></td>
</tr>
<tr>
<td>7,402</td>
<td>8,198</td>
</tr>
</tbody>
</table>

The rates of interest on the Company’s long-term bank loans denominated in US$ ranged from 4.35% to 5.97% p.a. Weighted average interest rates on these loans were 5.96% and 6.58% (LIBOR plus 0.64%, LIBOR plus 2.19%) as of December 31, 2006 and 2005, respectively. These bank loans are primarily secured by contracts for the export of crude oil.

In January 2006, a subsidiary of the Company registered in Cyprus signed a loan agreement with a major international bank for an amount of EUR 188 million or US$ 247.7 million at the CBR exchange rate as of December 31, 2006. The loan bears an interest rate of EURIBOR plus 0.35% p.a. The first drawdown was made during 2006 in the amount of EUR 115.88 million or US$ 152.69 million using the CBR exchange rate as of December 31, 2006. Funds borrowed are to be invested in the construction of ice-reinforced tankers for crude oil transportation purposes in north-western regions of the Russian Federation (see also Note 15). The loan is scheduled to be repaid within the twelve years following the completion of tanker construction.

In February 2006, the Company signed a loan agreement with a syndicate of Western banks for US$ 2,000 million with a term of 5 years. The loan bears interest at LIBOR plus 0.65% p.a. The loan funds were used to repay other loans with less favorable terms.

As of December 31, 2006 the bank loans raised for funding the acquisition of OJSC Yuganskneftegaz represent a long-term loan obtained through a government-owned bank at a rate of LIBOR plus 0.7% p.a. repayable in equal monthly installments. It is scheduled for repay-
ment in 2011 and is secured by the Company’s receiv-
ables under a long-term contract for the supply of crude oil (see Note 25).

Weighted average interest rates on US$ denominated borrowings were 8.85% and 8.67% as of December 31, 2006 and 2005, respectively.

Customer deposits include fixed-term RUB and foreign currency denominated customer deposits placed with the Company’s subsidiary bank which mature primarily during 2007 and are included in the current portion of long-term debt. The RUB-denominated deposits bear an interest rate ranging from 5% to 12% p.a. Deposits denominated in foreign currencies bear an interest rate of 9% p.a.

As of December 31, 2006 other long-term liabilities include promissory notes with interest rates ranging from 0% to 4.75% which mature mostly in 2007. The promissory notes are recorded at amortized cost and are included in the current portion of long-term debt.

Generally, long-term loans are secured by oil export contracts. Usually, under the terms of such contracts, the lender is provided with an express right of claim for contractual revenue which must be remitted directly to transit currency (US$ denominated) accounts with those banks, should the Company fail to repay its debt in time.

The Company is obliged to comply with a number of restrictive financial and other covenants contained within its loan agreements. Restrictive covenants include maintaining certain financial ratios. As a result of the Company’s acquisition of OJSC Yuganskneftegaz in December 2004, and the resulting debt incurred and assets and liabilities, including contingent liabilities, consolidated, the Company was not in compliance with various financial and other covenants of existing loan agreements as of that date.

In July 2005, the creditors waived violations related to restrictive financial ratios and agreed to amend the financial ratio covenants in line with the Company’s new structure and new scope of activities. The creditors also waived other events of default arising from the breach of other covenant provisions. Effective January 1, 2007, the creditors granted amendments to the loan agreements which remove these provisions and have included new waivers which state that the Company must:

- redeem, secure, discharge in full or restructure (and comply with any restructuring plans once it is agreed upon) all OJSC Yuganskneftegaz’s tax liabilities by January 3, 2008;
- pay any arbitration award relating to Moravel Litigation (see Note 25) or the Yukos Capital S.a.r.l. Litigation (see Note 17 above) if any such arbitration award is granted by a court of the Russian Federation, within the time frame provided for such payment under Russian Law.

These conditions also apply to certain new borrowings obtained throughout 2005 and 2006. Thus, as of December 31, 2005, long-term borrowings, for which creditors either waived events of default arising from the breach of certain covenant provisions amounted to US$ 2,831 million. This debt continued to be reflected as long term in nature as of December 31, 2005. As of December 31, 2006, the Company was in compliance with all of the restrictive financial covenants. Following the amendments granted effective 1 January 2007, the Company is in compliance with all restrictive financial and other covenants contained within its loan agreements.

The aggregate maturity of long-term debt outstanding as of December 31, 2006 is as follows (assuming the debt will not be called by creditors ahead of scheduled maturities):

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2,362</td>
</tr>
<tr>
<td>2008</td>
<td>2,468</td>
</tr>
<tr>
<td>2009</td>
<td>2,449</td>
</tr>
<tr>
<td>2010</td>
<td>2,114</td>
</tr>
<tr>
<td>2011</td>
<td>250</td>
</tr>
<tr>
<td>2012 and after</td>
<td>121</td>
</tr>
<tr>
<td><strong>Total long-term debt</strong></td>
<td><strong>9,764</strong></td>
</tr>
</tbody>
</table>

To finance its current operations, acquisitions and to refinance its short-term loans, the Company continues to raise external funding. Operating income depends heavily on oil prices and oil export quotas available to the Company. In the event of a long-term drop in crude oil prices and a failure to raise external funding, the Company may be compelled to reduce its capital expenditures thus limiting its ability to maintain or increase the current level of oil production.

18. SHAREHOLDERS' EQUITY

In June 2005, the Company contributed all of its shares to the share capital of OJSC Rosneftegaz, wholly
owned by the State as represented by the Federal Agency for Federal Property Management.

In the third quarter of 2005, 1 share of Rosneft was transferred to the Federal Agency of Federal Property Management.

In the third quarter of 2005, Rosneft increased the number of common shares by splitting one common share with par value of RUB 1 into 100 common shares with par value of RUB 0.01. As a result the total number of shares issued and outstanding became 9,092 million. Net earnings per share for 2006 and the comparable data for 2005 and 2004 were calculated retrospectively based on the new number of outstanding shares.

In July 2006, the shareholders of Rosneft undertook an initial public offering of ordinary shares of Rosneft in Russia, as well as GDRs for these shares on the London Stock Exchange. 1,126 million of the Company’s ordinary shares were sold by the Company’s shareholders. Additionally, the Company issued 285 million new ordinary shares. As a result of the offering, the Company’s proceeds from sales of new shares amounted to US$ 2,115 million (net of commissions and expenses). The difference between the nominal value of the shares issued (US$ 105 thousand) and the amount received for shares (US$ 2,115,408 thousand) was recognized as additional paid-in capital.

In December 2006, the Federal Tax Service of the Russian Federation registered the change in the Company’s share capital, which was increased due to an additional share issue for the purposes of the Share Swap and consolidation of the Merging Subsidiaries (see Notes 1 and 3). The Company’s issued ordinary share capital was increased by 1,221 million shares to 10,598 million shares. The fair value of the shares issued was determined to be US$ 9,218 million (see Note 3). The difference between the par value (US$ 456 thousand) and the fair value (US$ 9,218,093 thousand) of the issued shares was recognized as additional paid-in capital of the Company.

The number of common shares authorized (in addition to shares issued) was 6,333 million and 7,839 million as of December 31, 2006 and 2005, respectively.

**Amounts Available for Distribution to Shareholders**

Amounts available for distribution to shareholders are based on the Company’s unconsolidated statutory accounts prepared in accordance with Russian accounting standards, which differ significantly from US GAAP (see Note 2). Russian legislation identifies the basis of distribution as the current period consolidated net profit calculated in accordance with statutory accounting standards. According to Russian legislation, dividends cannot exceed the accounting income for the reporting year. However, this legislation and other statutory laws and regulations dealing with distribution rights are open to different legal interpretations.

In June 2006, the annual general shareholders’ meeting approved dividends on the Company’s common shares for 2005 in the amount of RUB 11.3 billion or US$ 424 million at the CBR exchange rate as at the date of decision, which corresponds to US$ 0.05 per share.

19. INCOME AND OTHER TAX LIABILITIES

Income and other tax liabilities as of December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mineral extraction tax</td>
<td>1,156</td>
<td>1,158</td>
</tr>
<tr>
<td>Value added tax</td>
<td>615</td>
<td>776</td>
</tr>
<tr>
<td>Excise tax</td>
<td>73</td>
<td>62</td>
</tr>
<tr>
<td>Personal income tax</td>
<td>15</td>
<td>19</td>
</tr>
<tr>
<td>Property tax</td>
<td>36</td>
<td>18</td>
</tr>
<tr>
<td>Income tax</td>
<td>454</td>
<td>644</td>
</tr>
<tr>
<td>Other</td>
<td>123</td>
<td>133</td>
</tr>
<tr>
<td><strong>Total income and other tax liabilities</strong></td>
<td><strong>2,472</strong></td>
<td><strong>2,810</strong></td>
</tr>
</tbody>
</table>

20. MINORITY INTEREST

As a result of the Share Swap (see Notes 1 and 3) minority owners’ interests in Merging Subsidiaries with a carrying value of US$ 1,711 million were acquired.
21. REVENUE RELATED TAXES

Revenues include the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and gas sales</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export customs duty</td>
<td>9,763</td>
<td>5,322</td>
<td>535</td>
</tr>
<tr>
<td>Petroleum products sales and processing fees</td>
<td>1,377</td>
<td>942</td>
<td>171</td>
</tr>
<tr>
<td>Total revenue related taxes</td>
<td>11,140</td>
<td>6,264</td>
<td>706</td>
</tr>
</tbody>
</table>

Petroleum products sales also include excise taxes which are presented in Note 22.

22. INCOME AND OTHER TAXES

Income tax expenses for the years ended December 31 comprise the following:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current income tax expense</td>
<td>2,385</td>
<td>1,688</td>
<td>309</td>
</tr>
<tr>
<td>Deferred income tax benefit</td>
<td>(1,845)</td>
<td>(79)</td>
<td>(11)</td>
</tr>
<tr>
<td>Total income tax expense</td>
<td>540</td>
<td>1,609</td>
<td>298</td>
</tr>
</tbody>
</table>

The Company does not file a consolidated tax return, rather each legal entity files separate tax returns with various authorities, primarily in the Russian Federation.

Temporary differences between these consolidated financial statements and tax records gave rise to the following deferred income tax assets and liabilities as of December 31:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred income tax asset arising from tax effect of:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax loss carry-forward</td>
<td>100</td>
<td>101</td>
</tr>
<tr>
<td>Asset retirement obligations</td>
<td>60</td>
<td>54</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>70</td>
<td>75</td>
</tr>
</tbody>
</table>

The deferred income tax liability related to mineral rights, other oil and gas properties, plant and equipment, and other includes the deferred tax liability assumed as a result of the Share Swap (see Note 3) in the amount of US$ 1,961 million.

Deferred income tax asset related to accounts receivable primarily relates to the deferred tax asset recorded as a result of the favorable court decision on the Company’s claim against Yukos Oil Company received at the end of 2006, whereby taxable non-operating income was recognized in tax records relating to the expected reimbursement of “lost profits” to the Company.

Classification of deferred taxes:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current deferred tax assets</td>
<td>1,135</td>
<td>48</td>
</tr>
<tr>
<td>Long-term deferred tax assets</td>
<td>110</td>
<td>8</td>
</tr>
<tr>
<td>Current deferred tax liabilities</td>
<td>(17)</td>
<td>(40)</td>
</tr>
</tbody>
</table>
Although the Company does not pay tax on a consolidated basis, a reconciliation of expected income tax expense to the actual tax expense for the years ended December 31 is as follows:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term deferred tax liabilities</td>
<td>(5,446)</td>
<td>(3,696)</td>
</tr>
</tbody>
</table>

In addition to income tax, the Company accrued other taxes as follows:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mineral extraction tax</td>
<td>6,342</td>
<td>4,716</td>
<td>739</td>
</tr>
<tr>
<td>Excise tax</td>
<td>329</td>
<td>286</td>
<td>88</td>
</tr>
<tr>
<td>Social security</td>
<td>154</td>
<td>118</td>
<td>98</td>
</tr>
<tr>
<td>Property tax</td>
<td>107</td>
<td>73</td>
<td>40</td>
</tr>
<tr>
<td>Land tax</td>
<td>7</td>
<td>14</td>
<td>13</td>
</tr>
<tr>
<td>Transport tax</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Other taxes and payments</td>
<td>49</td>
<td>117</td>
<td>32</td>
</tr>
<tr>
<td>Taxes, other than income tax</td>
<td>6,990</td>
<td>5,326</td>
<td>1,011</td>
</tr>
</tbody>
</table>

### 23. ASSET RETIREMENT OBLIGATIONS

The movement of asset retirement obligations is as follows:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset retirement obligations as of the beginning of the reporting period</td>
<td>566</td>
<td>555</td>
</tr>
<tr>
<td>Recognition of additional obligations for new wells</td>
<td>16</td>
<td>5</td>
</tr>
<tr>
<td>Accretion expense</td>
<td>34</td>
<td>35</td>
</tr>
<tr>
<td>Increase/(decrease) as a result of changes in estimates</td>
<td>132</td>
<td>(27)</td>
</tr>
<tr>
<td>Spending on existing obliga-  tions</td>
<td>–</td>
<td>(2)</td>
</tr>
<tr>
<td>Asset retirement obligations as of the end of the reporting period</td>
<td>748</td>
<td>566</td>
</tr>
</tbody>
</table>
Asset retirement obligations represent an estimate of costs of wells liquidation, recultivation of sand pits, slurry ponds, disturbed lands and dismantling pipelines and power transmission lines.

Russian legislation does not stipulate any funds reservation for purposes of settling asset retirement obligations.

### 24. RELATED PARTY TRANSACTIONS

In the course of its usual activity, the Company regularly enters into transactions with other enterprises which are directly or indirectly controlled by the Russian Government. Such enterprises are business units of RAO UES, OJSC Gazprom, OJSC Russian Railways, OJSC Sberbank, Vnesheconombank, OJSC Bank VTB, CJSC Gazprombank, OJSC Transneft and federal agencies including tax authorities. Management considers these business relations as part of regular activities in the Russian Federation and believes that they will remain unchanged in the foreseeable future.

Total amounts of transactions with companies controlled by the Government of the Russian Federation for each of the reporting periods ending December 31, as well as related party balances are provided in the table below:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil and gas sales</td>
<td>27</td>
<td>19</td>
<td>12</td>
</tr>
<tr>
<td>Sales of petroleum products and processing fees</td>
<td>148</td>
<td>195</td>
<td>78</td>
</tr>
<tr>
<td>Support services and other revenues</td>
<td>8</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>183</td>
<td>216</td>
<td>91</td>
</tr>
<tr>
<td><strong>Costs and expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pipeline tariffs and transportation costs</td>
<td>2,032</td>
<td>1,305</td>
<td>430</td>
</tr>
<tr>
<td>Other expenses</td>
<td>22</td>
<td>1</td>
<td>–</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,054</td>
<td>1,306</td>
<td>430</td>
</tr>
<tr>
<td><strong>Other operations</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchases of property, plant and equipment</strong></td>
<td>87</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td><strong>Sale of short-term and long-term investments</strong></td>
<td>4</td>
<td>38</td>
<td>725</td>
</tr>
<tr>
<td><strong>Acquisition of short-term and long-term investments</strong></td>
<td>14</td>
<td>38</td>
<td>294</td>
</tr>
<tr>
<td><strong>Sale of shares in CJSC Sevmorneft-gaz</strong></td>
<td>–</td>
<td>1,303</td>
<td>–</td>
</tr>
<tr>
<td><strong>Proceeds from short-term and long-term debt</strong></td>
<td>2,463</td>
<td>1,527</td>
<td>9,479</td>
</tr>
<tr>
<td><strong>Repayment of short-term and long-term debt</strong></td>
<td>2,104</td>
<td>3,458</td>
<td>192</td>
</tr>
<tr>
<td><strong>Deposits placed</strong></td>
<td>374</td>
<td>1,945</td>
<td>226</td>
</tr>
<tr>
<td><strong>Deposits paid</strong></td>
<td>499</td>
<td>1,782</td>
<td>226</td>
</tr>
<tr>
<td><strong>Borrowings issued</strong></td>
<td>131</td>
<td>574</td>
<td>–</td>
</tr>
<tr>
<td><strong>Repayment of borrowings issued</strong></td>
<td>134</td>
<td>574</td>
<td>–</td>
</tr>
<tr>
<td><strong>Interest expense</strong></td>
<td>384</td>
<td>487</td>
<td>56</td>
</tr>
<tr>
<td><strong>Interest income</strong></td>
<td>25</td>
<td>–</td>
<td>1</td>
</tr>
<tr>
<td><strong>Banking fees</strong></td>
<td>13</td>
<td>12</td>
<td>2</td>
</tr>
</tbody>
</table>

| **Assets**               |      |      |      |
| Cash and cash equivalents| 69   | 376  | 702  |
| Accounts receivable and other current assets | 20   | 23   | 2    |
| Prepayments              | 137  | 154  | 14   |
| Short-term and long-term investments | 172  | 180  | –    |
| **Total**                | 398  | 733  | 718  |

| **Liabilities**          |      |      |      |
| Accounts payable         | 24   | 4    | 2    |
| Short-term and long-term debt (including interest) | 7,282| 6,890| 10,506|
| **Total**                | 7,306| 6,894| 10,508|
Total amounts of transactions with other related parties, excluding the companies controlled by the Government of the Russian Federation, primarily equity investees and joint ventures, for each of the reporting periods ending December 31, as well as related party balances are provided in the table below:

<table>
<thead>
<tr>
<th>Revenues</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and gas sales</td>
<td>31</td>
<td>27</td>
<td>2</td>
</tr>
<tr>
<td>Sales of petroleum products and processing fees</td>
<td>84</td>
<td>50</td>
<td>4</td>
</tr>
<tr>
<td>Support services and other revenues</td>
<td>26</td>
<td>60</td>
<td>36</td>
</tr>
<tr>
<td></td>
<td>141</td>
<td>137</td>
<td>42</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Costs and expenses</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase of oil and petroleum products</td>
<td>103</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>Other expenses</td>
<td>74</td>
<td>64</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td>177</td>
<td>65</td>
<td>32</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other operations</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisitions of property, plant and equipment</td>
<td>2</td>
<td>73</td>
<td>21</td>
</tr>
<tr>
<td>Lease payments</td>
<td>–</td>
<td>29</td>
<td>14</td>
</tr>
<tr>
<td>Sales of short-term and long-term investments</td>
<td>–</td>
<td>514</td>
<td>809</td>
</tr>
<tr>
<td>Acquisition of short-term and long-term investments</td>
<td>48</td>
<td>345</td>
<td>756</td>
</tr>
<tr>
<td>Proceeds from short-term and long-term debt</td>
<td>33</td>
<td>–</td>
<td>612</td>
</tr>
<tr>
<td>Repayment of short-term and long-term debt</td>
<td>51</td>
<td>8</td>
<td>664</td>
</tr>
<tr>
<td>Borrowings issued</td>
<td>88</td>
<td>61</td>
<td>63</td>
</tr>
<tr>
<td>Repayment of borrowings issued</td>
<td>22</td>
<td>46</td>
<td>52</td>
</tr>
<tr>
<td>Interest expense</td>
<td>4</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Interest income</td>
<td>8</td>
<td>–</td>
<td>–</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends received</td>
<td>13</td>
<td>19</td>
<td>13</td>
</tr>
<tr>
<td>Accounts receivables and other current assets</td>
<td>33</td>
<td>13</td>
<td>15</td>
</tr>
<tr>
<td>Prepayments</td>
<td>42</td>
<td>–</td>
<td>4</td>
</tr>
<tr>
<td>Short-term and long-term investments</td>
<td>121</td>
<td>128</td>
<td>232</td>
</tr>
<tr>
<td></td>
<td>196</td>
<td>141</td>
<td>251</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>193</td>
<td>24</td>
<td>30</td>
</tr>
<tr>
<td>Short-term and long-term debt (including interest)</td>
<td>9</td>
<td>2</td>
<td>23</td>
</tr>
<tr>
<td></td>
<td>202</td>
<td>26</td>
<td>53</td>
</tr>
</tbody>
</table>

25. COMMITMENTS AND CONTINGENCIES

Russian Business Environment

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government. In addition laws and regulations, including interpretations, enforcement and judicial processes, continue to evolve in Russia. Other laws and regulations and certain other restrictions producing a significant effect on the Company’s industry, including, but not limited to the following issues: rights to use subsurface resources, environmental matters, site restoration, transportation and export, corporate governance, taxation, etc.

Taxation

Legislation and regulations regarding taxation in Russia continue to evolve. The various legislation and regulations are not always clearly written and their inter-
Interpretation is subject to the opinions of the local, regional and national tax authorities. Instances of inconsistent opinions are not unusual.

The current regime of penalties and interest related to reported and discovered violations of Russia’s laws, decrees and related regulations is severe. Interest and penalties are levied when an understatement of a tax liability is discovered. As a result, the amounts of penalties and interest can be significant in relation to the amounts of unreported taxes.

In Russia tax declarations remain open and subject to inspection for a period of up to three years. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review during the three-year period.

Russian transfer pricing rules were introduced in 1999, giving Russian tax authorities the right to make transfer pricing adjustments and impose additional tax liabilities in respect of all “controlled” transactions, provided that the transaction price deviates from the market price by more than 20%. Controlled transactions include transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions with significant (by more than 20%) price fluctuations.

The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and courts. Due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge the Group’s prices and propose an adjustment. If such price adjustments are upheld by the Russian courts and implemented, the Group’s future financial results could be adversely affected. The Group’s management believes that such transfer pricing related tax contingencies are remote rather than possible and will not have any significant impact on the Company’s financial statements.

The Company and its certain subsidiaries are currently being audited by tax authorities for the years 2004-2006 (for the period up to September 30, 2006). The Company’s management believes that the outcome of these tax audits will not have any significant impact on the Company’s financial statements.

The Company provides finance for operations of its subsidiaries by various means which may lead to certain tax risks. The Company’s management believes that the related tax contingencies are remote rather than possible and will not have any significant impact on the Company’s financial statements.

The Company is currently appealing a number of decisions made by the tax authorities not to reimburse VAT paid by the Company. The Company’s related claims in the amount of RUB 324 million (US$ 12 million at the CBR exchange rate as of the balance sheet date) have been upheld by various courts. The remaining claims in the amount of RUB 1,420 million (US$ 54 million at the CBR exchange rate as of the balance sheet date) are still being heard in the courts.

Overall, management believes that the Company has paid or accrued all taxes that are applicable. Where uncertainty exists, the Company has accrued tax liabilities based on management’s best estimate of the probable outflow of resources embodying economic benefits, which will be required to settle these liabilities. Possible liabilities which were identified by management at the balance sheet date as those that can be subject to different interpretations of the tax laws and regulations are not accrued in the consolidated financial statements.

Capital Commitments

The Company and its subsidiaries are engaged in ongoing capital projects for exploration and development of production facilities and modernization of refineries and the distribution network. The budgets for these projects are generally set on an annual basis. Depending on the current market situation, actual expenditures may vary from the budgeted amounts.

It is planned that future costs will be primarily self-financed. In addition, the Company is seeking external sources of financing. Management believes that the Company will receive all the financing required to complete both existing and scheduled projects.
Environmental Matters

Due to the nature of its business, Rosneft and its subsidiaries are subject to federal legislation regulating environmental protection. The majority of environmental liabilities arise as a result of accidental oil spills and leaks that pollute land, and air pollution. The Company considers fines paid and other environmental liabilities as immaterial, given the scale of its operations.

In the course of its operations, the Company seeks to comply with international environmental standards and monitors compliance therewith on a regular basis. With a view to improve environmental activities, the Company takes specific measures to mitigate the adverse impact of its current operations on the environment.

Legislation that regulates environmental protection in the Russian Federation is evolving, and the Company evaluates its liabilities in accordance therewith. Currently it is not possible to reasonably estimate the liabilities of the Company which may be incurred should the legislation be amended.

The management believes that, based on the existing legislation, the Company is unlikely to have liabilities that need to be accrued in addition to the amounts already recognized in the consolidated financial statements and that may have a material adverse effect on the operating results or financial position of the Company.

Social Commitments

The Company is required to maintain certain social infrastructure assets (not owned by the Company and not recorded in the consolidated financial statements) for use by its employees.

The Company incurred US$ 64 million, US$ 66 million and US$ 81 million in social infrastructure and similar expenses in 2006, 2005 and 2004, respectively. These expenses are presented as other expenses in the consolidated statement of income.

Charity and Sponsorship

During 2006, 2005 and 2004, the Company made donations of US$ 41 million, US$ 25 million and US$ 44 million, respectively, for charity and sponsorship in various regions of Russia where the Company operates. These expenses are presented as other expenses in the consolidated statements of income.

Pension Benefits

The Company and its subsidiaries make payments to State Pension Fund of Russian Federation. These payments are calculated by the employer as percentage from the salary expense and are expensed as they are accrued.

The Company contributes to corporate pension fund to finance non-state pensions of its employees. These payments are done based on the defined contribution plan. In 2006, 2005 and 2004, the Company made contributions to non-state corporate pension fund amounting to US$ 41 million, US$ 16 million and US$ 13 million, respectively.

In 2006, the Company paid special termination benefits to the retiring employees in the amount of US$ 4.5 million.

Insurance

The Company insured its assets through the insurance company SK Neftepolsis LLC.

As of December 31, 2006 and 2005, the amount of coverage on assets for such insurance was US$ 2,209 million and US$ 1,420 million, respectively.

Russian insurance providers do not offer business interruption insurance. Currently, it is not a common practice in Russia to obtain such insurance.

Guarantees and Indemnity

As of December 31, 2006, the Company has provided guarantees for certain debt agreements primarily of its subsidiaries. In accordance with the debt agreements, the Company is obliged to perform on the guarantee and to pay the bank all amounts of outstanding guaranteed liabilities, including interest.

The Company cannot substitute guarantees issued by any novation agreement or mutual offset. The Company’s obligations under guarantees issued are valid in case of any change in loan agreements.

After the full payment and settlement of all obligations under the guarantees, the Company has the right to subrogate its respective part of all bank claims against the debtor in accordance with the loan agreements. In the event the Company makes payments under guarantees issued, it has a right to claim the amounts paid from the debtor.
In December 2006, the Company signed a guarantee agreement in respect of all the obligations of CJSC Vankorneft per an irrevocable uncovered documentary letter of credit for the amount of EUR 30 million (US$ 40 million at the CBR exchange rate as of December 31, 2006) for a period of up to 730 days. In the event of default, specified in the agreement, the bank may request the Company to place a deposit with the issuing bank in the amount and for the period of validity of such letter of credit.

The Company’s outstanding guarantees as of December 31, 2006 are as follows:

<table>
<thead>
<tr>
<th>Beneficiary Bank</th>
<th>Loan debtor</th>
<th>Maturity date</th>
<th>Contractual principal amount</th>
<th>Maximum guarantee amount as of December 31, 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Societe Generale S.A (as Facility Agent)</td>
<td>Yukos Oil Company</td>
<td>May 29, 2009</td>
<td>1,600</td>
<td>662</td>
</tr>
</tbody>
</table>

In May 2005, Moravel Investments Limited, an affiliate of Yukos Oil Company, filed an arbitral claim against OJSC Yuganskneftegaz in the London Court of International Arbitration for the recovery of US$ 662 million pertaining to the loan of US$ 1,600 million from Societe Generale S.A. The case was heard in July 2006. On April 16, 2007, the London Court of International Arbitration made an intermediate ruling to dismiss Moravel’s claim to OJSC Yuganskneftegaz. On April 26, 2007, Moravel informed the Company that in its view the intermediate ruling was a nullity and accused the Company of a repudiatory breach of the arbitration clause contained in the guarantee under which the London Court of International Arbitration was brought. Moravel reserved its rights to challenge the interim ruling. The Company expects to receive the final ruling in May, 2007. The Company believes that the probability of any payments under the above guarantee is remote. On March 17, 2006, the Moscow Arbitration Court ruled that the guarantee agreement signed by OJSC Yuganskneftegaz with respect to Yukos Oil Company loan received from Societe Generale S.A. in the amount of US$ 1,600 million was invalid. This ruling was upheld on May 15, 2006 by the 9th Appeal Arbitration Court in appeal hearings, which made it legally binding and enforceable. This ruling was also upheld in cassational instance on August 31, 2006.

**Litigation, Claims and Assessments**

In 2002, an option agreement was entered into between Total E&P Vankor (Total) and Anglo-Siberian Oil Company Limited (ASOC) under which Total had a conditional option to buy the latter’s 60% stake in Taimyrneft LLC which ASOC held through Anglo-Siberian. After the purchase of the 60% stake in Taimyrneft by Total in 2006 and the final decision was made in late 2006 in the Company’s favor. Apart from the court expenses, which are not significant for the Company, there are no additional liabilities related to this claim. No additional actions have been taken by any of the parties regarding this case.

Total obtained injunctions in various jurisdictions to prevent ASOC Cyprus from trading in the shares of Taimyrneft LLC. In 2005 Total E&P Vankor filed an arbitration claim, asking to exercise the option or cover the losses amounting to above US$ 700 million. In the early 2007 the court decision was made to collect US$ 116 million from ASOC Cyprus in favor of Total including interest at 6.5% p.a. from December 31, 2004 to the date of payment and to compensate Total for the related court expenses of US$ 2.8 million. The amounts to be paid are recognized in full in these financial statements.

The Company is a co-defendant in the litigation in the USA in respect of the acquisition of OJSC Yuganskneftegaz. This litigation was brought by certain holders of American Depositary Receipts ("ADRs") of Yukos Oil Company seeking unspecified damages due to the fall in market value of the ADRs. On July 13, 2006, plaintiffs filed an amended complaint. The amended complaint seeks to recover from alleged loss resulting from events surrounding Yukos Oil Company, including levying of taxes upon Yukos Oil Company by the Russian Federation, the arrest of certain assets of Yukos Oil Company to pay owed taxes. Defendants filed motions to dismiss on numerous grounds. The Company believes that this claim is without merit.
The Company is also a co-defendant in litigation in the Moscow Arbitration Court with respect to the auction for the common shares of OJSC Yuganskneftegaz. This litigation was brought by Yukos Oil Company. The claimant is seeking to recover all the common shares of OJSC Yuganskneftegaz and also damages in the total amount of RUB 388 billion (approximately US$ 14.7 billion at the CBR exchange rate as of December 31, 2006). In February 2007, the Moscow Arbitration Court dismissed Yukos Oil Company’s claim. Yukos Oil Company subsequently filed an appeal which is scheduled to be heard on May 7, 2006.

The Company’s subsidiaries are involved in other litigations which arise from time to time in the course of their business activities. The Company’s management believes that the ultimate result of these litigations will not significantly affect the operating results or financial position of the Company.

Licence Agreements

In accordance with certain licence agreements or separate agreements concluded from time to time with the local and regional authorities the Company is required to maintain certain levels of expenditures for health, safety and environmental protection, as well as maintain certain level of capital expenditures. Generally these expenditures are within the normal operating and capital budgets and are accounted for when incurred in accordance with existing accounting policies for respective costs and expenses.

Oil Supplies

In January 2005, the Company entered into a long-term contract until 2010 with China National United Oil Corporation for export supplies of crude oil in the total amount of 48.4 million tonnes to be delivered in equal annual amounts. The prices are determined based on usual commercial terms for crude oil deliveries.

26. SEGMENT INFORMATION

Presented below is information about the Company’s operating segments in accordance with SFAS 131, Disclosures about Segments of an Enterprise and Related Information. The Company determines its operating segments based on the nature of their operations. The performance of these operating segments is assessed by management on a regular basis. The exploration and production segment is engaged in field exploration and development and production of crude oil and natural gas. The refinery, marketing and distribution segment is engaged in processing crude oil and other hydrocarbons into petroleum products, as well as purchasing, sale and transportation of crude oil and petroleum products. The other activities segment consists of banking, finance services, drilling services, construction services and other activities. Substantially all of the Company’s operations are conducted in the Russian Federation. Further, the geographical regions within the Russian Federation have substantially similar economic and regulatory conditions. Therefore, the Company has not presented any separate geographical disclosure.

The significant accounting policies applied to each operating segment are consistent with those applied to the consolidated financial statements. Sales transactions for goods and services between the operating segments are carried out using prices agreed upon between Rosneft and its subsidiaries.

Operating segments in 2006:

<table>
<thead>
<tr>
<th></th>
<th>Exploration and production</th>
<th>Refining, marketing and distribution</th>
<th>Other activities</th>
<th>Total elimination</th>
<th>Consolidated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues from external customers</td>
<td>442</td>
<td>32,460</td>
<td>197</td>
<td>–</td>
<td>33,099</td>
</tr>
<tr>
<td>Interssegmental revenues</td>
<td>10,465</td>
<td>1,287</td>
<td>903</td>
<td>(12,655)</td>
<td>–</td>
</tr>
<tr>
<td>Total revenues</td>
<td>10,907</td>
<td>33,747</td>
<td>1,100</td>
<td>(12,655)</td>
<td>33,099</td>
</tr>
<tr>
<td>Operating expenses and cost of purchased oil and petroleum products</td>
<td>1,670</td>
<td>1,635</td>
<td>212</td>
<td>–</td>
<td>3,517</td>
</tr>
</tbody>
</table>
### Operating segments in 2005:

<table>
<thead>
<tr>
<th>Explorations and production</th>
<th>Refining, marketing and distribution</th>
<th>Other activities</th>
<th>Total elimination</th>
<th>Consolidated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation, depletion and amortization</td>
<td>1,420</td>
<td>201</td>
<td>17</td>
<td>–</td>
</tr>
<tr>
<td>Operating income</td>
<td>2,126</td>
<td>15,367</td>
<td>766</td>
<td>(12,655)</td>
</tr>
<tr>
<td>Total other income, net</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income before income tax</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>33,934</td>
<td>10,757</td>
<td>2,099</td>
<td>–</td>
</tr>
</tbody>
</table>

### Operating segments in 2004:

<table>
<thead>
<tr>
<th>Explorations and production</th>
<th>Refining, marketing and distribution</th>
<th>Other activities</th>
<th>Total elimination</th>
<th>Consolidated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues from external customers</td>
<td>378</td>
<td>23,151</td>
<td>334</td>
<td>–</td>
</tr>
<tr>
<td>Intersegmental revenues</td>
<td>9,534</td>
<td>797</td>
<td>297</td>
<td>(10,628)</td>
</tr>
<tr>
<td>Total revenues</td>
<td>9,912</td>
<td>23,948</td>
<td>631</td>
<td>(10,628)</td>
</tr>
<tr>
<td>Operating expenses and cost of purchased oil and petroleum products</td>
<td>1,333</td>
<td>863</td>
<td>64</td>
<td>–</td>
</tr>
<tr>
<td>Depreciation, depletion and amortization</td>
<td>1,320</td>
<td>143</td>
<td>9</td>
<td>–</td>
</tr>
<tr>
<td>Operating income</td>
<td>1,781</td>
<td>13,902</td>
<td>467</td>
<td>(10,628)</td>
</tr>
<tr>
<td>Total other income, net</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income before income tax</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>23,005</td>
<td>5,841</td>
<td>1,170</td>
<td>–</td>
</tr>
</tbody>
</table>
During the reporting periods, different three customers in 2006 and different single customers in 2005 and 2004, whom are international oil traders accounted for revenues of US$ 18,001 million, US$ 5,041 million and US$ 831 million or 54%, 21% and 16% of gross revenues, respectively. These revenues are recognized mainly under the Refining, Marketing and Distribution segment. Management does not believe that the Company is dependent on any particular customer.

Below is a breakdown of revenues by domestic and export sales, with a classification of export sales based on the country of incorporation of the foreign customer.

<table>
<thead>
<tr>
<th>Oil and gas sales</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export sales of crude oil – Europe</td>
<td>15,888</td>
<td>11,489</td>
<td>1,689</td>
</tr>
<tr>
<td>Export sales of crude oil – Asia</td>
<td>5,145</td>
<td>2,303</td>
<td>353</td>
</tr>
<tr>
<td>Export sales of crude oil – CIS</td>
<td>1,620</td>
<td>1,491</td>
<td>411</td>
</tr>
<tr>
<td>Export sales of crude oil – other directions</td>
<td>435</td>
<td>94</td>
<td>60</td>
</tr>
<tr>
<td>Domestic sales of crude oil</td>
<td>214</td>
<td>600</td>
<td>104</td>
</tr>
<tr>
<td>Domestic sales of gas</td>
<td>197</td>
<td>175</td>
<td>118</td>
</tr>
<tr>
<td>Total oil and gas sales</td>
<td>23,499</td>
<td>16,152</td>
<td>2,735</td>
</tr>
<tr>
<td>Petroleum products and processing fees</td>
<td>2006</td>
<td>2005</td>
<td>2004</td>
</tr>
<tr>
<td>Export sales of petroleum products – Europe</td>
<td>3,152</td>
<td>2,827</td>
<td>344</td>
</tr>
<tr>
<td>Export sales of petroleum products – Asia</td>
<td>1,941</td>
<td>1,618</td>
<td>640</td>
</tr>
<tr>
<td>Export sales of petroleum products – CIS</td>
<td>202</td>
<td>64</td>
<td>–</td>
</tr>
<tr>
<td>Domestic sales of petroleum products and processing fees</td>
<td>3,955</td>
<td>2,865</td>
<td>1,249</td>
</tr>
<tr>
<td>Total petroleum products and processing fees</td>
<td>9,250</td>
<td>7,374</td>
<td>2,233</td>
</tr>
</tbody>
</table>
27. FAIR VALUE OF FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks. The Company manages these risks and monitors its exposure on a regular basis.

The fair value of cash and cash equivalents, accounts receivable and accounts payable, other current assets, asset retirement obligations, promissory notes receivable approximates their carrying value recognized in these financial statements. The Company’s management believes that accounts receivable recorded net of allowance for doubtful accounts will be recovered in full during an acceptable time period. The fair value of long-term debt differs from amounts recognized in the consolidated financial statements. The estimated fair value of long-term debt discounted using the estimated market interest rate for similar financial liabilities amounted to US$ 9,710 million, US$ 10,026 million and US$ 10,012 million as of December 31, 2006, 2005 and 2004, respectively. These amounts include all future cash outflows related to the repayment of long-term loans, including their current portion and interest expenses.

A substantial portion of the Company’s sales revenues is received in US dollars. In addition, substantial financing and investing activities, obligations and commitments are also undertaken in US dollars. However, significant operating and investing expenditures, other obligations and commitments as well as tax liabilities are undertaken in rubles. As a result of any decline of the US dollar against the ruble, the Company is exposed to the corresponding currency risk. Starting from January 2007, the Company entered into agreements for forward sale of currency denominated revenue at fixed exchange rate in order to hedge currency risk.

28. SUBSEQUENT EVENTS

In January 2007, the Company paid RUB 629 million (US$ 24 million at the CBR exchange rate as of the transaction date) to acquire 55,331,951 ordinary shares of OJSC Ohinskaya TETS, which represents 85.61% of its equity. This acquisition is not material.

In January 2007, the Company bought 339,582 ordinary shares of additional share issue of OJSC Verhnechonskneftegaz paying RUB 201 million (US$ 7.6 million at the CBR exchange rate as of the transaction date). Through this purchase the Company maintained its previous share of 25.94% in this investment.

In January 2007, the Company entered into a long-term contract until 2009 with a Russian producer of steel pipes for the supply of various types of pipes used in the oil and gas industry. The purchase price of the products will be fixed twice a year and depends on the product mix.

In January 2007, the Company signed a guarantee agreement in respect of all the obligations of Vankorneft per the irrevocable uncovered documentary letter of credit for the amount of US$ 62 million and the period of up to 730 days. In the event of default, as specified in the agreement, the bank may request the Company to place a deposit in the amount necessary to ensure all of the Company’s existing and potential obligations are payable for the period of validity of such letter of credit.

In February 2007, the Company signed and drew down a six month bridge-loan from a consortium of international banks in the amount of US$ 2.5 billion at LIBOR plus 0.25-0.30% p.a, depending on the final settlement date. These funds are to be used for temporary refinancing (until other long-term loans are received) of short term loans obtained from the Russian banks in the fourth quarter of 2006, with less favorable terms.

In March 2007, two companies of the Group signed loan agreements with a consortium of international banks which assume the following terms: part of loan for the amount of US$ 9.5 billion is for 6 months, US$ 6 billion is for 12 months and US$ 6.5 billion is for 18 months. These loan agreements are at LIBOR plus 0.25-0.50% annual interest rate depending on the final settlement date. These loans were drawn to finance the planned acquisition of assets during the auctions for sales of the assets of Yukos Oil Company. The total amount drawn down up to May 3, 2007 was US$ 11,555 million.

In March 2007, RN-Razvitie LLC, the Company’s wholly owned subsidiary, won the auction for the acquisition of 1 billion ordinary shares of Rosneft (9.44% of share
capital) and promissory notes of OJSC Yuganskneftegaz from Yukos Oil Company. RN-Razvitie LLC offered RUB 197.84 billion (US$ 7.59 billion at the CBR exchange rate as of the date of the auction), or RUB 194.28 for 1 share (US$ 7.45 at the CBR exchange rate as of the date of the auction). The face value of the promissory notes amounted to RUB 3,558 million (US$ 136 million at the CBR exchange rate as of the date of the auction), for which RUB 3,601 million was paid (US$ 138 million at the CBR exchange rate as of the date of the auction). Title to the shares and promissory notes was transferred to RN-Razvitie LLC on April 17, 2007.

Rosneft and Sinopec have signed a Shareholder and Operating Agreement related to their joint work in exploring and developing the Veninsky block of fields on the shelf of Sakhalin Island (Sakhalin-3 project). According to the document, which was signed on March 26, 2007 in Moscow, the wholly owned subsidiaries of Rosneft and Sinopec – Rosneft International Limited and Sinopec Overseas Oil and Gas Limited – will become the owners of Venin Holding Ltd., which was established in October 2006. Venin Holding Ltd. will in turn be the sole shareholder of Venineft LLC, the licence holder and operator of the Sakhalin-3 project. Rosneft will have a 74.9% stake in the project, with the remaining 25.1% owned by Sinopec. The Company considers Venin Holding Ltd. to be a joint venture under the joint control of Rosneft and Sinopec and will account for this investment using the equity method of accounting.

On April 3, 2007, the Company acquired 100% interest in CJSC Yukos-Mamontovo for no consideration. Transfer of rights of ownership was made by the Moscow Arbitration Court. CJSC Yukos-Mamontovo is an owner of wells and related facilities leased by RN-Yuganskneftegaz (see Note 10). This acquisition is not expected to have a significant impact on the Company’s financial statements.

On May 3, 2007, Neft-Aktiv LLC, the Company’s wholly owned subsidiary, won the auction for the sale of certain assets of Yukos Oil Company. These assets comprise shares in various exploration and production and refining and marketing companies in Eastern Siberia. Neft-Aktiv LLC offered RUB 175.7 billion (US$ 6.82 billion at the CBR exchange rate as of the date of the auction).

Supplementary Oil and Gas Disclosure (unaudited)

In accordance with SFAS 69, Disclosures about Oil and Gas Producing Activities, the Company makes certain supplemental disclosures about its oil and gas exploration and production operations. While this information was developed with reasonable care and disclosed in good faith, it is emphasized that the data represents management’s best estimates. Accordingly, this information may not necessarily represent the current financial condition of the Company and its expected future financial results.

All of the Company’s activities are conducted in Russia, which is considered as one geographic area.

Capitalized Costs Relating to Oil and Gas Producing Activities

<table>
<thead>
<tr>
<th></th>
<th>As of December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
</tr>
<tr>
<td>Oil and gas properties related to proved reserves</td>
<td>34,259</td>
</tr>
<tr>
<td>Oil and gas properties related to unproved reserves</td>
<td>3,878</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>38,137</td>
</tr>
<tr>
<td>Accumulated depreciation, depletion and amortization, and valuation allowances</td>
<td>(5,178)</td>
</tr>
<tr>
<td><strong>Net capitalized costs</strong></td>
<td>32,959</td>
</tr>
</tbody>
</table>

The share of the Company in the capitalized costs of equity investees on December 31, 2006 was US$ 388 million. On December 31, 2005, the share of the Company was immaterial.

Cost Incurred in Oil and Gas Property Acquisition, Exploration and Development Activities

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition of proved oil and gas properties</td>
<td>8,392</td>
<td>3,475</td>
<td>11,877</td>
</tr>
<tr>
<td>Acquisition of unproved oil and gas properties</td>
<td>2,350</td>
<td>487</td>
<td>775</td>
</tr>
<tr>
<td>Exploration costs</td>
<td>193</td>
<td>164</td>
<td>51</td>
</tr>
</tbody>
</table>
The share of the Company in acquisition, exploration and development expenditures of its equity investees was US$ 46 million in 2006, and was immaterial during 2005 and 2004.

Results of Operations for Oil & Gas Producing Activities

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development costs</td>
<td>2,795</td>
<td>1,606</td>
<td>568</td>
</tr>
<tr>
<td><strong>Total costs incurred</strong></td>
<td><strong>13,730</strong></td>
<td><strong>5,732</strong></td>
<td><strong>13,271</strong></td>
</tr>
</tbody>
</table>

The Company’s share in the results of operations for oil and gas production of equity investees in 2006, 2005 and 2004 was US$ 59 million, US$ 35 million and US$ 41 million, respectively.

Reserve Quantity Information

For the purposes of evaluation of reserves as of December 31, 2006, 2005 and 2004 the Company used the oil and gas reserve information prepared by DeGolyer and MacNaughton, independent reservoir engineers, prepared in accordance with United States Securities and Exchange Commission definitions. Proved reserves are those estimated quantities of crude oil and gas which, by analysis of geological and engineering data, demonstrate with reasonable certainty to be recoverable in the future from existing reservoirs under the existing economic and operating conditions. In certain cases, recovery of such reserves may require considerable investments in wells and related equipment. Proved reserves also include additional oil and gas reserves that will be extracted after the expiry date of licence agreements or may be discovered as a result of secondary and tertiary extraction which have been successfully tested and checked for commercial benefit. Proved developed reserves are the quantities of crude oil and gas expected to be recovered from existing wells using existing equipment and operating methods.

Proved undeveloped oil and gas reserves are reserves that are expected to be recovered from new wells on undeveloped acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undeveloped acreage are limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undeveloped units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Under no circumstances are estimates of proved undeveloped reserves attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless those techniques have been proved effective by actual tests in the area and in the same reservoir.

Due to inherent industry uncertainties and the limited nature of deposit data, estimates of reserves are subject to change as additional information becomes available.

The Company included in proved reserves those reserves which the Company intends to extract after the
expiry of the current licences. The licences for the development and production of hydrocarbons currently held by the Company generally expire between 2009 and 2031, and the licences for the most important deposits expire between 2013 and 2019. In accordance with the effective version of the law of the Russian Federation, On Subsurface Resources (the "Law"), licences are currently granted for a production period determined on the basis of technological and economic criteria applied to the development of a mineral deposit which guarantee rational use of subsurface resources and necessary environmental protection. In accordance with the Law and upon gradual expiration of old licences issued under the previous version of the Law, the Company extends its hydrocarbon production licences for the whole productive life of the fields. Extension of the licences depends on both current and future compliance with the terms set forth in the licence agreements. As of the date of these financial statements, the Company is generally in compliance with all the terms of the licence agreements and intends to continue complying with such terms in the future (see Note 10).

The Company’s estimates of net proved oil and gas reserves and changes thereto for the years ended December 31, 2006, 2005 and 2004 are shown in the table below and expressed in million barrels of oil equivalent (oil production data was recalculated from tonnes to barrels using a ratio of 7.3 barrels per tonne, gas production data was recalculated from cubic meters to barrels of oil equivalent using a ratio of 35.3/6 cubic meters per barrel):

The Company’s share in the proved reserves of equity investees in 2006, 2005 and 2004 was 330 million barrels of oil equivalent, 46 million barrels of oil equivalent and 37 million barrels of oil equivalent, respectively.

The Company’s share in the proved developed reserves of equity investees in 2006, 2005 and 2004 was 281 million barrels of oil equivalent, 45 million barrels of oil equivalent and 22 million barrels of oil equivalent, respectively.

The minority interest in proved developed and total proved reserves in 2005 and 2004 mainly relates to OJSC Yuganskneftegaz. The increase in acquisition of new properties in 2004 primarily relates to proved reserves of OJSC Yuganskneftegaz.

### Standardized Measure of Discounted Future Net Cash Flows and Changes therein Relating to Proved Oil and Gas Reserves

The standardized measure of discounted future net cash flows related to the above oil and gas reserves is calculated in accordance with the requirements of SFAS 69. Estimated future cash inflows from oil and gas production are computed by applying year-end prices for oil and gas to year-end quantities of estimated net proved reserves. Adjustment in this calculation for future price changes is limited to those

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>mln. boe.</td>
<td>mln. boe.</td>
<td>mln. boe.</td>
</tr>
<tr>
<td><strong>Beginning of year reserves</strong></td>
<td>11,813</td>
<td>12,744</td>
<td>3,346</td>
</tr>
<tr>
<td><strong>Revisions of previous estimates</strong></td>
<td>1,142</td>
<td>(373)</td>
<td>330</td>
</tr>
<tr>
<td><strong>Increase and discovery of new reserves</strong></td>
<td>297</td>
<td>63</td>
<td>–</td>
</tr>
<tr>
<td><strong>Acquisitions of new properties</strong></td>
<td>74</td>
<td>–</td>
<td>9,216</td>
</tr>
<tr>
<td><strong>Production</strong></td>
<td>(655)</td>
<td>(621)</td>
<td>(148)</td>
</tr>
<tr>
<td><strong>End of year reserves</strong></td>
<td>12,671</td>
<td>11,813</td>
<td>12,744</td>
</tr>
<tr>
<td><strong>Of which:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proved reserves under PSA Sakhalin 1</td>
<td>71</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Proved developed reserves</td>
<td>9,891</td>
<td>8,507</td>
<td>8,355</td>
</tr>
<tr>
<td>Minority interest in total proved reserves</td>
<td>15</td>
<td>2,393</td>
<td>2,728</td>
</tr>
<tr>
<td>Minority interest in proved developed reserves</td>
<td>15</td>
<td>1,732</td>
<td>1,847</td>
</tr>
</tbody>
</table>
required by contractual arrangements in existence at the end of each reporting period. Future development and production costs are those estimated future expenditures necessary to develop and produce estimated proved reserves as of year-end based on year-end cost indices and assuming continuation of year end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future net pre-tax cash flows, net of the tax bases of related assets.

Discounted future net cash flows are calculated using a 10% discount factor. Discounting requires a year-by-year estimates of future expenditures to be incurred in the periods when the reserves will be extracted.

Discounted future net cash flows are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future net pre-tax cash flows, net of the tax bases of related assets.

Discounted future net cash flows are calculated using a 10% discount factor. Discounting requires a year-by-year estimates of future expenditures to be incurred in the periods when the reserves will be extracted.

The information provided in the tables below does not represent management’s estimates of the Company’s expected future cash flows or of the value of its proved oil and gas reserves. Estimates of proved reserves change over time as new information becomes available. Moreover, probable and possible reserves which may become proved in the future are excluded from the calculations. The arbitrary valuation prescribed under SFAS 69 requires assumptions as to the timing and the amount of future development and production costs. The calculations should not be relied upon as an indication of the Company’s future cash flows or of the value of its oil and gas reserves.

The Company’s share in the discounted value of future cash flows related to the oil and gas reserves of equity in-vestees in 2006, 2005 and 2004 was US$ 1,086 million, US$ 549 million and US$ 147 million, respectively.

Discounted value of future cash flows as of December 31, 2006, 2005 and 2004 includes the interest of other (minority) shareholders in the amount of US$ 25 million, US$ 10,574 million and US$ 6,431 million, respectively.

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discounted value of future cash flows as of the beginning of year</td>
<td>51,157</td>
<td>29,176</td>
<td>7,068</td>
</tr>
<tr>
<td>Sales and transfers of oil and gas produced, net of production costs and taxes other than income taxes</td>
<td>(7,714)</td>
<td>(7,432)</td>
<td>(1,566)</td>
</tr>
<tr>
<td>Changes in price estimates, net</td>
<td>(22,018)</td>
<td>26,798</td>
<td>3,808</td>
</tr>
<tr>
<td>Changes in future development costs</td>
<td>(4,084)</td>
<td>3,471</td>
<td>(2,751)</td>
</tr>
<tr>
<td>Development costs incurred during the period</td>
<td>2,795</td>
<td>1,752</td>
<td>568</td>
</tr>
<tr>
<td>Revisions of previous reserves estimates</td>
<td>4,034</td>
<td>1,097</td>
<td>415</td>
</tr>
<tr>
<td>Discovery of new reserves, less respective expenses</td>
<td>1,177</td>
<td>115</td>
<td>–</td>
</tr>
<tr>
<td>Net change in income taxes</td>
<td>3,580</td>
<td>(5,743)</td>
<td>(454)</td>
</tr>
<tr>
<td>Accretion of discount</td>
<td>5,116</td>
<td>2,918</td>
<td>707</td>
</tr>
<tr>
<td>Purchase of new oil and gas fields</td>
<td>1,464</td>
<td>–</td>
<td>22,143</td>
</tr>
<tr>
<td>Other</td>
<td>6,063</td>
<td>(995)</td>
<td>(762)</td>
</tr>
<tr>
<td><strong>Discounted value of future cash flows as of the end of year</strong></td>
<td><strong>41,570</strong></td>
<td><strong>51,157</strong></td>
<td><strong>29,176</strong></td>
</tr>
</tbody>
</table>
MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

The following discussion of Rosneft’s financial condition and results of operations are based on, and should be read in conjunction with, the Company’s financial statements and the notes thereto for the periods ended 31 December 2004, 2005 and 2006 (the “Financial Statements”). Such terms as “Rosneft”, “Company”, “Group” and “we” in its different forms in this report mean OJSC Rosneft and its consolidated subsidiaries and affiliated companies. This report presents Rosneft’s financial condition and results of operations on a consolidated basis. This report contains forward looking statements that involve risks and uncertainties. Rosneft’s actual results may differ materially from those discussed in such forward looking statements as a result of various factors.
OVERVIEW

Rosneft is a vertically integrated oil and gas company with upstream and downstream operations located principally in Russia. Rosneft believes it is one of the world’s largest publicly traded oil companies in terms of proved crude oil reserves and among the top ten in terms of crude oil production. According to DeGolyer and MacNaughton (“D&M”), Rosneft’s independent reservoir engineers, as of 31 December 2006, under SPE classification, Rosneft had proved reserves of 20.09 billion boe, including proved crude oil reserves of approximately 15.96 billion barrels (2.20 billion tonnes) and proved gas reserves of approximately 701.07 bcm. Also according to D&M, as of 31 December 2006, Rosneft had proved and probable crude oil reserves of approximately 24.72 billion barrels (3.40 billion tonnes) and proved and probable gas reserves of approximately 1,133.86 bcm.

Rosneft’s reserves are located in Western Siberia, Timano Pechora, the Russian Far East, Southern Russia and Eastern Siberia. Rosneft also has significant prospective crude oil resources in Western Siberia, the Russian Far East, which includes Sakhalin Island and the Kamchatka Peninsula, Southern Russia and Eastern Siberia. Rosneft has recently agreed to purchase additional reserves as a result of the auction for the sale of certain exploration and production assets of OJSC Yukos (“Yukos”) won by the Group in May 2007. See “—Significant Acquisitions—2007—Acquisition of Assets in Yukos Auctions—Eastern Siberia Assets”.

In 2006, Rosneft and its fully consolidated subsidiaries and proportionately consolidated joint venture produced 1,578.94 thousand barrels of crude oil per day (78.8 million tonnes in the year). Rosneft sold approximately 70% of this crude oil to customers outside Russia, comprising both sales to CIS countries and exports to international markets other than the CIS. Most of the remainder was refined at Rosneft’s two main refineries and at third party refineries in Russia and then sold in the form of petroleum products in international and domestic markets. Rosneft has recently agreed to purchase certain third party refineries as a result of the auction for the sale of certain refining assets of Yukos won by the Group in May 2007. In addition, Rosneft is planning to make a bid in the auction for the sale of certain refining assets of Yukos in the Samara region. See “—Significant Acquisitions—2007—Acquisition of Assets in Yukos Auctions—Eastern Siberia Assets”. Rosneft has an integrated production, transportation, refining and marketing strategy and seeks to maximise netbacks by optimising its product mix and available transport routes.


Rosneft’s total revenues have grown both organically (in part due to increases in hydrocarbon prices) and by acquisition. The most significant acquisition during the periods under review was the December 2004 purchase of Baikalfinancegroup, which had won an auction for the sale of 76.79% of the shares (100% of the common shares) of OJSC Yuganskneftegaz (“Yuganskneftegaz”), the second largest oil production enterprise in Russia at that time. As of 31 December 2006, Yuganskneftegaz accounted for approximately 71.2% of Rosneft’s proved crude oil reserves.

In 2006, Rosneft and its fully consolidated subsidiaries produced 1,578.94 thousand barrels of crude oil per day (78.8 million tonnes in the year). Rosneft sold approximately 70% of this crude oil to customers outside Russia, comprising both sales to CIS countries and exports to international markets other than the CIS. Most of the remainder was refined at Rosneft’s two main refineries and at third party refineries in Russia. Rosneft has recently agreed to purchase certain third party refineries as a result of the auction for the sale of certain refining assets of Yukos won by the Group in May 2007. See “—Significant Acquisitions—2007— Acquisition of Assets in Yukos Auctions—Eastern Siberia Assets”.

Business Segments

The Company operates primarily in the Russian Federation. As geographical regions of the Russian Federation have similar economic and legal characteristics, the Company does not present geographic segments separately. The Company also carries out projects outside Russia, including projects in Kazakhstan, Turkmenistan and Algeria. These projects are at early stages and have had little to no impact to date on the financial condition or results of operations of the Company.

Business Segments

The activities of Rosneft are divided into two main business segments:

1. Exploration and production (“upstream”). Geological exploration and development of fields, and crude oil and gas production; and

2. Refining, marketing and distribution (“downstream”). Refining of crude oil, as well as the purchase, transportation, sale and transshipment of crude oil and petroleum products.
Rosneft does not separate its distribution and transportation divisions into a “midstream” segment. These activities are reflected in the “downstream” segment. Other types of activities are incorporated in the “other activities” segment and include banking and financial services and drilling and construction services provided to third parties.

Intersegment Sales and Segment Presentation

Rosneft’s two main business segments are interconnected: the majority of the revenues of one main segment is included in the expenses of the other main segment. In particular, the holding company, OJSC OC Rosneft, buys crude oil from its producing subsidiaries, part of which it sells in and outside Russia and the remainder of which it delivers to its proprietary or third party refineries in Russia for processing. Petroleum products are then either sold by the holding company through wholesale sales in the international or domestic markets or sold to the Company’s marketing subsidiaries for subsequent wholesale and retail sale in Russia. Following the Share Swap discussed below, OJSC OC Rosneft became the producer and owner of the crude oil previously produced by the subsidiaries that were merged into it.

It is difficult to determine market prices for crude oil in the Russian domestic market, mainly due to the significant intragroup turnover within the vertically integrated oil companies that dominate the market. Moreover, to the extent they exist, crude oil market prices in Russia can be significantly lower than they might otherwise be due to seasonal oversupply and regional imbalances. Prior to the Share Swap in 2006, transaction prices for crude oil between Rosneft companies were established taking into consideration market prices and transportation costs, but were also affected to a considerable degree by the capital investment requirements of different enterprises within the upstream segment. Accordingly, an analysis of individual segments in isolation from the analysis of other activities may present a distorted view of Rosneft’s financial and operating performance. For this reason, the Company’s management does not analyse each main business segment in isolation. The Company does, however, provide financial data by segment in Note 26 to the Financial Statements.

On 1 October 2006, twelve subsidiaries, Yuganskneftegaz, OJSC Purneftegaz, OJSC Selkupneftegaz, OJSC Severnaya Neft, OJSC Krasnodarneftegaz, OJSC Severnaya Neft, OJSC Sakhalinmorneftegaz, OJSC Komsomolskiy Refinery, OJSC Arkhangelsknefteprodukt, OJSC Nakhodka, Komsomolskiy Refinery, OJSC Nakhodkanefteprodukt and OJSC Tuapsenepetrolef, which were merged into the Company by means of a share swap (the “Share Swap”), following the merger, the Company became the legal successor to the rights and obligations of the Merged Subsidiaries to the extent provided by Russian law. The Company leases the assets previously owned by the Merged Subsidiaries to wholly owned subsidiaries of the Company, which are limited liability operating and servicing companies each corresponding to a Merged Subsidiary and which operate these assets under service agreements. Revenues and costs from operations of the seven Merged Subsidiaries previously engaged in exploration and production were and continue to be accounted for under the upstream segment and revenues and costs from operations of the five Merged Subsidiaries previously involved in refining and marketing were and continue to be accounted for under the upstream segment.

Significant Acquisitions

2007

Acquisition of Assets in Yukos Auctions

Treasury stock

On March 27, 2007 RN-Razvitie LLC, a wholly owned subsidiary of the Company, won the tender for the acquisition of 9.44% of the share capital of Rosneft and promissory notes of Yuganskneftegaz having a face value of RUB 3.558 billion (USD 136 million at the Central Bank of Russia (“CBR”) exchange rate in effect as at the date of the auction), from Yukos for a total consideration of RUB 197.84 billion (USD 7.59 billion at the CBR exchange rate in effect as at the date of the auction), or RUB 194.28 for 1 share (USD 7.45 at the CBR exchange rate in effect as at the date of the auction).

Eastern Siberia Assets

On 3 May 2007, Neft-Aktiv LLC, a wholly owned subsidiary of the Company, won the auction for the sale of certain assets of Yukos. These assets comprise shares in various exploration and production and refining and marketing companies in Eastern Siberia. Neft-Aktiv LLC purchased these assets for a total consideration of RUB 175.70 billion (USD 6.82 billion at the CBR exchange rate in effect as at the date of the auction).
Rosneft is planning to make a bid in the auction that is expected to take place on 10 May 2007 for the sale of certain refining assets of Yukos in the Samara region.

Financing of the Acquisitions

In March 2007, the Company and its wholly owned subsidiary RN-Razvitie LLC entered into loan agreements with a syndicate of international banks. The agreements provide for a USD 9.5 billion loan that has a 6 months term, a USD 6 billion loan that has a 12 months term and a USD 6.5 billion loan that has a 18 months term. These loan agreements bear interest at London inter-bank offered rate (“LIBOR”) plus 0.25-0.50% per annum, depending on the final repayment date. These loans were drawn to finance the acquisition of certain Yukos’ assets in the course of auctions for sales of these assets. The total amount drawn down under these loans through May 3, 2007 was USD 11,555 million.

Truboprovodny Consortium Burgas-Alexandroupolis LLC

In January 2007, the Company participated in the creation of a joint venture, LLC Truboprovodny Consortium Burgas-Alexandroupolis, with equal equity contributions from the Company, OJSC AK Transneft (“Transneft”) and OJSC Gazprom (“Gazprom”). This joint venture was registered with a share capital of RUB 9 million (USD 0.4 million at the CBR exchange rate in effect as at the registration date). The joint venture is expected to design, construct and operate oil terminals in Burgas (Bulgaria) and Alexandroupolis (Greece), which will be connected by a long-distance pipeline crossing the Black Sea and the territories of Greece and Bulgaria. Rosneft has no funding commitments in connection with this joint venture.

OJSC Ohinskaya TETS

In January 2007, the Company purchased 85.61% of the ordinary shares of OJSC Ohinskaya TETS for RUB 629 million (USD 24 million at the CBR exchange rate in effect as at the transaction date). OJSC Ohinskaya TETS is a combined heat and power station mainly servicing the production activities of RN-Sakhalinmorneftegaz LLC, one of the Company’s exploration and production wholly owned operating and service companies.

OJSC Verhnechonskneftegaz

In January 2007, the Company purchased 339,582 newly issued ordinary shares of OJSC Verhnechonskneftegaz, an exploration and production company, for a total consideration of RUB 201 million (USD 8 million at the CBR exchange rate in effect as at the transaction date). As a result, the Company maintained its 25.94% share in this company. The other shareholders of OJSC Verhnechonskneftegaz are TNK-BP with a more than 60% share and Vostochno-Sibirskaya Gazovaya Kompaniya with a more than 10% share.

2006

Exponeft LLC

In December 2006, the Company purchased 100% of LLC Exponeft for total consideration of RUB 335 million (USD 13 million at the CBR exchange rate in effect as at the transaction date). LLC Exponeft owns a network of filling stations in the Murmansk region.

OJSC Nakhodka Oil Seatrade Port

In June 2006, the Company purchased 97.51% of the shares of Nakhodka Oil Seatrade Port (“Nefteport”) for RUB 528 million (USD 20 million at the CBR exchange rate in effect as at the settlement date). The acquisition created USD 10 million in goodwill, which is attributed to synergies expected to result from the integration of Nefteport with the operations of Rosneft’s subsidiary LLC Nakhodkanefteprodukt.

Nefteport is one of the largest commercial trade seaport on Russia’s Pacific coast located in Novitskiy Bay on the west side of the Nakhodka Gulf. Nefteport has now been integrated into Rosneft’s technological and infrastructural chain for the storage and transshipment of oil products, enabling Rosneft to establish a single self-contained industrial complex in the Nakhodka Gulf, which the Company believes is one of the largest of its kind in Russia.

OJSC Udmurtneft

On 28 April 2006, Rosneft and China Petrochemical Corporation (“Sinopec”) entered into an option agreement granting to Rosneft an option to purchase a controlling interest in OJSC Udmurtneft (“Udmurtneft”) if Sinopec were to win the tender for purchasing 96.86% of Udmurtneft’s shares from OJSC TNK-BP (“TNK-BP”). In June 2006, TNK-BP announced its decision to sell 96.86% shares of Udmurtneft to Sinopec. Sinopec completed the purchase of Udmurtneft on 10 August 2006. In November 2006, Rosneft and Sinopec created a joint venture, Taihu Limited
(“Taihu”), of which Rosneft owns 51% through its wholly-owned subsidiary, Rosneft International Ltd, and Sinopec owns 49% through its wholly-owned subsidiary, Sinopec Overseas Oil and Gas Ltd. Taihu purchased 96.86% of Udmurtneft’s shares via a wholly-owned subsidiary in December 2006 from Sinopec. Pursuant to a shareholder agreement entered into between Rosneft and Sinopec in respect of Taihu, key decisions regarding its business shall be subject to unanimous approval by both participants and none of the participants has a preferential voting right. As a result, the Company accounted for this investment using the equity method from December 2006. On 13 November 2006 Bank of China provided a credit facility to Taihu in the amount of USD 3.6 billion for financing the purchase of the 96.86% stake in Udmurtneft and the additional 3.14% shares from minority shareholders. The cash flows of Udmurtneft will be used directly, to repay this financing, without the recourse to the shareholders’ assets.

Udmurtneft is located in the Volga-Ural region. As of 31 December 2006, under SPE classification, it had proved crude oil reserves of 323.92 million barrels (45.87 million tonnes). Udmurtneft has 24 producing fields and, in 2006, it produced 119.65 thousand barrels of crude oil per day.

Change in accounting for Sakhalin-1 PSA

In February 2001, the Company entered into a sales and purchase agreement with Oil and Natural Gas Corporation (“ONGC”) in relation to the Company’s interest in the Sakhalin-1 production sharing agreement (“PSA”), which reduced the Company’s interest in the project to 20%. The Company recorded the investment in its retained share under the “carried interest” method. Commercial hydrocarbon production under Sakhalin-1 PSA commenced in October 2005. Accordingly, the Company’s share in Sakhalin-1 hydrocarbon reserves was reclassified as proved developed reserves.

On 31 July 2006, the Company repaid USD 1,339 million (including accumulated interest) to ONGC with respect to the Company’s costs carried by ONGC in previous years. Following this repayment the Company recovered the right to receive its pro rata income in the Sakhalin-1 project and commenced accounting for this investment using the proportionate consolidation method. Of the total amount repaid, USD 1,328 million was recorded as an addition to oil and gas property as of 31 December 2006 and effectively treated as capital expenditures.

2005

OJSC Verkhnechonskneftegaz

In the fourth quarter of 2005, the Company purchased 25.94% of the ordinary shares of OJSC Verkhnechonskneftegaz, which holds the licence for the development of the Verkhnechonskoye oil and gas field, which is the largest field in the Irkutsk region. The purchase price was RUB 6,637 million (USD 230 million at the CBR exchange rate in effect as at the transaction date). The Company’s interest in OJSC Verkhnechonskneftegaz is accounted for using the equity method.

2004

Yuganskneftegaz

On 22 December 2004, Rosneft purchased for nominal consideration a 100% interest in Baikalfinancegroup LLC (“Baikalfinancegroup”), which had won an auction for the sale of 76.79% of the shares (100% of the common shares) of Yuganskneftegaz at a price of RUB 260,782 million (USD 9,398 million at the CBR exchange rate in effect as at the settlement date). The auction was conducted on 19 December 2004 by the Russian bailiff service to enforce tax liens against Yukos, which had previously controlled Yuganskneftegaz.

Following Rosneft’s acquisition of Baikalfinancegroup, Rosneft made loans to Baikalfinancegroup to enable it to repay the principal of and interest on the debt it had incurred to finance its deposit for the auction, and to purchase and pay for the shares of Yuganskneftegaz it had won in the auction. Baikalfinancegroup purchased and paid for these shares on 31 December 2004.

The sources of the funds Rosneft loaned to Baikalfinancegroup and also used to meet Yuganskneftegaz’ immediate working capital requirements included:

- Borrowings characterised as long-term loans in the aggregate amount of USD 6,465 million;
- Short-term borrowings in the aggregate amount of USD 1,442 million; and
- Funds, in the aggregate amount of approximately USD 1,746 million, accumulated from the sale of Rosneft’s interests in the Prirazlomnoye and Shtokmanovskoye projects, including USD 1,344 million from the sale of Rosneft’s 50% interest in CJSC Svevmorneftegaz described in more detail below under “—Results of Opera-
tions—Other Income/(Expenses)—Gain on disposal of share in CJSC Sevmorneftegaz.”

The borrowings characterised as long-term loans included USD 6,000 million obtained from Vnesheconombank, initially through the issue of promissory notes by the Company and its subsidiaries in December 2004. The financing was intended to be, and was, put on a long-term basis in January 2005, when OJSC Vnesheconombank (“Vnesheconombank”) raised funds from two Chinese banks, China Development Bank and the Export Import Bank of China, and loaned these funds to Rosneft, which used them to repay the promissory notes. The loan from Vnesheconombank is repayable in monthly installments, with the final installment being due in 2011. It initially carried interest at a rate of LIBOR plus 3% per annum, but in the first quarter of 2006 the interest rate was reduced to LIBOR plus 0.7% per annum. Rosneft secured this arrangement by entering into, and pledging its receivables under, a long-term contract for the supply of crude oil to China National United Petroleum Corporation (“United”) in a total amount of 48.4 million tonnes to be delivered from 2005 through 2010 (4 million tonnes in 2005 and 8.88 million tonnes in each of the five years thereafter) at prices determined on the basis of a formula that takes into account standard international crude oil price indicators and adjusts for quality and other factors. Payments by United under the contract are guaranteed by United’s parent company, China National Petroleum Corporation (“CNPC”), and China Development Bank and Export Import Bank of China. The remaining USD 465 million of borrowings characterised as long-term loans came from Sberbank.

The short-term borrowings, obtained mainly from Sberbank and Vnesheconombank, were repaid, or refinanced in 2005 with other loans, including a portion of a 5-year loan raised in July 2005 from a syndicate of foreign banks in the amount of USD 2,000 million and carrying interest at a rate of LIBOR plus 1.8% per annum. This loan is repayable in monthly installments and is secured by contracts for the export of crude oil. The interest rate on this loan was reduced to LIBOR plus 0.65% in April 2006.

The acquisition of Yuganskneftegaz contributed significantly to Rosneft’s reserves, production and results of operations. However, it also increased Rosneft’s indebtedness considerably and resulted in significant contingencies. These included contingencies relating to, among other things: challenges to the acquisition itself; tax claims against or related to Yuganskneftegaz; guarantee claims against Yuganskneftegaz; loan claims against Yuganskneftegaz; and breaches by Rosneft of covenants in its loan agreements arising from the incurrence of the acquisition indebtedness (subsequently waived by Rosneft’s creditors). In addition, if certain shareholders of Yukos or its affiliated parties are successful in obtaining an arbitral award against the Russian Federation, those shareholders may seek to enforce that award against Rosneft. While certain of these contingencies have now been resolved, others remain open. These contingencies, if realised, may expose Rosneft to substantial liability. Rosneft is relatively highly leveraged and must observe certain financial and other restrictive covenants under the terms of its indebtedness, and any failure to comply with such covenants could put Rosneft into default. Following the merger of Yuganskneftegaz into Rosneft pursuant to the Share Swap, completed on 1 October 2006, certain of the claims against Yuganskneftegaz may have become claims against Rosneft. See “—Development of the Group—Consolidation via Share Swap”.

DEVELOPMENT OF THE GROUP

Stakes in Subsidiaries

2006

OJSC Tuapsenefteprodukt

In January 2006, Rosneft purchased 39.26% of the common shares (30.24% of the share capital) in OJSC Rosneft Tuapsenefteprodukt, a company providing transshipment services for crude oil and petroleum products, increasing its stake in the common shares from 50.67% to 89.93% and in the total share capital from 38.00% to 68.24%. The purchase price was RUB 2,835 million (USD 100 million at the CBR exchange rate in effect as at the settlement date). The acquisition resulted in USD 34 million of goodwill, attributed to estimated benefits arising from obtaining over 75% of voting shares in this company.

OJSC Daltransgaz

In February 2006, the Company purchased its 25% pro rata share of an additional issue of shares in OJSC Daltransgaz, a company operating an independent pipeline system, for RUB 722 million (USD 26 million at the CBR exchange rate in effect as at the settlement date), thus maintaining its share at 25% plus one share.

In August 2006, the Company purchased its 25% pro rata share of an additional issue of shares by OJSC Dal-
transgaz for RUB 525 million (USD 19 million at the CBR exchange rate in effect as at the settlement date), thus maintaining its stake at 25% plus one share.

OJSC Vserossiysky Bank Razvitiya Regionov

In July 2006, the Company won an auction for the purchase of 25.49% of the common shares in OJSC Vserossiysky Bank Razvitiya Regionov (“VBRR”), a Russian full service bank making corporate loans to third parties, thereby increasing its stake in the common shares of VBRR from 50.98% to 76.47%. The purchase price was RUB 333 million (USD 12 million at the CBR exchange rate in effect as at the settlement date).

In September 2006, the shareholders of VBRR approved an additional share issue of 223,500 shares (RUB 10,000 per share at par value), all of which will be purchased by the Company. The total par value of the shares to be purchased is USD 85 million at the CBR exchange rate in effect as at 31 December 2006. As a result, the Company’s ownership interest in VBRR will be increased to 94.00%. This additional share issue is planned to take place later in 2007.

2005

OJSC Krasnodarnneftegaz

In the first half of 2005, the Company purchased 38.66% of the common shares and 61.63% of the preferred shares in OJSC Rosneft Krasnodarnneftegaz, an exploration and production company, increasing its stake in the common shares from 58.97% to 97.91% and in the total share capital from 50.78% to 95.46%. The purchase price was RUB 2,971 million (USD 110 million at the CBR exchange rate in effect as at the settlement date).

OJSC Selkupneftegaz

In July 2005, the Company purchased 34% of the shares of OJSC Selkupneftegaz, an exploration and production company, increasing its stake from 66.00% to 100.00%. The purchase price was RUB 573 million (USD 20 million at the CBR exchange rate in effect as at the settlement date).

2004

Eniseyneft LLC

In the first half of 2004, the Company purchased 100% of Losiem Commercial for RUB 2,003 million (USD 69 million at the CBR exchange rate in effect as at the settlement date). Losiem Commercial held a 40.00% minority interest in Eniseyneft LLC, an exploration and production company. The purpose of the transaction was to increase the Company’s stake in Eniseyneft from 59.00% to 99.00%.

OJSC Tuapsinskiy Refinery

In December 2004, Rosneft purchased 39.38% of the common shares and 49.79% of the preferred shares in OJSC Rosneft Tuapsinskiy Refinery, a Russian oil refinery, increasing its stake in the common shares from 52.70% to 92.08% and in the total share capital from 39.53% to 81.51%. The purchase price was RUB 5,106 million (USD 184 million at the CBR exchange rate in effect as at the settlement date).

Corporate Restructuring

RN-Burenie LLC

In March 2006, the Company created LLC RN-Burenie (“RN-Burenie”) following the Board of Directors’ decision to optimise the Company’s service arrangements. During the second quarter of 2006, drilling and other supporting assets were transferred from upstream subsidiaries to RN-Burenie. In the third quarter of 2006, the drilling divisions of the Company, namely LLC PNG-Burenie, LLC KNG-Burenie and LLC KNG-Sibir, were merged into LLC RN-Burenie.

Consolidation via Share Swap

Until the autumn of 2006, the Merged Subsidiaries had significant minority interests. See “Results of Operations—Minority Interest in Subsidiaries’ Earnings.” On 1 October 2006, the Company exchanged 1,220,939,458 newly issued ordinary shares (11.52% of the Company’s share capital) for shares of the Merged Subsidiaries held by third parties at specified exchange ratios and as approved by the respective shareholders. These subsidiaries were then merged into the Company. This Share Swap has been accounted for as a purchase. The fair value of purchase consideration, that is Rosneft shares, issued for the Share Swap, was determined based on the market value of the shares as of the date nearest to the date of all the terms of the deal were agreed to and amounted to US$ 9,218 million. The excess of the fair value of the shares issued over the fair value of minority interests purchased in the amount of US$ 69 million has been reflected as goodwill and relates to the refining and marketing segment. The Company attributes this goodwill to the synergy effects from the merger. The majority of the purchase price was allocated to oil and gas properties, property, plant and equipment and mineral
rights. Where the fair value of the net assets purchased exceeded the purchase price, negative goodwill existed which has reduced, on a pro rata basis, amounts assigned to the long-term assets purchased. As a result of the merger following the Share Swap, all licences for the development and production of hydrocarbons previously held by the Merged Subsidiaries operating in the exploration and production segment were transferred to the Company.

Licences Won at Auctions

The Company won a number of licences at auctions for blocks that have are not yet developed.

2006

Tukolandskiy, Vadinskiy and Pendomayakhskiy blocks

In February 2006, the Company won auctions for licences for exploration and production in the Tukolandskiy, Vadinskiy and Pendomayakhskiy blocks in the Krasnoyarsk territory. The total cost of the licences amounted to RUB 5,377 million (USD 199 million at the CBR exchange rate in effect as at the settlement date). These blocks are located in close proximity to the Vankorskoye field, which Rosneft started to develop in 2003. Consequently, they will be able to share certain infrastructure with the Vankorskoye field, thereby reducing development costs should commercial volumes of hydrocarbons be discovered. The licences expire in 2031.

Vostochno Sughdinskiy block

In March 2006, the Company obtained a licence for the exploration and production of crude oil and gas in the Vostochno Sughdinskiy block as a result of an auction won in December 2005. The total cost of the licence was RUB 7,470 million of which RUB 300 million (USD 10 million at the CBR exchange rate in effect as at the settlement date) was paid in December 2005 in the form of an auction fee and the remaining consideration of RUB 7,170 million (USD 258 million at the CBR exchange rate in effect as at the settlement date) was paid in 2006. The licence expires in 2031.

Mogdinskiy and Sanarskiy blocks

In April 2006, the Company won an auction for licences for the exploration and production of crude oil and gas in the Mogdinskiy and Sanarskiy blocks in the Irkutsk region. The total cost of the licences was RUB 2,523 million (USD 94 million at the CBR exchange rate in effect as at the settlement date). These blocks are located in close proximity to the Verkhnechonskoye field, currently under development, allowing for reduced development costs, should commercial volumes of hydrocarbons be discovered, through the share of certain infrastructure with the Verkhnechonskoye field. The licences expire in 2031.

Danilovskoye block

In June 2006, the Company won an auction for the exploration and production of crude oil and gas in the Danilovskoye block in the Irkutsk region. The total cost of the licence was RUB 1,210 million (USD 45 million at the CBR exchange rate in effect as at the settlement date). The licence expires in 2031.

Severo-Charskiy block

In July 2006, Rosneft won an auction for the exploration and production of crude oil and gas in the Severo-Charskiy block located at the border of Taimir and Yamalo-Nenets autonomous district. The total cost of the licence was RUB 4,730 million (USD 177 million at the CBR exchange rate in effect as at the settlement date). This acquisition brought Rosneft’s total number of licences at the Vankorskoye field in Eastern Siberia to 14. The licence expires in 2031.

Osoveysky block

In July 2006, the Company won an auction for the exploration and production of crude oil and gas in the Osoveysky block in the Nenetsky autonomous district which is in close proximity to the developed Cherpayuskoye, Khasyreiskoye and Nyadeiyuskoye fields in the Nenetsky autonomous district. The total cost of the licence was RUB 2,250 million (USD 84 million at the CBR exchange rate in effect as at the settlement date). The licence expires in 2026.

Kulindinsky block

In August 2006, the Company won an auction for the exploration and production of crude oil and gas in the Kulindinsky block in the Evenkiysky autonomous district. The total cost of the licence amounted to RUB 1,561 million (USD 59 million at the CBR exchange rate in effect as at the settlement date). The Kulindinsky block is located in the territory of Tungus-Chusky region in the South-Eastern part of Evenkiya. The Company expects to benefit from synergies arising from the development of the Kulindinsky and Sanarskiy blocks. The licence expires in 2031.
2005

Vorgamusurskoe block

On 19 May 2005, Rosneft won an auction for the exploration and production of the Vorgamusurskoe block in Timano Pechora. The consideration for the licence was RUB 3,750 million (USD 134 million at the CBR exchange rate in effect as at the settlement date). The licence expires in 2030.

Strategic Partnership Agreement with OJSC Gazprom

In November 2006, Rosneft and Gazprom signed a strategic partnership agreement. The parties intend to participate jointly in tenders and auctions for subsoil use rights and implement joint projects, the terms of which will be defined in separate agreements, involving in particular the creation of gas-processing and petrochemical facilities in Eastern Siberia and the Russian Far East. Both Rosneft and Gazprom will share equally in joint projects involving geological prospecting and development of gas deposits, except projects with third party participation. Pursuant to this agreement, Gazprom and its affiliated companies will purchase from Rosneft and its affiliated companies the excess of its actual production of natural gas at the West Siberian fields connected to the Unified Gas Supply system (the "UGSS"), the national gas pipeline network operated by Gazprom, over the levels of the Company’s production in 2006.

The strategic partnership agreement is effective until the end of 2015.

Joint venture for the exploration and development Sakhalin-3

On 26 March 2007, Rosneft and Sinopec entered into a shareholder and operating agreement for the exploration and development of a portion of the Veninsky block on the shelf of Sakhalin Island (Sakhalin-3 project). According to this agreement, a wholly owned subsidiary of the Company, Rosneft International Limited, and a wholly owned subsidiary of Sinopec, Sinopec Overseas Oil and Gas Limited, will hold the shares of Venin Holding Ltd., which was established in October 2006. Venin Holding Ltd. will in turn become the sole shareholder of Venineft LLC, the licence owner and operator of the Sakhalin-3 project. Rosneft will have a 74.9% stake in the project, the remaining 25.1% being held by Sinopec. The transfer of Rosneft’s stake in Venineft LLC to Venin

Sakhalin-4, 5 - joint projects with British Petroleum (“BP”)

On 21 November 2006, Rosneft and BP entered into two shareholder and operating agreements for the exploration and development of the East Schmidtovsky (Sakhalin-5) and West Shmidtovsky (Sakhalin-4) blocks. The corporate structures of the two projects are the same. According to the agreements, Rosneft and BP will hold the shares of the incorporated in The Netherlands holding companies: Vostok-Shmidt Neftegaz Holdings B.V. and Zapad-Shmidt Neftegaz Holdings B.V. Rosneft will hold 51% and BP – 49% in these companies. Vostok-Shmidt Neftegaz Holdings B.V. and Zapad-Shmidt Neftegaz Holdings B.V. in turn become the sole shareholders of Russian companies: ZAO Vostok-Shmidt Neftegaz and ZAO Zapad-Shmidt Neftegaz, the license owners and operators of the respective Sakhalin-5 and Sakhalin-4 projects. The transfer of Rosneft’s stake in ZAO Zapad-Shmidt Neftegaz and ZAO Vostok-Shmidt Neftegaz to Zapad-Smidt Neftegaz Holdings B.V. and Vostok Shmidt Neftegaz Holdings B.V. will be submitted for the approval of Rosneft’s Board of Directors.

The financing of the project is based on the carry financing principals, where BP has agreed to carry a full portion of Rosneft’s financing of these projects on the geological phase.

West Kamchatka project

On 8 December 2006, Rosneft and KKC Korea Kamchatka Co. Limited entered into a shareholder and operating agreement for the exploration and development of a West Kamchatka shelf area. KKC Korea Kamchatka Co. Limited is owned for 50% by Korean National Oil Corporation (KNOC) and for the rest 50% - by the Korean consortium consisting of 6 companies. According to the corporate structure of the project Kamchatneftegaz LLC, the license owner and operator of the West Kamchatka project, for 100% belongs to the holding project company West Kamchatka Holding B.V., incorporated in The Netherlands in 2005. The share participation in West Kamchatka Holding B.V. and in the project is: 60% - Rosneft and 40% - KKC Korea Kamchatka Co. Limited.

The financing of the project is based on the carry financing principals, where the Korean side has agreed to carry a full portion of Rosneft’s financing of this project on the geological phase.
Main Factors Affecting Results of Operations

In addition to the acquisition of Yuganskneftegaz described above under “—Significant Acquisitions—2004—Yuganskneftegaz,” the main factors that have affected Rosneft’s results of operations during the periods being analysed, and that can be expected to affect its results of operations in the future, are:

- Changes in crude oil, petroleum product prices and gas prices;
- RUB/USD exchange rate movements and inflation;
- Changes in mineral production tax and export customs duty; and
- Changes in transport tariffs.

Changes in prices, export customs duty and transport tariffs can have a significant impact on the mix of products and export routes the Company selects, as it seeks to maximise netback prices for the crude oil it produces. The Company’s net income has been negatively affected by a significant growth in export customs duties in 2006.

Changes in Crude Oil, Petroleum Product Prices and Gas Prices

The prices of crude oil and petroleum products internationally and in Russia have a significant impact on the Company’s results of operations. World prices for crude oil are characterised by significant fluctuations that are determined by the global balance of supply and demand. The crude oil that Rosneft exports through the Transneft pipeline system is blended with oil of other producers that is of a different quality. The resulting Urals blend is traded at a discount to Brent.

Russian domestic market prices for crude oil are difficult to determine, mainly due to the significant intra-group turnover of the vertically integrated oil companies that dominate the market. Moreover, to the extent they exist, crude oil market prices in Russia can be significantly lower than they might otherwise be due to seasonal oversupply and regional imbalances.

The dynamics of petroleum product prices in the international and Russian markets are determined by a number of factors, the most important among them being the level of world prices for crude oil, supply and demand for petroleum products, competition in the different markets and distances from the refineries where the crude oil is refined into usable end products or intermediate products.

The table below sets forth the average crude oil and petroleum products prices worldwide and in Russia for the years indicated.

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>% change from the years ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>World market</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brent</td>
<td>65.14</td>
<td>54.38</td>
</tr>
<tr>
<td>Urals (average Med+NWE)</td>
<td>61.27</td>
<td>50.47</td>
</tr>
<tr>
<td>Dubai-Oman (Singapore)</td>
<td>62.01</td>
<td>49.88</td>
</tr>
<tr>
<td>(USD per tonne)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuel oil 3.5% (average Med)</td>
<td>286.00</td>
<td>222.00</td>
</tr>
<tr>
<td>Gasoil 0.2% (average Med)</td>
<td>587.00</td>
<td>508.00</td>
</tr>
<tr>
<td>Naphtha (average Med)</td>
<td>547.00</td>
<td>456.00</td>
</tr>
<tr>
<td>Russian market 1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude oil</td>
<td>254.06</td>
<td>213.15</td>
</tr>
</tbody>
</table>

1 Including VAT of 18%. Sources: Platts (world market), Kortes (Russian market).
Rosneft’s gas sales have been limited to date, but the Company’s strategy anticipates a significant increase in its gas business. Gazprom controls access to the UGSS, and is a monopoly supplier of gas in Russia and the only exporter of gas produced in Russia. Pursuant to the strategic partnership agreement entered into between Rosneft and Gazprom in November 2006, Gazprom and its affiliated companies will purchase from Rosneft and its affiliated companies the excess of its actual production of natural gas at the West Siberian fields connected to the Unified Gas Supply system (the “UGSS”), the national gas pipeline network operated by Gazprom, over the levels of the Company’s production in 2006. See “Strategic Partnership Agreement with Gazprom.”

The Russian government regulates the prices for the gas Gazprom sells in Russia. While the regulated price has been rising in Russia, and is expected to continue to rise to a level closer to parity with export netbacks, it is currently still significantly below the world prices levels. The regulated price has affected, and is likely to continue to affect, the pricing of the gas Rosneft sells to Gazprom from time to time or pursuant to the strategic partnership agreement entered into with Gazprom. Rosneft’s average gas sale price was RUB 560 (USD 20.58) per thousand cubic meters, RUB 531 (USD 18.82) per thousand cubic meters and RUB 464 (USD 16.16) per thousand cubic meters in 2006, 2005 and 2004, respectively. These prices were affected by the appreciation of the rouble over the U.S. dollar.

For a discussion of the risks associated with crude oil, gas and petroleum products prices, see “—Quantitative and Qualitative Disclosures About Market risk—Prices for Crude Oil, Gas and Petroleum Products Risk”.

### RUB/USD Exchange Rate Movements and Inflation

The rouble – U.S. dollar exchange rate and inflation trends in the Russian Federation affect the Company’s results of operations since most of Rosneft’s revenues from sales of crude oil and petroleum products are denominated in U.S. dollars, while a substantial portion of its expenses are denominated in Russian roubles. Accordingly, any real appreciation of the rouble versus the U.S. dollar negatively affects Rosneft’s margins. The rouble has appreciated against the U.S. dollar in real terms throughout the periods being analysed, and in nominal terms on average as well. Rosneft began to use currency hedging mechanisms in January 2007 in order to mitigate the effects of the fluctuation of the rouble against the U.S. dollar. See “—Quantitative and qualitative disclosures about Market risk—Foreign Currency Risk”.

Whether the rouble appreciates or depreciates in real terms is a function of the relationship between movements in the nominal exchange rate and inflation. The table below sets forth information on exchange rate movements and inflation during the periods being analysed.

### Inflation and Exchange Rates

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>% change from the years ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuel oil</td>
<td>204.38</td>
<td>145.30</td>
</tr>
<tr>
<td>Diesel fuel</td>
<td>557.79</td>
<td>495.15</td>
</tr>
<tr>
<td>High octane gasoline</td>
<td>740.10</td>
<td>606.76</td>
</tr>
<tr>
<td>Low octane gasoline</td>
<td>597.17</td>
<td>494.48</td>
</tr>
<tr>
<td>Rouble inflation (CPI)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rouble/U.S. dollar exchange rate at the beginning of the period</td>
<td>28.78</td>
<td>27.75</td>
</tr>
<tr>
<td>Rouble/U.S. dollar exchange rate at the end of the period</td>
<td>26.33</td>
<td>28.78</td>
</tr>
</tbody>
</table>

1 Source: CBR, State Statistics Committee of Russia.
Changes in Mineral Production Tax and Export Customs Duty

Mineral production tax and export customs duty accounted for between 27.5% and 52.8% of Rosneft’s total revenues during the periods being analysed. The table below sets out the mineral production tax and export customs duty paid by Rosneft during these periods. When volumes of hydrocarbon sales remain unchanged, the mineral production tax and export customs duty reduce to a considerable degree the impact of upward or downward movements in crude oil export prices on the Company’s net income from the export of crude oil after a time lag of several months from the change in the hydrocarbon prices.

Rates of Mineral Production Taxes and Export Customs Duty

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mineral production tax</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude oil (RUB per tonne)</td>
<td>2.282</td>
<td>1.883</td>
</tr>
<tr>
<td>Gas (RUB per thousand cubic meters)</td>
<td>147</td>
<td>135</td>
</tr>
<tr>
<td><strong>Export customs duty (USD per tonne)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude oil</td>
<td>196.86</td>
<td>130.02</td>
</tr>
<tr>
<td>Light and medium distilled products</td>
<td>143.66</td>
<td>91.53</td>
</tr>
<tr>
<td>Fuel oil</td>
<td>77.41</td>
<td>52.43</td>
</tr>
</tbody>
</table>
during the tax-free period without paying mineral production tax. These mineral production tax-free periods do not apply to the extraction of natural gas; and
• Lower mineral production tax rates for “brownfield” fields that are 80% or more depleted.

This legislation is expected to benefit Rosneft as it has extensive “greenfield” interests in Eastern Siberia.

Export Customs Duty

As described in the following table, the rate of export customs duty is linked to the average Urals price in the markets of the North-West of Europe and the Mediterranean in U.S. dollars per barrel of extracted crude oil (expressed in U.S. dollars per tonne).

Calculation of Export Customs Duty (from June 2004)

<table>
<thead>
<tr>
<th>Urals price</th>
<th>Export customs duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>(USD/barrel)</td>
<td>(USD/tonne)</td>
</tr>
<tr>
<td>Below 109.5 (15 USD/barrel)</td>
<td>Export customs duty is not levied</td>
</tr>
<tr>
<td>109.5 to 146 (15 to 20 USD/barrel)</td>
<td>35% of the difference between the average Urals price in USD per tonne and USD 109.5</td>
</tr>
<tr>
<td>146 to 182.5 (20 to 25 USD/barrel)</td>
<td>USD 12.78 plus 45% of the difference between the average Urals price in USD per tonne and USD 146</td>
</tr>
<tr>
<td>Above 182.5 (25 USD/barrel)</td>
<td>USD 29.2 plus 65% of the difference between the average Urals price in USD per tonne and USD 182.5</td>
</tr>
</tbody>
</table>

Calculation of Export Customs Duty (before June 2004)

<table>
<thead>
<tr>
<th>Urals price</th>
<th>Export customs duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>(USD/barrel)</td>
<td>(USD/tonne)</td>
</tr>
<tr>
<td>Below 109.5 (15 USD/barrel)</td>
<td>Export customs duty is not levied</td>
</tr>
</tbody>
</table>

The level of export customs duty for crude oil has increased in line with the rise in oil prices in 2004, 2005 and 2006, from USD 7.51 per barrel of crude oil exported in 2004 to USD 18.22 in 2005 and USD 27.24 in 2006. The Russian government sets the rate of export customs duty every two months based on changes in the average world prices for the Urals crude oil.

Export duties for petroleum products are established by the Russian government depending on rates of crude oil export customs duties. Export duties are not payable on exports of crude oil and petroleum products to the CIS countries that are members of the Customs Union, which are Belarus, Kazakhstan, Kirgizia and Tadzhikistan. Sales to these countries were USD 1,575 million (42.71 million barrels) in 2006, USD 1,190 million (39.51 million barrels) in 2005 and USD 270 million (12.53 million barrels) in 2004.

As a result of these taxes after a time lag of several months, the net income of businesses that export crude oil and petroleum products from Russia has a reduced sensitivity to changes in crude oil prices. Moreover, the impact of export customs duty on crude oil relative to the impact of excise taxes on petroleum products affects the choice to be made between exporting crude oil and refining it for sale both internationally and in Russia.

Changes in Transport Tariffs

Rosneft transports most of its crude oil through the pipeline networks owned and operated by Transneft. In accordance with Article 4 of the Federal law dated 17 August 1995 No. 147-FZ “On natural monopolies”, Transneft is a monopoly provider of crude oil transportation services via proprietary pipelines networks to customers within and outside
the Russian Federation. The Russian Federation owns 75% of Transneft’s share capital. Transneft charges its customers fees for transportation services in accordance with tariffs set by the Federal Tariffs Service (“FTS”), a governmental body regulating the natural monopolies. The overall expense per tonne for the transport of crude oil depends on the length of the transportation route from the producing field to the ultimate destination and the number of Transneft “districts” through which the crude oil is transported. Rosneft’s crude oil tariff per tonne of crude oil transported via Transneft raised by 18% on average in 2006, by 11% on average in 2005 and by 18% on average in 2004.

Rosneft seeks to utilise alternative means of transportation to optimise netbacks, including the Northern route via Rosneft’s Belokamenka export transshipment facility, the Nakhodka export transshipment facility for exports to Asia, the Far Eastern route via Rosneft’s pipeline Okha-Komsomolskon-Amur located on the Sakhalin Island and the Southern route via the Caspian Pipeline Consortium (“CPC”) pipeline.

In 2006, Rosneft exported approximately 12% of its petroleum products through the OJSC AK Transnefteprodukt (“Transnefteprodukt”) pipeline system. Transnefteprodukt, wholly owned by the Russian Federation and soon to be transferred to Transneft, is a monopoly provider of petroleum products transportation services via proprietary pipelines networks to customers within and outside the Russian Federation. The overall expense per tonne for the transport of petroleum products depends on the length of the transportation route to the ultimate destination. Petroleum products transported through the Transnefteprodukt pipeline system were produced at refineries owned by Yukos located in the Samara region under processing contracts. Rosneft’s petroleum products tariff per tonne of petroleum products transported via Transnefteprodukt raised by 17% in 2006 compared to 2005. Rosneft did not incur petroleum products transportation expenses prior to 2005 as these expenses were paid by its customers.

Rosneft also depends on railway transportation, which accounted for approximately 33% of its export sales of crude oil in 2006, including crude oil produced by Yuganskneftegaz and Purneftegaz for sale to China, and approximately 22% of its export sales of petroleum products in 2006. The Russian railway system (“RZD”) is a state owned monopoly provider of railway transportation services. Rosneft’s railway tariff per tonne of crude oil shipped increased by 23% on average in 2004, but declined by 9% on average in 2005, due to the favourable pricing Rosneft was able to negotiate on the basis of the high volume of crude oil it transports by rail. RZD’s tariffs are subject to control by FTS and to antimonopoly regulations. In 2006 RZD has increased its tariffs by approximately 13% for domestic market and export via Russian ports.

### Production of Crude Oil, Petroleum Products and Gas

Rosneft’s ability to generate revenues depends on its production of crude oil and petroleum products. In addition, as noted elsewhere, an important part of Rosneft’s strategy is to expand its production and sale of gas.

### Production of Crude Oil

Rosneft produces crude oil at seven production business units (previously fully consolidated production and development subsidiaries merged into Rosneft on 1 October 2006 as a result of the Share Swap) and four fully consolidated production and development subsidiaries. Rosneft also has a 20% share in the Sakhalin-1 project consolidated into the Group under the proportionate consolidation method starting from 31 July 2006. See “—Significant Acquisitions—Change in accounting for PSA Sakhalin-1 PSA”. In addition, Rosneft produces oil at two producing joint ventures, which the Group accounts for using the equity method. Yuganskneftegaz and Purneftegaz in Western Siberia and Severnaya Neft in Timano Pechora are Rosneft’s most important production and development wholly owned operating and servicing companies, collectively accounting for approximately 89.7% of Rosneft’s production in 2006 and for approximately 89.6% in 2005. Yuganskneftegaz and Purneftegaz accounted for approximately 71.1% and 70.0%, Purneftegaz 11.5% and 12.9% and Severnaya Neft 7.1% and 6.7% of Rosneft’s production in 2006 and 2005, respectively.

The following table sets forth Rosneft’s crude oil production during the periods being analysed:
In 2006, Rosneft increased its production of crude oil by 7.7%, to 576.31 million barrels compared with 535.16 million barrels in 2005. This growth was largely attributable to increased production by Yuganskneftegaz and Severnaya Neft. Yuganskneftegaz increased its production from 374.60 million barrels in 2005, to 409.61 million barrels in 2006 or by 9.3%, and Severnaya Neft increased its production from 35.66 million barrels in 2005 to 41.04 million barrels in 2006, or by 15.1%.

Commercial production of crude oil and gas started at Sakhalin-1 PSA in October 2005. Rosneft’s net share of oil produced under Sakhalin-1 PSA for the five last months of 2006 amounted to 1.96 million barrels.

In 2005, Rosneft increased its production of crude oil by 261.0%, to 535.16 million barrels, mainly as a result of the acquisition of Yuganskneftegaz. Without Yuganskneftegaz, crude oil production increased by approximately 8.3% in 2005, to 160.56 million barrels. This organic growth was largely attributable to the oil fields of Severnaya Neft, where crude oil production grew by 43.2%, to 35.66 million barrels.

Yuganskneftegaz’ 2005 crude oil production declined by 1.1% compared to 2004, primarily due to the substantial reduction of capital expenditure during the second half of 2004, while it was still owned by Yukos. From January to May 2005, Rosneft focused on integrating the production of Yuganskneftegaz into Rosneft’s operations, stabilising the production decline that commenced in 2004 mainly associated with a lack of investment, optimising the logistics and improving the profitability of crude oil production by the enterprise. As a result, the Company managed to reverse the production decline during the second quarter of 2005.

Daily crude oil production in 2006 was 1,578.94 thousand barrels as compared with 1,466.19 thousand barrels in 2005. Among the factors contributing to an increase in daily oil production was a raise in average well production rates from 101.7 barrels per day in 2005 to 109.0 barrels per day in 2006, in particular for newly drilled wells from 662.7 to 715.4 barrels per day.

Daily crude oil production in 2005 was 1,466.19 thousand barrels as compared with 405.09 thousand barrels in 2004, primarily resulting from the acquisition of Yuganskneftegaz. Among the factors contributing to an increase in daily oil production was a raise in average well production rates from 54.1 barrels per day in 2004 to 101.7 barrels per day in 2005, in particular for newly drilled wells from 502.5 to 662.7 barrels per day.

### Production of Gas

The table below sets forth Rosneft’s gas production during the periods being analyzed:

<table>
<thead>
<tr>
<th>Period</th>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil production by fully consolidated subsidiaries 1</td>
<td>576.31</td>
<td>535.16</td>
</tr>
<tr>
<td>Crude oil production, including the share in production of affiliated enterprises 2</td>
<td>582.70</td>
<td>540.39</td>
</tr>
</tbody>
</table>

*1 Crude oil production by subsidiaries includes Rosneft’s share of oil produced under the Sakhalin-1 PSA, starting from August 2006, net of 8.00% royalty of 0.17 million barrels and 2.07% government’s share of 0.05 million barrels for the last five months of 2006.

*2 Crude oil production, together with the share in production of affiliates is Crude oil production by fully consolidated subsidiaries, as set forth above, plus 50% share of Rosneft in crude oil produced by Polar Lights and Aday Petroleum joint venture in Kazakhstan and 49% share of Rosneft in crude oil produced by Udmurtneft.*
Gas production increased by 4.2% in 2006, to 13.56 bcm, primarily due to the growth of production in Krasnodarneftegaz, Selkupneftegaz and Purneftegaz. In 2006, the level of associated gas utilisation was 59.0%, compared to 62.5% in 2005, due to the time necessary for the development of additional facilities necessary to accommodate the growing gas production.

The Company has started developing a gas programme to increase the level of associated gas utilisation. This programme envisages the construction of associated gas gathering facilities, booster compression stations and underground gas storage facilities. In addition, the Company plans to improve the gas quality by constructing oil and gas separation equipment and gas treatments facilities.

Pursuant to the strategic partnership agreement entered into with Gazprom in November 2006, it is expected that Rosneft will participate in joint projects with Gazprom involving geological prospecting and development of gas deposits.

Gas production increased by 39.1% in 2005, to 13.01 bcm, taking into account the acquisition of Yuganskneftegaz. Gas production increased by 24.0% without Yuganskneftegaz, primarily due to growth of gas production in the fields of Krasnodarneftegaz, Purneftegaz and Selkupneftegaz. In 2005, the level of associated gas utilisation was 62.5%, compared to 74.7% in 2004. This decrease was due mainly to the low level of utilisation of associated gas in Yuganskneftegaz, which decreased to 47.9%. In 2005, the Company resumed the construction of a gas compressor station at Priobskoye field with the aim of reducing the flaring of associated gas; construction had ceased in the second half of 2004 while Yuganskneftegaz was under prior ownership.

### Production of Petroleum Products

Rosneft refines the crude oil it produces at its two major refineries, Tuapsinskiy Refinery on the Black Sea in the South of Russia and Komsomolskiy Refinery in the Russian Far East. Rosneft also arranges for the crude oil it produces to be processed at refineries owned by third parties. These operations have increased considerably from the beginning of 2005 as a result of acquiring Yuganskneftegaz and routing oil produced by it for processing at refineries within the Yukos group. Rosneft has recently agreed to purchase certain third party refineries as a result of the auction for the sale of certain refining assets of Yukos won by the Group in May 2007. In addition, Rosneft is planning to make a bid in the auction for the sale of certain refining assets of Yukos in the Samara region. See "—Significant Acquisitions—2007—Acquisition of Assets in Yukos Auctions—Eastern Siberia Assets."

Rosneft also owns the MZ Nefteprodukt refinery in Moscow and mini-refineries in Gubkinsky in the Yamalo-Nenetsky autonomous district, in Usinsk in the Komi Republic and in Nalchik in the Kabardino-Balkarskaya Republic.

The following table sets forth Rosneft’s petroleum product production from its crude oil during the periods being analysed:

<table>
<thead>
<tr>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>(billions cubic meters)</td>
<td>(%)</td>
</tr>
<tr>
<td>Gas production by subsidiaries</td>
<td>13.56</td>
</tr>
<tr>
<td>Gas production, including the share in production of affiliates</td>
<td>13.58</td>
</tr>
</tbody>
</table>

1 Gas production by subsidiaries includes Rosneft’s net share of gas produced under Sakhalin-1 PSA starting from August 2006.
2 Gas production, together with the share in production of affiliates, includes Rosneft’s net share of gas produced under Sakhalin-1 PSA starting from August 2006, 50% share of Rosneft in gas produced by Polar Lights and 49% share of Rosneft in gas produced by Udmurtneft.

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In 2006, the Tuapsinskiy and Komsomolskiy refineries processed 78.04 million barrels of Rosneft produced crude oil, 2.9% more than in 2005. Depth of refining by Komsomolskiy Refinery increased from 60.1% in 2005 to 60.7% in 2006, and by Tuapsinskiy Refinery from 55.8% in 2005 to 56.4% in 2006, yielding an aggregate of 10.38 million tonnes of petroleum products in 2006. The total output of petroleum products from Rosneft produced crude oil, including output of mini refineries and refineries controlled by third parties, increased by 6.6%, from 21.26 million tonnes in 2005 to 22.66 million tonnes in 2006. In 2006, 95.90 million barrels of Rosneft produced crude oil were refined at third party refineries including Yukos controlled refineries, yielding approximately 12.17 million tonnes of petroleum products.

In 2005, the Tuapsinskiy and Komsomolskiy refineries processed 75.81 million barrels of Rosneft produced crude oil, 53.0% more than in 2004. The depth of refining by the Komsomolskiy Refinery increased from 59.6% in 2004 to 60.7% in 2005, and by Tuapsinskiy Refinery from 55.4% in 2004 to 56.4% in 2005, yielding 10.03 million tonnes of petroleum products in 2005. The total output of petroleum products from Rosneft produced crude oil, including output of mini refineries and refineries controlled by third parties, increased by 6.6%, from 21.26 million tonnes in 2005 to 22.66 million tonnes in 2006. In 2005, 85.42 million barrels of Rosneft produced crude oil were refined at third party refineries, yielding an aggregate of 10.88 million tonnes of petroleum products. The increase in petroleum product output in 2005 was due mainly to the increased availability of crude oil, arising principally from the acquisition of Yuganskneftegaz.

In addition to refining Rosneft produced crude oil, the Komsomolskiy and Tuapsinskiy refineries also refine crude oil produced by third parties. Such throughput represented 1.1% of the total throughput of these refineries in 2006, 1.2% in 2005 and 27.5% in 2004.

The majority of the crude oil that Rosneft refined for third parties in 2006 was processed at Komsomolskiy Refinery. Both the Tuapsinskiy Refinery and the Komsomolskiy Refinery have also been operating at near full capacity during the periods being analysed.

### Results of Operations

<table>
<thead>
<tr>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Petroleum products output by Tuapsinskiy, Komsomolskiy and mini refineries</td>
<td>10.49</td>
</tr>
<tr>
<td>Petroleum products output by third party refineries</td>
<td>12.17</td>
</tr>
<tr>
<td>Total</td>
<td>22.66</td>
</tr>
</tbody>
</table>
### For the year ended 31 December

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% of total revenues</td>
<td>% of total revenues</td>
<td>% of total revenues</td>
</tr>
<tr>
<td><strong>Revenues</strong></td>
<td>(USD millions, except %)</td>
<td>(USD millions, except %)</td>
<td>(USD millions, except %)</td>
</tr>
<tr>
<td>Oil and gas sales</td>
<td>23,499</td>
<td>71.00%</td>
<td>16,152</td>
</tr>
<tr>
<td>Petroleum products and processing fees</td>
<td>9,250</td>
<td>27.95%</td>
<td>7,374</td>
</tr>
<tr>
<td>Support services and other revenues</td>
<td>350</td>
<td>1.05%</td>
<td>337</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>33,099</td>
<td>100.00%</td>
<td>23,863</td>
</tr>
<tr>
<td><strong>Cost and expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Production and operating expenses</td>
<td>2,197</td>
<td>(6.64)%</td>
<td>1,623</td>
</tr>
<tr>
<td>Cost of purchased oil, petroleum products and refining costs</td>
<td>1,320</td>
<td>(3.99)%</td>
<td>637</td>
</tr>
<tr>
<td>Selling, general and administrative expenses</td>
<td>757</td>
<td>(2.29)%</td>
<td>589</td>
</tr>
<tr>
<td>Pipeline tariffs and transportation costs</td>
<td>3,226</td>
<td>(9.75)%</td>
<td>2,321</td>
</tr>
<tr>
<td>Exploration expenses</td>
<td>193</td>
<td>(0.58)%</td>
<td>164</td>
</tr>
<tr>
<td>Depreciation, depletion and amortisation</td>
<td>1,638</td>
<td>(4.95)%</td>
<td>1,472</td>
</tr>
<tr>
<td>Accretion expense</td>
<td>34</td>
<td>(0.10)%</td>
<td>35</td>
</tr>
<tr>
<td>Taxes other than income tax</td>
<td>6,990</td>
<td>(21.12)%</td>
<td>5,326</td>
</tr>
<tr>
<td>Export customs duty</td>
<td>11,140</td>
<td>(33.66)%</td>
<td>6,264</td>
</tr>
<tr>
<td><strong>Total cost and expenses</strong></td>
<td>27,495</td>
<td>(83.08)%</td>
<td>18,341</td>
</tr>
<tr>
<td><strong>Operating income</strong></td>
<td>5,604</td>
<td>16.92%</td>
<td>5,522</td>
</tr>
<tr>
<td><strong>Other income/ (expenses)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income</td>
<td>135</td>
<td>0.41%</td>
<td>81</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(724)</td>
<td>(2.19)%</td>
<td>(775)</td>
</tr>
<tr>
<td>(Loss)/gain on disposal of property, plant and equipment</td>
<td>(95)</td>
<td>(0.29)%</td>
<td>(74)</td>
</tr>
<tr>
<td>(Loss)/gain on disposal of investments</td>
<td>3</td>
<td>0.01%</td>
<td>(13)</td>
</tr>
<tr>
<td>For the year ended 31 December</td>
<td>2006</td>
<td>2005</td>
<td>2004</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td></td>
<td>USD millions</td>
<td>% of total revenue</td>
<td>USD millions</td>
</tr>
<tr>
<td>Crude oil</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export to non-CIS countries</td>
<td>21,468</td>
<td>64.8%</td>
<td>13,886</td>
</tr>
</tbody>
</table>
The following table analyses the crude oil, petroleum products and gas sales volumes for the years indicated:

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(USD millions)</td>
<td>% of total revenue</td>
</tr>
<tr>
<td>Europe and other directions</td>
<td>16,323</td>
<td>49.3%</td>
</tr>
<tr>
<td>Asia</td>
<td>5,145</td>
<td>15.5%</td>
</tr>
<tr>
<td>Export to CIS</td>
<td>1,620</td>
<td>4.9%</td>
</tr>
<tr>
<td>Domestic</td>
<td>214</td>
<td>0.6%</td>
</tr>
<tr>
<td>Gas</td>
<td>197</td>
<td>0.6%</td>
</tr>
<tr>
<td>Total oil and gas</td>
<td>23,499</td>
<td>70.9%</td>
</tr>
<tr>
<td>Petroleum products</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export to non-CIS countries</td>
<td>5,093</td>
<td>15.4%</td>
</tr>
<tr>
<td>Europe and other directions</td>
<td>3,152</td>
<td>9.5%</td>
</tr>
<tr>
<td>Asia</td>
<td>1,941</td>
<td>5.9%</td>
</tr>
<tr>
<td>Export to CIS</td>
<td>202</td>
<td>0.6%</td>
</tr>
<tr>
<td>Domestic</td>
<td>3,953</td>
<td>12.0%</td>
</tr>
<tr>
<td>Wholesale</td>
<td>3,239</td>
<td>9.8%</td>
</tr>
<tr>
<td>Retail</td>
<td>714</td>
<td>2.2%</td>
</tr>
<tr>
<td>Refining services</td>
<td>2</td>
<td>0.0%</td>
</tr>
<tr>
<td>Total petroleum products and processing fees</td>
<td>9,250</td>
<td>28.0%</td>
</tr>
<tr>
<td>Support services and other revenues</td>
<td>350</td>
<td>1.1%</td>
</tr>
<tr>
<td>Total sales</td>
<td>33,099</td>
<td>100.0%</td>
</tr>
<tr>
<td>phthalmic fluid</td>
<td>For the year ended 31 December</td>
<td>% change from the year ended 31 December</td>
</tr>
<tr>
<td>---------------</td>
<td>-------------------------------</td>
<td>-----------------------------------------</td>
</tr>
<tr>
<td></td>
<td>% of total sales volume</td>
<td>% of total sales volume</td>
</tr>
<tr>
<td>Crude oil</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export to non-CIS countries</td>
<td>357.58</td>
<td>62.1%</td>
</tr>
<tr>
<td>Europe and other directions</td>
<td>275.85</td>
<td>47.9%</td>
</tr>
<tr>
<td>Asia</td>
<td>81.73</td>
<td>14.2%</td>
</tr>
<tr>
<td>Export to CIS</td>
<td>43.53</td>
<td>7.6%</td>
</tr>
<tr>
<td>Domestic</td>
<td>6.82</td>
<td>1.2%</td>
</tr>
<tr>
<td>Total Crude oil sales</td>
<td>55.76</td>
<td>70.9%</td>
</tr>
<tr>
<td>Petroleum products</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export to non-CIS countries</td>
<td>12.66</td>
<td>16.1%</td>
</tr>
<tr>
<td>Europe and other directions</td>
<td>7.85</td>
<td>10.0%</td>
</tr>
<tr>
<td>Asia</td>
<td>4.81</td>
<td>6.1%</td>
</tr>
<tr>
<td>Export to CIS</td>
<td>0.68</td>
<td>0.9%</td>
</tr>
<tr>
<td>Domestic</td>
<td>9.53</td>
<td>12.1%</td>
</tr>
<tr>
<td>Wholesale</td>
<td>8.43</td>
<td>10.7%</td>
</tr>
<tr>
<td>Retail</td>
<td>1.1</td>
<td>1.4%</td>
</tr>
<tr>
<td>Total Petroleum products sales</td>
<td>22.87</td>
<td>29.1%</td>
</tr>
</tbody>
</table>

Note: The total volume sold is different from the volume of crude oil produced due to changes in inventory levels, purchases for resale, own use of oil by Rosneft and losses during transportation and in refining. The petroleum products exported include tanker fuelling volumes, by which they differ from those amounts set forth in the main body of this report.
Average Crude Oil and Petroleum Products Sales Prices Achieved by Rosneft

The unit prices in the following table may differ from unit prices of crude oil and petroleum products provided by information agencies due to the following factors:

- Seasonal and other production fluctuations;
- Different conditions of sales and supplies versus those cited in mass media;
- Discounts or mark-ups depending on crude oil or petroleum product quality, sales volume and timing of transactions; and
- Terms of individual contracts differing from average market prices.

The following table sets forth the average export and domestic prices of Rosneft in 2006, 2005 and 2004.

### For the year ended 31 December

<table>
<thead>
<tr>
<th></th>
<th>% of total sales volume</th>
<th>% of total sales volume</th>
<th>% of total sales volume</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total crude oil and petroleum product sales</td>
<td>78.64</td>
<td>100.0%</td>
<td>70.73</td>
<td>100.0%</td>
</tr>
<tr>
<td>Gas</td>
<td>9.57</td>
<td>9.3</td>
<td>7.3</td>
<td>2.9%</td>
</tr>
</tbody>
</table>

### For the year ended 31 December

<table>
<thead>
<tr>
<th></th>
<th>(USD/barrel)</th>
<th>(USD/tonne)</th>
<th>(USD/barrel)</th>
<th>(USD/tonne)</th>
<th>(USD/barrel)</th>
<th>(USD/tonne)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average export prices</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude oil export to non-CIS countries</td>
<td>60.04</td>
<td>439.20</td>
<td>49.20</td>
<td>360.01</td>
<td>31.85</td>
<td>233.04</td>
</tr>
<tr>
<td>Europe and other directions</td>
<td>59.18</td>
<td>432.88</td>
<td>48.55</td>
<td>354.96</td>
<td>31.79</td>
<td>232.58</td>
</tr>
<tr>
<td>Asia</td>
<td>62.95</td>
<td>460.53</td>
<td>52.80</td>
<td>386.41</td>
<td>32.18</td>
<td>235.33</td>
</tr>
<tr>
<td>Crude oil export to CIS</td>
<td>37.21</td>
<td>272.23</td>
<td>30.85</td>
<td>225.57</td>
<td>23.14</td>
<td>169.14</td>
</tr>
<tr>
<td>Petroleum products export to non-CIS countries</td>
<td>—</td>
<td>402.60</td>
<td>—</td>
<td>335.49</td>
<td>—</td>
<td>212.07</td>
</tr>
<tr>
<td>Europe and other directions</td>
<td>—</td>
<td>401.76</td>
<td>—</td>
<td>341.84</td>
<td>—</td>
<td>230.87</td>
</tr>
<tr>
<td>Asia</td>
<td>—</td>
<td>403.95</td>
<td>—</td>
<td>332.24</td>
<td>—</td>
<td>203.17</td>
</tr>
<tr>
<td>Petroleum products export to CIS</td>
<td>—</td>
<td>295.17</td>
<td>—</td>
<td>213.33</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Average domestic prices</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude oil</td>
<td>31.36</td>
<td>229.40</td>
<td>20.89</td>
<td>152.67</td>
<td>19.81</td>
<td>144.44</td>
</tr>
</tbody>
</table>
Revenues were USD 33,099 million in 2006, a 38.7% increase over 2005 (USD 23,863 million). Revenues from the sale of crude oil and gas grew by 45.5%, and revenues from the sale of petroleum products by 25.4%, in 2006 compared with 2005. The growth in revenues was due to increased prices and increased sales volumes of crude oil and petroleum products. The growth in volumes was made possible by a 7.7% increase in crude oil production and a 6.6% increase in petroleum product production.

Revenues were USD 23,863 million in 2005, a 353.5% increase over 2004 (USD 5,262 million). Revenues from the sale of crude oil and gas grew by 490.6%, and revenues from the sale of petroleum products by 230.2%, in 2005 compared with 2004. The growth in revenues was due to increased prices and increased sales volumes of crude oil and petroleum products. The growth in volumes was made possible by a 261.0% increase in crude oil production, and a 200.3% increase in petroleum product production, resulting mainly from the acquisition of Yuganskneftegaz.

The increase in petroleum product production was facilitated by the agreements entered into at the end of the first quarter of 2005 with Yukos controlled refineries for the refining of crude oil produced by Yuganskneftegaz.

Crude Oil Export Sales to CIS Countries

In 2006, crude oil export revenues were USD 21,468 million compared to USD 13,886 million in 2005, an increase of USD 7,582 million, or 54.6%. The growth resulted from a 22.0% increase in average prices, which increased revenues by USD 3,934 million, and a 26.3% increase in sales volumes, which had a positive impact on revenues of USD 3,648 million. The price increases were attributable to the general growth of world prices; in particular, the average price for Urals crude oil Mediterranean rose by 21.4%. Sales volumes grew, mainly in respect of sales to Europe and other directions (including South and North America, Tunisia, Lebanon, Syria, Israel and Turkey), as these directions were the most profitable in 2006.

In 2005, crude oil export revenues were USD 13,886 million compared to USD 2,102 million in 2004, an increase of USD 11,784 million, or 560.6%. The growth resulted from a 54.5% increase in prices, which increased revenues by USD 4,865 million, and a 329.2% increase in sales volumes, which had a positive impact on revenues of USD 6,919 million. The price increases were attributable to the general growth of world prices; in particular, the average price for Urals crude oil Mediterranean increased by 47.3%. Sales volumes grew to both Europe and Asia, mainly due to the acquisition of Yuganskneftegaz.

Crude Oil Export Sales to Non-CIS Countries

In 2006, crude oil export revenues were USD 21,468 million compared to USD 13,886 million in 2005, an increase of USD 7,582 million, or 54.6%. The growth resulted from a 22.0% increase in average prices, which increased revenues by USD 3,934 million, and a 26.3% increase in sales volumes, which had a positive impact on revenues of USD 3,648 million. The price increases were attributable to the general growth of world prices; in particular, the average price for Urals crude oil Mediterranean rose by 21.4%. Sales volumes grew, mainly in respect of sales to Europe and other directions (including South and North America, Tunisia, Lebanon, Syria, Israel and Turkey), as these directions were the most profitable in 2006.

In 2005, crude oil export revenues were USD 13,886 million compared to USD 2,102 million in 2004, an increase of USD 11,784 million, or 560.6%. The growth resulted from a 54.5% increase in prices, which increased revenues by USD 4,865 million, and a 329.2% increase in sales volumes, which had a positive impact on revenues of USD 6,919 million. The price increases were attributable to the general growth of world prices; in particular, the average price for Urals crude oil Mediterranean increased by 47.3%. Sales volumes grew to both Europe and Asia, mainly due to the acquisition of Yuganskneftegaz.

Crude Oil Export Sales to CIS

In 2006, revenues from sales of crude oil to the CIS were USD 1,620 million compared to USD 1,491 million in 2005, an increase of USD 129 million, or 8.7%. A 20.6% increase in prices, which would have increased revenues by USD 278 million, was offset in part by a 9.9% decrease in volumes, which had a negative impact on revenues of USD 149 million. The growth in volumes sold to Belarus was offset by a more significant reduction of volumes sold to Ukraine, a less profitable CIS market due to the applicability of export customs duty.

In 2005, revenues from sales of crude oil to the CIS were USD 1,491 million compared to USD 411 million in 2004, an increase of USD 1,080 million, or 262.8%. The primary contributors to growth were a 33.3% increase in prices, which increased revenues by USD 373 million, and a 172.1% increase in volumes, which had a positive impact on revenues of USD 707 million. Volumes grew

<table>
<thead>
<tr>
<th>Product</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gas (USD/thousand cubic meter)</td>
<td>—</td>
<td>20.58</td>
<td>18.82</td>
</tr>
<tr>
<td>Petroleum products</td>
<td>—</td>
<td>414.54</td>
<td>356.34</td>
</tr>
<tr>
<td>Wholesale</td>
<td>—</td>
<td>384.02</td>
<td>335.08</td>
</tr>
<tr>
<td>Retail</td>
<td>—</td>
<td>648.44</td>
<td>511.34</td>
</tr>
</tbody>
</table>
due to the overall increase in crude oil production, resulting mainly from the acquisition of Yuganskneftegaz, and the increase in supplies to Belarus.

Crude Oil Domestic Sales

The volume of crude oil sold in Russia decreased significantly in 2006. In 2006, domestic crude oil sales decreased by USD 386 million to USD 214 million. This resulted from a 76.3% decrease in sales volume, which accounted for USD 458 million of the decrease in revenues, and was partially offset by a 50.3% increase in average prices, which had a positive impact on revenues of USD 72 million. The decline in volumes resulted from the allocation of more crude oil to export sales and refining to achieve maximum netback prices as domestic sales of crude oil have a relatively low profitability in comparison to export sales.

The volume of crude oil sold in Russia increased in the first half of 2005. It took some time for the Company to put in place arrangements for the refining or export of the significant quantities of crude oil produced by Yuganskneftegaz after its acquisition in December 2004, which resulted in increased crude oil sales in the domestic market. In the second half of 2005, the volume of crude oil domestic sales was significantly reduced. Domestic crude oil sales revenues were USD 600 million in 2005, an increase of USD 496 million compared to 2004. The primary contributors to growth were a 5.7% increase in prices, accounting for USD 32 million of the revenue growth, and a 447.0% increase in sales volume, which had a positive impact on revenues of USD 464 million.

Petroleum Products Export Sales to Non-CIS Countries

Revenue from the export of petroleum products was USD 5,093 million in 2006 compared to USD 4,445 million in 2005, an increase of USD 648 million, or 14.6%. The growth in revenue from the export of petroleum products was attributable to a 20.0% increase in prices, which increased revenues by USD 810 million, partially offset by a 3.7% decrease in sales volume, which had a negative impact on revenues of USD 162 million. The growth in average prices was due to the overall increase in world prices; in particular, the average price for fuel oil Mediterranean grew by 28.8%. The decrease in volumes was mainly attributable to the reduction of petroleum products export to Europe and other non-CIS countries.

Revenue from the export of petroleum products was USD 4,445 million in 2005 compared to USD 984 million in 2004, an increase of USD 3,461 million, or 351.7%. The growth in revenue from the export of petroleum products was attributable to a 58.2% increase in prices, which increased revenues by USD 1,658 million, and a 183.2% growth in sales volume, which had a positive impact on revenues of USD 1,803 million. The growth in prices was due to the overall increase in world prices; in particular, the price for diesel fuel Mediterranean grew by 51.0%.

The growth in volumes was mainly attributable to petroleum products exported to Europe.

Petroleum Products Export Sales to CIS Countries

In 2006, revenues from sales of petroleum products to the CIS were USD 202 million compared to USD 64 million in 2005, an increase of USD 138 million, or 215.6%. This growth primary resulted from a 126.7% increase in volumes, which was mainly due to a shift of volumes to the CIS from other export destinations and increased sales of certain petroleum products for which the demand exists only in the CIS countries. The increase in volumes resulted in a USD 82 million increase in revenues and was accompanied by 38.4% increase in prices, which resulted in a USD 56 million increase in revenues.

The Company had no sales of petroleum products to CIS prior to 2005.

Petroleum Products Domestic Sales

Revenue from the sale of petroleum products on the domestic market was USD 3,953 million in 2006 compared to USD 2,865 million in 2005, an increase of USD 1,088 million, or 38.0%. The growth in revenue from domestic sales petroleum products was attributable to a 16.3% average price increase, which increased revenues by USD 557 million, and a 18.5% increase in sales volume, which had a positive impact on revenues of USD 531 million. The growth in sales prices was mainly attributable to the growth in world prices of petroleum products and inflation in Russia. The volume growth was mainly due to an increase in crude oil production and a decrease in domestic crude oil sales that was facilitated by the agreements entered into in the beginning of 2005 with Yukos-controlled refineries for the refining of crude oil produced by Yuganskneftegaz.

Revenue from the sale of petroleum products on the domestic market was USD 2,865 million in 2005 com-
pared to USD 1,240 million in 2004, an increase of USD 1,625 million, or 131.0%. The growth in revenue from domestic sales of petroleum products was attributable to a 15.2% price increase, which increased revenues by USD 379 million, and a 100.5% increase in sales volume, which had a positive impact on revenues of USD 1,246 million. The volume growth was mainly due to the acquisition of Yuganskneftegaz.

Gas Sales

Revenue from the sale of gas was USD 197 million in 2006 compared to USD 175 million in 2005, an increase of USD 22 million, or 12.6%. The growth in revenue from gas sales was attributable to a 9.4% increase in prices, which increased revenues by USD 17 million, and a 2.9% growth in sales volume, from 9.3 bcm to 9.57 bcm, which had a positive impact on revenues of USD 5 million.

Revenue from the sale of gas was USD 175 million in 2005 compared to USD 118 million in 2004, an increase of USD 57 million, or 48.3%. The growth in gas sales was attributable to a 16.5% increase in prices, which increased revenues by USD 25 million, and a 27.4% growth in sales volume, from 7.3 bcm to 9.3 bcm, which had a positive impact on revenues of USD 32 million.

Rosneft sells gas to Gazprom and to other parties. In 2006, the regional structure of Rosneft’s sales was as follows:

- In Western Siberia, 3.3 bcm were sold to Gazprom, 0.9 bcm to independent gas traders, 0.2 bcm to an independent company for further refining and 0.9 bcm to end consumers.
- In Southern Russia, 1.4 bcm were sold to end consumers, 1.2 bcm to independent gas traders and 1 bcm to Gazprom.
- In the Russian Far East, 0.7 bcm were sold to end consumers.

Support Services and Other Revenues

Support services and other revenues were USD 350 million in 2006, 3.9% higher than in 2005 (USD 337 million). This growth was mainly attributable to an increase in the volume and value of drilling services.

Support services and other revenues were USD 337 million in 2005, 14.6% higher than in 2004 (USD 294 million). This growth was mainly attributable to an increase in the volume and value of construction services.

Costs and Expenses

The following table sets forth Rosneft’s costs and expenses during the periods being analysed.

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(USD millions)</td>
<td>(%)</td>
</tr>
<tr>
<td>Production and operating expenses</td>
<td>2,197</td>
<td>1,623</td>
</tr>
<tr>
<td>Cost of purchased oil, petroleum products and refinery costs</td>
<td>1,320</td>
<td>637</td>
</tr>
<tr>
<td>Selling, general and administrative expenses</td>
<td>757</td>
<td>589</td>
</tr>
<tr>
<td>Pipeline tariffs and transportation costs</td>
<td>3,226</td>
<td>2,231</td>
</tr>
<tr>
<td>Exploration expenses</td>
<td>193</td>
<td>164</td>
</tr>
<tr>
<td>Depreciation, depletion and amortisation</td>
<td>1,638</td>
<td>1,472</td>
</tr>
<tr>
<td>Accretion expense</td>
<td>34</td>
<td>35</td>
</tr>
<tr>
<td>Taxes other than income tax</td>
<td>6,990</td>
<td>5,326</td>
</tr>
<tr>
<td>Export customs duty</td>
<td>11,140</td>
<td>6,264</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td><strong>27,495</strong></td>
<td><strong>18,341</strong></td>
</tr>
</tbody>
</table>

1 Unwinding of discount related to asset retirement obligations.
Costs and expenses were USD 27,495 million in 2006, or 49.9% higher than in 2005 (USD 18,341 million). The growth in costs and expenses was driven by higher amounts of export customs duty and mineral production tax, pipeline tariffs for transportation of oil and petroleum products, and by higher cost of crude oil purchases from Sakhalin-1 PSA. Costs and expenses accounted for 83.08% and 76.86% of Rosneft’s total revenues in 2006 and 2005, respectively.

Costs and expenses were USD 18,341 million in 2005, or 352.2% higher than in 2004 (USD 4,056 million). The growth in costs and expenses was driven by higher export custom duties and taxes other than income taxes (mainly mineral production tax), as well as increased production and sales volumes of crude oil and petroleum products, due mainly to the acquisition of Yuganskneftegaz. Costs and expenses accounted for 76.86% and 77.08% of Rosneft’s total revenues in 2005 and 2004, respectively.

Production and Operating Expenses

In 2006, production and operating costs were USD 2,197 million compared to USD 1,623 million in 2005, a 35.4% increase. The main contributors (excluding rouble appreciation) were higher production volumes, an increase in staff and employees, salaries and an increase in the cost of materials used in the downstream segment.

The acquisition of Yuganskneftegaz accounted for USD 825 million (80.3%) of the USD 1,028 million increase in production and operating expense in 2005 compared to 2004. Without accounting for Yuganskneftegaz, these expenses grew by 34.1%, mainly due to an 8.3% increase in production volumes, the real appreciation of the Russian rouble, and higher electricity tariffs, raw material and supplies costs, as well as increases in well workover and enhanced oil recovery service costs. Average salaries and allowances were also raised throughout Rosneft during 2005.

Upstream production and operating expenses include costs related to raw materials and supplies, equipment maintenance and repair, wages and salaries, activities to enhance oil recovery, wages and salaries, activities to enhance oil recovery, procurement of fuel and lubricants, electricity and other similar costs of production and exploration subsidiaries. Upstream operating expenses were USD 1,632 million in 2006, or USD 2.83 per barrel of crude oil produced and USD 2.49 per barrel of oil equivalent produced. Upstream operating expenses in 2006 net of Sakhalin-1 costs were USD 2.78 per barrel of crude oil produced and USD 2.44 per barrel of oil equivalent produced. These measures are defined below under “Key Financial Ratios.”

Upstream operating expenses were USD 1,333 million in 2005, or USD 2.49 per barrel of crude oil produced and USD 2.18 per barrel of oil equivalent produced. Upstream operating expenses were USD 344 million in 2004, or USD 2.32 per barrel of crude oil produced and USD 1.69 per barrel of oil equivalent produced.

Downstream operating expenses include costs of services provided by third parties (such as transshipment and storage services), operating expenses of the marketing companies, operating expenses of refineries and other items.

Of the total production and operating expenses, the upstream and downstream segments accounted for USD 1,632 million and USD 353 million, respectively, in 2006, USD 1,333 million and USD 226 million, respectively, in 2005 and USD 344 million and USD 122 million, respectively, in 2004.

Other activities’ operating expenses accounted for USD 212 million in 2006, USD 64 million in 2005 and USD 129 million in 2004.

The following table sets forth Rosneft’s refining costs and volumes at its proprietary refineries during the periods being analysed (including refineries’ operating expenses as well as selling, general and administrative expenses and taxes other than income taxes):

<table>
<thead>
<tr>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Refining costs for owned refineries (Komsomolskiy Refinery + Tuapsinskiy Refinery) (USD millions)</td>
<td>95</td>
</tr>
</tbody>
</table>
Cost of Purchased Oil, Petroleum Products and Refining Costs

The cost of purchased oil, petroleum products and refining costs includes crude oil and petroleum product procurement costs and costs of refining Rosneft’s crude oil at third-party refineries. The costs of refining Rosneft’s crude oil at third party refineries and petroleum products procurement costs, has been high in absolute terms since it is driven by the imbalance between Rosneft’s crude oil production and its refining capacity, as well as by the geographical complexity of Rosneft’s logistics. These factors explain the high proportion of crude oil refining costs paid to third-party refineries, as well as the need to purchase petroleum products from third parties, in 2005 and 2006.

The following table shows Rosneft’s third-party refining costs and crude oil and petroleum product procurement costs during the periods being analysed:

<table>
<thead>
<tr>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Throughput at Rosneft-owned refineries (Rosneft’s and other parties’ crude oil) (millions of tonnes)</td>
<td>10.79</td>
</tr>
<tr>
<td>Refining cost per tonne (USD)</td>
<td>8.80</td>
</tr>
<tr>
<td>Refining fees paid to third party refineries (USD millions)</td>
<td>506</td>
</tr>
<tr>
<td>Rosneft crude oil throughput at third party refineries (millions of tonnes)</td>
<td>13.11</td>
</tr>
<tr>
<td>Refining fees per tonne (USD)</td>
<td>38.60</td>
</tr>
<tr>
<td>Cost of procurement of petroleum products from third parties by the downstream segment ¹ (USD millions)</td>
<td>366</td>
</tr>
<tr>
<td>Procurement of petroleum products from third parties by the downstream segment ¹ (millions of tonnes)</td>
<td>0.94</td>
</tr>
<tr>
<td>Cost of procurement of crude oil from third parties by the downstream segment ² (USD millions)</td>
<td>448</td>
</tr>
<tr>
<td>Procurement of crude oil from third parties by the downstream segment ² (millions of barrels)</td>
<td>18.36</td>
</tr>
<tr>
<td>Total cost of purchased oil, petroleum products and refining costs</td>
<td>1,320</td>
</tr>
</tbody>
</table>

In 2006, the cost of purchased crude oil and petroleum products was USD 1,320 million, a 107.2% increase from USD 637 million in 2005, due to increases in refining fees paid to third party refineries and increased amounts of crude oil and petroleum products purchases.

¹ The upstream segment also purchases petroleum products from third parties for use in its own operations. These purchases are reflected in production and operating expenses and are included in upstream operating expenses to calculate the relevant key performance indicators mentioned below.

² The Company purchased crude oil from Sakhalin-1 and Udmurtneft.
In 2005, the cost of purchased oil, petroleum products and processing services was USD 637 million, a 16.5% increase from the USD 547 million reported in 2004. The increase was driven by the increased use of third party refineries to refine the greater volume of crude oil produced by Rosneft following the acquisition of Yuganskneftegaz in December 2004.

The cost of refining crude oil at third-party refineries is high relative to that of refining crude oil at Rosneft’s refineries, since the processing fees charged by third parties are fully costed, while the cost of refining crude oil at Rosneft’s refineries as reported above does not include depreciation, which is reported in depreciation, depletion and amortisation and taxes other than income tax. The need to rely on third-party refineries arose following the acquisition of Yuganskneftegaz, when Rosneft’s crude oil production increased significantly. At the end of the first quarter of 2005, Rosneft entered into agreements with Yukos controlled refineries for the refining of crude oil produced by Yuganskneftegaz. In 2006, third-party refining fees increased by 62.7% compared to 2005 which is explained by a 44.4% increase in processing cost per tonne at third parties’ refineries compared to 2005 due to a revised agreement with Yukos to cover capital expenditures in certain refineries to meet the new quality standards EURO-2 and EURO-3 and due to expanding the product mix to include more expensive petroleum products, in particular, lubricants. This increase was accompanied by a 12.7% increase in the volumes of refining.

In some circumstances, it may be more economical for Rosneft to purchase petroleum products from third parties to supply, together with its own petroleum products, to Rosneft’s marketing subsidiaries. The volume of petroleum products purchased from third parties during the periods being analysed amounted to 0.94 million tonnes in 2006, 0.72 million tonnes in 2005 and 1.85 million tonnes in 2004.

Until September 2006, Rosneft purchased almost all crude oil (approximately 7.32 million barrels) produced by the Sakhalin-1 PSA for USD 219 million. Approximately 4.61 million barrels of crude oil were supplied for refining to the Company’s Komsomolsky Refinery, and the rest was exported to Asia. Starting from September 2006, the Company no longer purchases oil from the Sakhalin-1 Consortium since the parties to the PSA commenced exports via the Consortium’s own terminal in De-Kastri, which started operations in the fourth quarter of 2006. In 2005 Rosneft purchased 2.14 million barrels of crude oil produced by the Sakhalin-1 PSA in the fourth quarter of 2005 for the amount of USD 95 million.

In 2006, Rosneft started to purchase oil from Udmurtneft. The volume of oil purchased in 2006 was 11.04 million barrels accounting for USD 229 million.

**General and Administrative Expenses**

General and administrative expenses include wages and salaries, banking commissions, third-party professional service fees for advisory, legal and audit services, insurance expenses, lease expenses with respect to non core property, expenses to establish allowances for doubtful accounts and other general expenses.

General and administrative expenses in 2006 were USD 757 million, 28.5% higher than in 2005 (USD 589 million). This increase was mainly due to increased legal, banking, consultancy, valuation, audit and other professional services, which were USD 102 million in 2006 and salaries, bonuses and social benefits, which were USD 325 million in 2006. In addition, office rent and insurance costs increased in 2006. Following the decision of the High Arbitrage court of the Russian Federation, the Company accrued provision for commitments and contingencies of Severnaya Neft in the amount of USD 39 million in 2006 in connection with a number of licence-related matters. In October 2006, the High Arbitrage court ruled against Severnaya Neft in favour of the Nenets autonomous district. As a result, Severnaya Neft will make payments to the administration of the Nenets autonomous district under the licence terms, amounting to USD 24 million, including USD 5 million of penalties, for periods prior to 2004 and to USD 15 million for 2004-2006.

General and administrative expenses were USD 589 million in 2005, 129.2% higher than in 2004 (USD 257 million), reflecting the first time inclusion of the selling, general and administrative expenses of Yuganskneftegaz of USD 92 million, expenses relating to audit, legal, consultancy, valuation and other professional services (including those incurred in connection with Yuganskneftegaz’ legal, tax and other cases) of USD 31 million; bank services and charges due to higher borrowings and a higher volume of operations of USD 52 million; direct write offs and allowances for doubtful accounts of USD 88 million (including amounts owed to Yuganskneftegaz by
Yukos following the payment by Yuganskneftegaz in 2005 of amounts Yukos had owed Transneft for the transportation of Yuganskneftegaz crude oil in 2004; salaries, pensions and social benefits to employees of USD 189 million.

**Pipeline Tariffs and Transportation Costs**

Pipeline tariffs and transportation costs include costs to transport crude oil for refining at own and third-party refineries and to end customers, and to deliver petroleum products from refineries to end customers. Transportation costs include the cost of pipeline transportation, sea freight, railway and river tariffs, handling, port fees and customs costs and demurrage.

Pipeline tariffs and transportation costs grew to USD 3,226 million in 2006 from USD 2,231 million in 2005, a 44.6% increase due mainly to an increase in the volume of transported oil (e.g. non-CIS export crude oil volumes increased by 26.3%) and in the pipeline and railway tariffs of natural monopolies. Rosneft’s crude oil export pipeline tariffs increased by 14.9% in 2006 compared to 2005. Rosneft’s crude oil domestic pipeline tariffs for transportation to refineries increased by 24.4% in 2006 compared to 2005. Rosneft’s tariff per tonne of exported petroleum products transported via Transneft increased by 17.1% in 2006 compared to 2005.

Railway domestic tariffs increased by 17.0% and railway export tariffs increased by 6.0% in 2006 compared to 2005. The main driver of domestic railroad tariffs’ growth was the overall increase in RZD tariffs and the curtailment of the discount in early 2006 granted to Rosneft by RZD in 2005, for crude oil supplies to Komsomolskiy Refinery in the Far East of the Russian Federation. Increased transportation volumes were due to oil supplies to China under the long-term contract signed in January 2005 with CNPC (see also “Crude Oil Export Sales” above) in connection with the acquisition of Yuganskneftegaz. See “—Significant Acquisitions—2004—Yuganskneftegaz.” A discount for supplies to China was granted by RZD subject to Rosneft transporting the minimum annual volumes agreed in advance.

Crude oil exported to China was transported in part by rail, and the rail tariffs were significantly higher than pipeline tariffs. In addition, the reduction in domestic sales of crude oil in 2006 resulted in higher transportation costs, since Rosneft, rather than its customers, bears the cost of transporting crude oil to refineries or to the border for export or for sale to the CIS.

In 2006, Rosneft transported approximately 165.2 million barrels (22.58 million tonnes) of crude oil via Transneft to domestic refineries and approximately 355.0 million barrels (48.53 million tonnes) for export sales via Transneft and CPC, compared to approximately 157.9 million barrels (21.58 million tonnes) of deliveries to domestic refineries and 292.5 million barrels (39.98 million tonnes) for export sales in 2005.

In 2005, Rosneft transported approximately 165.2 million barrels (22.58 million tonnes) of crude oil via Transneft to domestic refineries and approximately 355.0 million barrels (48.53 million tonnes) for export sales via Transneft and CPC, compared to approximately 157.9 million barrels (21.58 million tonnes) of deliveries to domestic refineries and 292.5 million barrels (39.98 million tonnes) for export sales in 2005.

**Exploration Expenses**

Exploration expenses mainly represent expenses relating to exploratory drilling, seismic and other geological and geophysical costs. Exploratory drilling costs are generally capitalized if commercial reserves of oil and gas are discovered, or written off as expenses in the current period in the event of unsuccessful exploration results. In 2006, 2005 and 2004, exploration expenditures were USD 193 million, USD 164 million and USD 51 million, respectively.

In 2006, exploration expenses were USD 193 million, an increase of USD 29 million, or 17.7%, as compared to 2005. The increase was mainly due to exploration expenses at the Sakhalin-5 and Kurmangazy projects and to a change in accounting for Sakhalin-1 in favour of a proportional consolidation from 31 July 2006. See “—Significant acquisitions—Change in accounting for Sakhalin-1 PSA”.

In 2005, exploration expenses increased by USD 113 million, or 221.6%, to USD 164 million from USD 51 mil-
lion in 2004. The increase was mainly due to Yuganskneftegaz’s expenses of USD 21 million (including expenses for geological and geophysical work) and a significant volume of exploratory work in the East Siberia region.

Depreciation, Depletion and Amortisation

Depreciation, depletion and amortisation includes depreciation of oil and gas producing assets, and other production and non-production assets.

Depreciation, depletion and amortisation was USD 1,638 million in 2006 compared to USD 1,472 million in 2005. The 11.3% increase was mainly due to significant capital expenditures which resulted in increased balance sheet value of fixed assets in 2006 as compared to 2005 and a 7.7% increase in oil production, while the depletion rate remained relatively unchanged, at 6.6% in 2005 and 6.1% in 2006.

Depreciation, depletion and amortisation was USD 1,472 million in 2005 compared to USD 307 million in 2004. The 379.5% increase was mainly due to the addition of the fixed assets of Yuganskneftegaz to the fixed assets of the Company, as well as additional investments to develop and maintain production. The carrying value of the Yuganskneftegaz fixed assets was determined on the basis of their estimated fair value after reduction for “negative goodwill” recorded under U.S. GAAP. Depreciation of the fixed assets of Yuganskneftegaz amounted to USD 968 million during 2005.

Taxes Other than Income Tax

Taxes other than income tax include mineral production tax, excise tax (mainly with respect to petroleum products), the unified social tax, property tax and other taxes. The basis for the calculation of mineral production tax is described under “—Main Factors Affecting Results of Operations—Changes in Mineral Production Tax and Export Customs Duties” above. Taxes other than income tax have increased throughout the periods being analysed, mainly due to the impact of mineral production tax.

The following table sets forth Rosneft’s taxes other than income tax during the periods being analysed:

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>(USD millions)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mineral production tax</td>
<td>6,342</td>
<td>4,716</td>
</tr>
<tr>
<td>Excise tax</td>
<td>329</td>
<td>286</td>
</tr>
<tr>
<td>Social security</td>
<td>154</td>
<td>118</td>
</tr>
<tr>
<td>Property tax</td>
<td>107</td>
<td>73</td>
</tr>
<tr>
<td>Land tax</td>
<td>7</td>
<td>14</td>
</tr>
<tr>
<td>Transportation tax</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Other taxes and payments</td>
<td>49</td>
<td>117</td>
</tr>
<tr>
<td><strong>Total taxes other than income tax</strong></td>
<td><strong>6,990</strong></td>
<td><strong>5,326</strong></td>
</tr>
</tbody>
</table>
prices. The higher production volume was mainly due to the acquisition of Yuganskneftegaz.

Export Customs Duty

Export customs duty payable by the Company includes crude oil and petroleum product export customs duties. Export customs duty is discussed above under “Main Factors Affecting Results of Operations—Changes in Mineral Production Tax and Export Customs Duties.” Export customs duty has increased as a percentage of total revenue throughout the periods being analysed.

The following table sets forth Rosneft’s export duties during the periods being analysed.

<table>
<thead>
<tr>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export duty for crude oil</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>5,322</td>
</tr>
<tr>
<td>2005</td>
<td>535</td>
</tr>
<tr>
<td>2004</td>
<td>83.4%</td>
</tr>
<tr>
<td>Export duty for petroleum products</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>1,377</td>
</tr>
<tr>
<td>2005</td>
<td>942</td>
</tr>
<tr>
<td>2004</td>
<td>46.2%</td>
</tr>
<tr>
<td>Total export customs duties</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>6,264</td>
</tr>
<tr>
<td>2005</td>
<td>706</td>
</tr>
<tr>
<td>2004</td>
<td>77.8%</td>
</tr>
</tbody>
</table>

Export customs duties were USD 11,140 million in 2006 compared to USD 6,264 million in 2005. The significant increase resulted from a 26.3% increase in the volumes of crude oil exported to the non-CIS countries and an increase in tariffs of export customs duties in the range of 47-57% depending on the type of hydrocarbons.

Export customs duties were USD 6,264 million in 2005 compared to USD 706 million in 2004. The increase resulted from greater volumes of crude oil and petroleum product exports and of domestic sales of petroleum products, as well as higher export customs duty.

Operating Income

As a result of the factors discussed above, operating income increased by 1.5% in 2006, 357.9% in 2005 and 81.6% in 2004.

As a percentage of total revenues, operating income was 16.92%, 23.14% and 22.92% in 2006, 2005 and 2004, respectively. As a percentage of total revenues, operating income before taxes other than income tax and export customs duty, was 71.70%, 71.70% and 55.55%, in 2006, 2005 and 2004, respectively.

Interest Income

Interest income increased by 66.7% to USD 135 million in 2006 from USD 81 million in 2005. Interest income increased by 24.6% to USD 81 million in 2005 from USD 65 million in 2004. These increases were mainly due to the growth in the Group’s banking operations.

Interest Expense

Interest expense decreased by 6.6% to USD 724 million in 2006 compared to USD 775 million in 2005. In April 2006, the Company entered into a contract im-

(Loss)/Gain on Disposal of Property, Plant and Equipment

The Company disposes of property, plant and equipment from time to time. In 2006, loss from property, plant and equipment disposition were USD
95 million compared to a loss of USD 74 million in 2005 due to the write-off of certain social infrastructure assets which were financed by the Company’s oil-related businesses. In 2004, customary losses on these dispositions were more than offset by a significant gain on the sale of an offshore drilling platform. As a result, Rosneft reported a USD 121 million gain in that year.

Gain on Disposal of Share in CJSC Sevmorneftegaz

In the first half of 2005, Rosneft sold a 50% interest in CJSC Sevmorneftegaz held by Purneftegaz to Gazprom for USD 1,344 million. Sevmorneftegaz is developing the Prirazlomnoye and Shtokmanovskoye fields in Yamalo-Nenetsky autonomous district. Under the terms of the sale, Gazprom paid for this interest in December 2004, while title to the interest passed to Gazprom in the second quarter of 2005. Gazprom also had the right to notify the Company not later than June 2005 of its intention to sell the purchased interest back to the Company, in which case the Company was obliged to repurchase and pay for it. Gazprom did not exercise this right. Accordingly, in June 2005, Rosneft recorded gain on the sale of its interest in CJSC Sevmorneftegaz in the amount of USD 1,303 million. As of 31 December 2004, the sale proceeds of USD 1,344 million were reflected as short-term debt on the Company’s balance sheet, because of Gazprom’s right to sell the interest back to the Company.

Other Expenses, Net

Other expenses, net, consist in 2006 principally of costs of court proceedings and judgments and arbitration and awards costs, as well as social expenditures and contributions to charity.

In 2006, other expenses, net, were USD 320 million, a 135.3% increase from 2005. This increase is mainly due to arbitration award and related expenses of USD 134 million accrued in 2006 as a result of an unfavourable award for the Company in the arbitration with Total E&P Vankor (see Note 25 to 2006 Financial Statements, “Commitments and contingencies”). In addition, in 2006 the Company spent USD 37 million for the construction of social facilities. The Company did not carry out such constructions in 2005. In 2005, other expenses, net, were USD 136 million, a 30.6% decrease from 2004.

Foreign Exchange (Loss)/Gain

Foreign exchange loss was USD 470 million in 2006 compared to a foreign exchange gain of USD 245 million in 2005. The loss resulted from the impact of the appreciation of the rouble against the U.S. dollar compared to its depreciation in 2005. As a result, the Company’s rouble denominated net monetary liability position increased when denominated in U.S. dollars but remained unchanged when denominated in roubles. The rouble-denominated net monetary position was negative mainly due to Yuganskneftegaz current and deferred tax liabilities following its acquisition at the end of 2004 whereby accounts receivable were denominated in U.S. dollars due to a high proportion of export sales. The gain in 2005 resulted from the impact of the depreciation of the rouble against the U.S. dollar on the Company’s rouble denominated monetary net liability position.

Income Tax Expenses

The following table sets forth the Company’s effective income tax rate under U.S. GAAP:

<table>
<thead>
<tr>
<th>For the year ended 31 December</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective income tax rate for Rosneft under U.S. GAAP</td>
<td>13%</td>
<td>26%</td>
<td>25%</td>
</tr>
</tbody>
</table>

The Company does not pay taxes based on consolidated income before taxes under Russian law. Income tax is calculated for each subsidiary based on its profits in accordance with RAR. The U.S. GAAP effective profit tax rate during 2006 was lower than the maximum rate of 24% established by Russian tax legislation throughout the periods being analysed.

The most significant factors influencing the effective income tax rate is the payment of income tax at 20% by Yuganskneftegaz and Purneftegaz resulting from regional tax benefits, the creation of a bad debt provision in tax accounting in relation to accounts re-
ceivable from Yukos recorded at zero fair value in the consolidated financial statements which resulted in a decrease in the current income tax of USD 539 million, and a decrease by USD 75 million in the deferred tax asset valuation allowance related to property, plant and equipment due to a change in estimates resulting from new circumstances increasing the chances of realisability of this asset.

As discussed above under “Business Segments and Intersegment Sales,” Rosneft subsidiaries engage in significant intragroup transactions for which Rosneft management determines transfer prices. Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to make transfer pricing adjustments and impose additional tax liabilities in respect of all controlled transactions, provided that the transaction price differs from the market price by more than 20%. Controlled transactions include transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions with significant (by more than 20%) price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and courts, especially when, as in the case of the domestic market for crude oil, market prices are difficult to determine. Due to the uncertainties in the interpretation of transfer pricing legislation, and the difficulty of determining domestic market prices for crude oil, the tax authorities may challenge Rosneft’s transfer prices and propose adjustments. If such price adjustments are upheld by the Russian courts and implemented, Rosneft’s future financial results could be adversely affected. In addition, Rosneft could face significant losses associated with the assessment of prior tax underpaid and related interest and penalties, which could have an adverse effect on Rosneft’s financial condition and results of operations. For example, a significant adjustment was made in 2005 in the total amount of USD 922 million (including penalties and interest) in relation to transfer pricing claims against Yuganskneftegaz arising from transactions entered into from 1999 through 2003, prior to its acquisition by Rosneft. USD 836 million of the USD 922 million was taken as an adjustment to the fair value of the liabilities assumed as a result of the Yuganskneftegaz acquisition, and the remaining amount of USD 86 million was treated as current income tax expense and taxes other than income tax. Rosneft seeks to ensure that its transfer pricing complies with the transfer pricing rules.

Income tax expense was USD 540 million in 2006 compared to USD 1,609 million in 2005. Current income tax increased from USD 1,688 million in 2005 to USD 2,385 million in 2006, while deferred income tax benefit increased from USD 79 million in 2005 to USD 1,845 million in 2006, mainly due to the recognition of a deferred tax asset in the amount of USD 1,285 million recorded as a result of a favourable court decision on the Company’s claim for the lost profits against Yukos rendered at the end of 2006, whereby taxable non-operating income relating to the amount awarded by the court was recognised for Russian accounting tax purposes but not under U.S. GAAP. Taxes paid in 2006 on this non-operating income are treated for U.S. GAAP purposes as the creation of a deferred tax asset resulting in corresponding deferred tax benefit. This income is expected to reverse in 2007 when the non-operating income is recognised under U.S. GAAP when it is realised in the Yukos bankruptcy procedure.

Income tax was USD 1,609 million in 2005 compared to USD 298 million in 2004. Current income tax increased from USD 309 million to USD 1,688 million, while deferred income tax benefit increased from USD 11 million in 2004 to USD 79 million in 2005. The increase in current income tax was mainly connected with the growth of the Company’s income before income taxes as a result of higher production volumes and market prices. Income tax expense in 2005 includes the tax of USD 313 million accrued on the proceeds from the divestment of Rosneft’s interest in CJSC Sevmorneftegaz and the USD 86 million adjustment referred to above.

Minority Interest in Subsidiaries’ Earnings

As discussed above under “Development of the Group—Consolidation via Share Swap,” there were significant minority interests in the Company’s subsidiaries during the periods being analysed prior to the Share Swap in October 2006, which were eliminated as a result of the Share Swap.

Minority interest in subsidiaries’ earnings was USD 92 million in 2006 compared to USD 446 million in 2005 including the USD 167 million effect on the minority interest of the divestment in 2005 of the 50% interest in Sevmorneftegaz described above. A further influence on minority interest was a decrease in the net income of Yuganskneftegaz in 2006 due to foreign exchange losses on current and deferred tax liabilities.

Minority interest in subsidiaries’ earnings was USD 446 million in 2005 compared to USD 66 million in 2004. The main changes were caused by the generation of profit in Yuganskneftegaz, where minority interest amounted to USD 234 million, and in Purneftegaz,
where minority interest increased by USD 150 million, mainly as a result of proceeds from the divestment of the 50% interest in Sevmorneftegaz described above.

**Net Income**

As a result of the factors discussed above, net income before minority interest decreased by 21.3% in 2006 to USD 3,625 million from USD 4,605 million in 2005. Net income before minority interest increased by 410.0% in 2005 from USD 903 million.

Net income before minority interest adjusted for gain from the sale of Sevmorneftegaz increased by 0.3% in 2006, by 300.3% in 2005 and by 106.2% in 2004. As a percentage of total revenues, adjusted net income was 11.0%, 15.1% and 17.2% in 2006, 2005 and 2004, respectively.

**Liquidity and Capital Resources**

**Cash Flows**

The principal items of the statement of cash flows for 2006, 2005 and 2004 are as follows:

<table>
<thead>
<tr>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net cash provided by/(used in) operating activities</td>
<td>(USD millions)</td>
</tr>
<tr>
<td>Net cash provided by/(used in) operating activities</td>
<td>2,593</td>
</tr>
<tr>
<td>Net cash used in investing activities</td>
<td>(6,516)</td>
</tr>
<tr>
<td>Net cash (used in)/provided by financing activities</td>
<td>3,225</td>
</tr>
</tbody>
</table>

**Net Cash Provided by/(Used in) Operating Activities**

Net cash provided by operating activities was USD 2,593 million, USD 2,941 million and USD 700 in 2006, 2005 and 2004, respectively. The increase in operating net cash flow from 2004 was primarily due to higher net income, which increased by more than 4 times in the period 2004-2006 (USD 837 million in 2004 compared to USD 3,533 million in 2006). Net cash provided by operating activities before taking into account changes in operating assets and liabilities net of acquisitions was lower in 2006, amounting to USD 3,760 million compared with USD 4,663 million in 2005 and amounted to USD 1,045 million in 2004. The decrease in cash provided by operating activities in 2006 reflected the decline in net income. Net income declined, despite an increase in revenues, in significant part due to the increase in export customs duty, which grew faster than revenues, as well as due to payment of USD 1,285 million income tax on non-operating income resulting from a favourable court decision on the Company’s claim for the lost profits against Yukos rendered at the end of 2006. See “—Main Factors Affecting Results of Operations—Changes in Mineral Production Tax and Export Customs Duty” and “—Results of Operations—Costs and expenses—Income tax expenses”. Depreciation, depletion and amortisation and minority interest in subsidiaries’ earnings, as non-cash charges to net income, had a significant positive impact in reconciling net income to operating cash flow in each year, while the adjustment for the gain on disposal of the Company’s share in CJSC Sevmorneftegaz had a significant negative effect in 2005 due to the full payment being received in 2004. Depreciation, depletion and amortisation was USD 1,638 million, USD 1,472 million and USD 307 million in 2006, 2005 and 2004, respectively. Minority interest in subsidiaries’ earnings was USD 92 million, USD 446 million and USD 66 million in 2006, 2005 and 2004, respectively.

Increase in operating assets and liabilities net of acquisitions amounted to USD 1,167 million, USD 1,722 million and USD 345 million in 2006, 2005 and 2004, respectively. The significant negative adjustment in 2006 resulted mainly from increases in accounts receivable (due to an increase in sales volumes and prices) and an increase in inventories. The increase in accounts receivable in 2006 compared to 2005 is due to the following factors:
• increase in input VAT of USD 556 million, which was mainly caused by a delay in the reimbursement of export VAT in connection with Yuganskneftegaz’ merger to the Company due to significant unsettled tax liabilities of Yuganskneftegaz and an increase in input VAT in relation to the Vankorskoye field generating significant capital expenditure made whereas VAT is reimbursed only when the field begins to produce crude oil;
• increase in banking loans to customers of USD 275 million in connection with loans provided VBRR and Dalnevostochny Bank; and
• the increase in trade accounts receivable totalling USD 241 million resulting from increased sales and the appreciation of the rouble.

The increase in operating assets and liabilities net of acquisitions in 2005 resulted mainly from increases in accounts receivable, receivables relating to sales and export VAT, combined with a reduction in accounts payable and accrued liabilities. This increase was partially offset by increased income tax liabilities and other tax liabilities. These changes resulted from the significant increase in the scale of Rosneft’s business following the acquisition of Yuganskneftegaz. In addition, the increase in accounts receivable also reflected a non-recurring change resulting from the initially low level of accounts receivable in Yuganskneftegaz, which normalised during 2005.

When businesses are purchased, changes in operating assets and liabilities shown in net cash provided by operating activities are only recorded from the date of acquisition. The initial contribution to operating assets and liabilities of businesses purchased are thus not recorded as a change thereto in the year of acquisition. The initial contribution of assets and liabilities from Yuganskneftegaz to Rosneft’s balance sheet as of 31 December 2004 is shown under “Initial allocation” in Note 4 to the financial statements for the year ended 31 December 2004 (“2005 Financial Statements”).

In 2005, Yuganskneftegaz’ contribution was adjusted as shown under “Final allocation” in Note 4 to the 2005 Financial Statements. This final allocation is in effect Yuganskneftegaz’ contribution to Rosneft’s opening balance sheet for 2005 and was used for the purposes of calculating changes in operating assets and liabilities in the statement of cash flows. Rosneft’s consolidated balance sheet as of 31 December 2004 was prepared using the initial allocation of assets and liabilities and has not been restated for this final allocation. However, the impact on Rosneft’s consolidated statement of income has been accounted for retrospectively from 1 January 2005 on the basis of the opening balance sheet that reflects the final allocation.

The principal adjustments in the final allocation were:
• A reduction in accounts receivable;
• An increase in income tax and other tax liabilities; and
• A reduction in negative goodwill, reflected as an increase in oil and gas properties, net.

**Net Cash Used in Investing Activities**

Net cash used in investing activities was USD 6,516 million in 2006 compared to USD 2,322 million in 2005. The increase is principally due to higher capital expenditures amounting to USD 3,462 million, repayment of Sakhalin-1 financing in the amount of USD 1,339 million, acquisition of licences, net purchases of short-term investments and the acquisition of Yukos debt from a consortium of Western banks in the amount of USD 483 million, of which USD 463 million was included in the cash flow statement for 2006.

Net cash used for investing activities amounted to USD 2,322 million in 2005 compared to USD 10,162 million in 2004. This decrease was primarily attributable to the high outflows in 2004 resulting from the Yuganskneftegaz acquisition. As discussed more fully below, capital expenditures and acquisitions of entities (other than the Yuganskneftegaz acquisition) and additional shares in subsidiaries increased from USD 1,099 million in aggregate in 2004 to USD 2,310 million in 2005. The Company made a significant short-term loan to its parent, Rosneftegaz, in 2005, which was repaid during the course of the year.

**Net Cash Provided by/(Used in) Financing Activities**

Net cash provided by financing activities was USD 3,225 million in 2006 compared to net cash used in financing activities of USD 458 million in 2005. The change was primarily due to the USD 2,115 million of proceeds from the Ordinary Share issue as part of the Company’s IPO.

Net cash used in financing activities decreased to USD 458 million in 2005 from USD 10,243 million of net cash provided by financial activities in 2004. The decrease was primarily attributable to Rosneft’s lower needs for borrowings compared to the previous year, which was affected by the need to finance the Yuganskneftegaz acquisition. Proceeds from short-term debt in 2004 include proceeds of USD 1,344 million from the disposal of CJSC Sevmorneftegaz. The Company was able to refi-
nance a significant part of its short-term debt with long-term borrowings in 2005.

**Capital Expenditures**

Rosneft’s total capital expenditures by types of activities for 2006, 2005 and 2004, as well as its licence acquisition costs, are set forth below:

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>% change from the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(USD millions)</td>
<td>(%)</td>
</tr>
<tr>
<td>Upstream</td>
<td>2,795</td>
<td>1,606</td>
</tr>
<tr>
<td>Downstream</td>
<td>483</td>
<td>303</td>
</tr>
<tr>
<td>Other activities</td>
<td>184</td>
<td>35</td>
</tr>
<tr>
<td>Total capital expenditures</td>
<td>3,462</td>
<td>1,944</td>
</tr>
<tr>
<td>Licence acquisition costs</td>
<td>916</td>
<td>146</td>
</tr>
<tr>
<td>Total capital expenditures and acquisition of licences</td>
<td>4,378</td>
<td>2,090</td>
</tr>
</tbody>
</table>

Rosneft’s total capital expenditures increased by 78.1% or by USD 1,518 million to USD 3,462 million in 2006 compared to USD 1,944 million in 2005. The increase in capital expenditures in 2006 was primarily driven by the upstream segment, where capital expenditures increased by 74.0%, or by USD 1,189 million. This growth was mainly attributable to investments in Yuganskneftegaz, new Stavropolineftegaz fields and the Vankorskoje field. Licence acquisition costs in 2006 totalled USD 916 million, compared to USD 146 million in 2005 and USD 0 million in 2004.

Rosneft’s total capital expenditures increased by approximately 134.5% to USD 1,944 million in 2005 compared to USD 829 million in 2004, or by USD 1,115 million. Growth of capital expenditures in 2005 was primarily driven by the upstream segment, where capital expenditures increased by approximately 182.7%, or by USD 1,038 million, from USD 568 million in 2004 to USD 1,606 million in 2005. This capital expenditure growth was mainly attributable to investments in Yuganskneftegaz for the purpose of stabilising and then increasing production. Licence acquisition costs totalled USD 916 million in 2005, including USD 134 million related to the Vorgamusurskoe field.

Capital expenditures in the downstream segment were USD 483 million in 2006, an increase of 59.4% in comparison with USD 303 million in 2005 as a result of expansion of Rosneft’s network of filling stations. Capital expenditures in the downstream segment increased by 22.7%, or by USD 56 million, from USD 247 million in 2004 to USD 303 million in 2005, primarily as a result of developing Rosneft’s seaport at Tuapse.

Capital expenditures for other activities increased by USD 149 million amounting to USD 184 million in 2006, primarily due to investments in the construction of twin-hull shuttle oil tankers. Capital expenditures for other activities increased by 150.0% in 2005 from USD 14 million in 2004, primarily as a result of increased capital expenditures of VBRR and RN-International LLC.

In addition to capital expenditures described above, the Company made acquisitions and increased its shareholdings in certain subsidiaries. See “—Significant Acquisitions” and “—Development of the Group—Increased Stakes in Subsidiaries”. In 2006, Rosneft spent USD 13 million to purchase a network of filling stations in the Murmansk region (via Exponeft LLC), USD 19 million to purchase Netreport and increase its shareholding in Rosneft-Tuapse nefteprodukt (USD 100 million), VBRR (USD 12 million) and Daltransgaz (USD 45 million). In 2005, Rosneft spent USD 360 million in relation to acquiring Verkhnechonskneftegaz and increasing its shareholdings in Krasnodarneftegaz and Selkupneftegaz. In 2004, in addition to its acquisition of Yuganskneftegaz, Rosneft spent USD 270 million to purchase additional shareholdings in its subsidiaries, the majority of which related to increasing Rosneft’s shareholdings in Eniseyneft and the Tuapsinskiy Refinery.

**Debt Obligations**

Over the past years, Rosneft has raised significant amounts of funds through net additional short term debt
and long-term loans to supplement the net cash generated by Rosneft’s operating activities in order to fund the capital expenditures required to develop Rosneft’s upstream and downstream operations and to purchase new businesses, assets and licences, in particular in the upstream segment. Most of the additional debt was raised in 2004 in connection with the acquisition of Yuganskneftegaz in December 2004. See “—Significant Acquisitions—2004—Yuganskneftegaz.”

Rosneft’s total loans and borrowings amounted to USD 13,829 million as of 31 December 2006, USD 12,203 million as of 31 December 2005 and USD 13,742 million as of 31 December 2004. As of 31 December 2006, 2005 and 2004, 68.2%, 85.5% and 18.0%, respectively, of Rosneft’s borrowings were secured against crude oil export contracts. As of 31 December 2006, 2005 and 2004, pledged oil export as a percentage of total crude oil export sales to non-CIS countries was 31.8%, 44.8% and 42.8% respectively.

Rosneft’s strategy has been to finance its growth primarily with long-term borrowings, which are predominantly denominated in U.S. dollars.

Rosneft’s long-term borrowings (excluding the current portion of long-term debt) decreased to USD 7,402 million as of 31 December 2006 from USD 8,198 million as of 31 December 2005. The weighted average rate of interest on the Company’s long-term loans, excluding bank loans raised for funding the acquisition of Yuganskneftegaz, denominated in U.S. dollars was 5.96% (LIBOR plus 0.64%) and 6.58% (LIBOR plus 2.19%) per annum as of 31 December 2006 and 2005, respectively.

Rosneft’s long-term borrowings (excluding the current portion of long-term debt) decreased to USD 8,198 million as of 31 December 2005 from USD 9,022 million as of 31 December 2004. The weighted average rate of interest on the Company’s long-term loans, excluding bank loans raised for funding the acquisition of Yuganskneftegaz, denominated in U.S. dollars was 6.58% and 5.50% (LIBOR plus 2.19% and LIBOR plus 3.10%) for 2005 and 2004, respectively. Rosneft’s long-term borrowings raised for funding the acquisition of Yuganskneftegaz are described in “—Significant Acquisitions—2004—Yuganskneftegaz.”

As discussed in Note 17 to the Financial Statements and in the report of independent auditors included therein, as of 31 December 2004, the Company was not in compliance with certain provisions of its debt agreements, which constituted events of default, and as a result, the related debt became callable by the respective creditors as of that date. In July 2005, the creditors waived violations related to restrictive financial ratios and agreed to amend the financial ratio covenants in line with the Company’s new structure and scope of activities. The creditors also waived other events of default arising from the breach of other covenant provisions. With effect from 1 January 2007, the creditors granted amendments to the loan agreements which remove these provisions and have included new waivers which state that the Company must:

- redeem, secure, discharge in full or restructure (and comply with any restructuring plans once it is agreed upon) all Yuganskneftegaz’s tax liabilities by 3 January, 2008;
- pay any arbitration award relating to Moravel Litigation or the Yukos Capital S.a.r.l. Litigation if any such arbitration award is granted by a court of the Russian Federation, within the time frame provided for such payment under Russian Law.

These conditions also apply to certain new borrowings obtained throughout 2005 and 2006. Thus, as of 31 December, 2006 and 2005, long-term borrowings, for which creditors either waived events of default arising from the breach of certain covenant provisions or amended loan agreements thereof, amounted to USD 3,444 million and USD 2,831 million, respectively. This debt continued to be reflected as long term in nature as of 31 December, 2006 and 2005. As of 31 December, 2006, the Company was in compliance with all restrictive financial and other covenants contained within its loan agreements.

Rosneft’s short-term loans (including the current portion of long-term debt) increased to USD 6,427 million as of 31 December 2006 from USD 4,005 million as of 31 December 2005. The range of average rates of interest on Rosneft’s short-term loans denominated in U.S. dollars ranged from LIBOR plus 0.75% to LIBOR plus 3.02% per annum in 2006. The rouble denominated loans bore average interest rates ranging from 4% to 8% per annum in 2006.

Rosneft’s short-term borrowings (including the current portion of long-term debt) decreased to USD 4,005 million as of 31 December 2005 from USD 4,720 million as of 31 December 2004. The range of average rates of interest on Rosneft’s short-term loans denominated in USD was LIBOR plus 1.0% to 3.32% per annum for the year 2005. The rouble denominated loans bore average interest rates of 1.25% to 9% per annum for the year 2005. To refinance its short-term loans, the Company continues to raise external funding.
The following table shows the scheduled maturities of Rosneft’s long-term debt outstanding as of 31 December 2006:

<table>
<thead>
<tr>
<th>Year</th>
<th>(USD millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2,362</td>
</tr>
<tr>
<td>2008</td>
<td>2,468</td>
</tr>
<tr>
<td>2009</td>
<td>2,449</td>
</tr>
<tr>
<td>2010</td>
<td>2,114</td>
</tr>
<tr>
<td>2011</td>
<td>250</td>
</tr>
<tr>
<td>2012 and after</td>
<td>121</td>
</tr>
<tr>
<td><strong>Total long term debt</strong></td>
<td><strong>9,764</strong></td>
</tr>
</tbody>
</table>

In March 2007, RN-Razvitie LLC, a wholly owned subsidiary of the Company, won the tender for the acquisition of 9.44% of the share capital of Rosneft and promissory notes of Yuganskneftegaz from Yukos for a total consideration of RUB 197.84 billion (USD 7.59 billion at the CBR exchange rate in effect as at the date of the auction), or RUB 194.28 for 1 share (USD 7.45 at the CBR exchange rate as at the date of the auction). In May 2007, Neft-Aktiv LLC, a wholly owned subsidiary of the Company, won the auction for the sale of certain assets of Yukos for a total consideration of RUB 175.70 billion (USD 6.82 billion at the CBR exchange rate in effect as at the date of the auction). These acquisitions were financed by syndicated loans in the total aggregate amount of USD 22 billion. See “—Significant Acquisitions—2007—Acquisition of Assets in Yukos Auctions.”

In February 2007, the Company entered into a six month bridge loan with a consortium of international banks in the amount of USD 2.5 billion at an interest rate of LIBOR plus 0.25 to 0.30% per annum, depending on the final repayment date. These funds are expected to be used for temporary refinancing (until corresponding long-term loans are entered into) of short-term loans obtained from Russian banks in the fourth quarter of 2006 with less favourable terms.

Rosneft’s plan for 2007 is to finance its budgeted capital expenditures, interest and dividends mainly out of operating cash flows, which Rosneft expects to increase through higher sales volumes (as a consequence of higher production volumes). Simultaneously, Rosneft intends to improve its debt profile. For this purpose, Rosneft intends to continue to rely mainly on long-term borrowings for its financing needs, decreasing the percentage of Rosneft’s secured debt and decreasing the charges associated with Rosneft’s debt. These activities are aligned with Rosneft’s ongoing efforts to improve its operating performance.

**Guarantee**

In January 2007, the Company entered into a guarantee agreement in respect of all the obligations of Vankorneft under a letter of credit for the amount of USD 62 million expiring 730 days after the date of issue of the letters of credit. The Company evaluates the default risk of Vankorneft under the letter of credit as low.

**Key Financial Ratios**

The Company monitors and evaluates its activities on an ongoing basis. Key financial ratios are given below for the years indicated:

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
</tr>
<tr>
<td>EBITDA margin</td>
<td>22.0%</td>
</tr>
<tr>
<td>Adjusted net income margin</td>
<td>11.0%</td>
</tr>
<tr>
<td>before minority interest</td>
<td></td>
</tr>
<tr>
<td>Return on average capital employed (ROACE)</td>
<td>18.2%</td>
</tr>
<tr>
<td>Return on average equity (ROAE)</td>
<td>23.1%</td>
</tr>
<tr>
<td>Net debt to capital employed ratio</td>
<td>0.38</td>
</tr>
<tr>
<td>Net debt to EBITDA ratio</td>
<td>1.83</td>
</tr>
<tr>
<td>Current ratio</td>
<td>0.87</td>
</tr>
<tr>
<td><strong>(USD)</strong></td>
<td></td>
</tr>
<tr>
<td>EBITDA/bbl</td>
<td>12.63</td>
</tr>
<tr>
<td>EBITDA/boe</td>
<td>11.09</td>
</tr>
</tbody>
</table>
The Company considers EBITDA/bbl, ROACE, ROAE, upstream operating expenses/bbl, upstream operating expenses/boe and the related indicators as important measures of its operating performance. In addition, these measures are frequently used by financial analysts, investors and other interested parties in the evaluation of oil and gas companies. These measures have limitations as analytical tools and should not be considered in isolation, or as a substitute for analysis of the Company’s operating results as reported under U.S. GAAP.

EBITDA/bbl and EBITDA/boe are calculated for any period by dividing EBITDA for that period by the barrels of crude oil or barrels of oil equivalent, respectively, produced during that period. No adjustments to these measures are made to take into account the effect of changes in inventories during the period.

Upstream capital expenditures/bbl and upstream capital expenditures/boe are calculated for any period by dividing the capital expenditures in the upstream segment during that period by the barrels of crude oil or barrels of oil equivalent, respectively, produced during that period. No adjustments to these measures are made to take into account the effect of changes in inventories during the period.

Upstream operating expenses/bbl and upstream operating expenses/boe are calculated for any period by dividing the production and operating expenses of the upstream segment during that period by the barrels of crude oil or barrels of oil equivalent, respectively, produced during that period. No adjustments to these measures are made to take into account the effect of changes in inventories during the period.

Adjusted free cash flow before interest/bbl and adjusted free cash flow before interest/boe are calculated for any period by dividing adjusted free cash flow before interest during that period by the barrels of crude oil or barrels of oil equivalent, respectively, produced during that period. Adjusted free cash flow before interest is net cash provided by operating activities minus capital expenditures plus cash interest payments. Licence acquisition costs are not included in capital expenditures. No adjustments to these measures are made to take into account the effect of changes in inventories during the period.

Upstream operating expenses include lifting costs, and the costs of gathering, treating, processing and storing the crude oil and gas in the fields and delivering the crude oil and gas to a main pipeline (e.g., a Transneft trunk pipeline transshipment point). Upstream operating expenses exclude a portion of the costs relating to intersegment transactions, mainly operating leases relating to certain oil and gas facilities. Upstream operating expenses include for 2006 similar operating leases between Yuganskneftegaz and service entities controlled by Yukos. One of these entities, CJSC Yukos-Mamontovo, has been transferred to Rosneft in April 2007 pursuant to a court decision and amounts in respect of these operating leases will be excluded as intersegment transactions going forward. The Company believes these exclusions are appropriate because if the leased oil and gas facilities had been owned by the upstream segment instead of being leased by it from another segment, depreciation expense would have accrued instead of lease expense, and that depreciation expense would not have been included in upstream operating expenses.

The following tables set forth relevant figures relating to these measures for the years indicated:

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
</tr>
<tr>
<td>Upstream capital expenditure/bbl</td>
<td>4.85</td>
</tr>
<tr>
<td>Upstream capital expenditure/boe</td>
<td>4.26</td>
</tr>
<tr>
<td>Upstream operating expenses/bbl</td>
<td>2.83</td>
</tr>
<tr>
<td>Upstream operating expenses/boe</td>
<td>2.49</td>
</tr>
<tr>
<td>Adjusted free cash flow before interest/bbl</td>
<td>(0.26)</td>
</tr>
<tr>
<td>Adjusted free cash flow before interest/boe</td>
<td>(0.23)</td>
</tr>
</tbody>
</table>
### Upstream Measures

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upstream capital expenditures (1) (USD millions)</td>
<td>2,795</td>
<td>1,606</td>
<td>568</td>
<td></td>
</tr>
<tr>
<td>Upstream operating expenses (USD millions)</td>
<td>1,632</td>
<td>1,333</td>
<td>344</td>
<td></td>
</tr>
<tr>
<td>Barrels of crude oil produced (milions)</td>
<td>576.31</td>
<td>535.16</td>
<td>148.26</td>
<td></td>
</tr>
<tr>
<td>Barrels of oil equivalent produced (milions)</td>
<td>656.03</td>
<td>611.76</td>
<td>203.28</td>
<td></td>
</tr>
</tbody>
</table>

### Calculation of Adjusted Free Cash Flow before Interest

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net cash provided by operating activities (USD millions)</td>
<td>2,593</td>
<td>2,941</td>
<td>700</td>
<td></td>
</tr>
<tr>
<td>Capital expenditures (1)</td>
<td>(3,462)</td>
<td>(1,944)</td>
<td>(829)</td>
<td></td>
</tr>
<tr>
<td>Free cash flow</td>
<td>(869)</td>
<td>997</td>
<td>(129)</td>
<td></td>
</tr>
<tr>
<td>Cash interest payments (2)</td>
<td>719</td>
<td>696</td>
<td>146</td>
<td></td>
</tr>
<tr>
<td>Adjusted free cash flow before interest (USD millions)</td>
<td>(150)</td>
<td>1,693</td>
<td>17</td>
<td></td>
</tr>
</tbody>
</table>

### Calculation of EBITDA Margin

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income (USD millions, except %)</td>
<td>3,533</td>
<td>4,159</td>
<td>837</td>
<td></td>
</tr>
<tr>
<td>Minority interest in subsidiaries’ earnings</td>
<td>92</td>
<td>446</td>
<td>66</td>
<td></td>
</tr>
<tr>
<td>Income tax expense</td>
<td>540</td>
<td>1,609</td>
<td>298</td>
<td></td>
</tr>
<tr>
<td>EBITDA</td>
<td>7,276</td>
<td>7,029</td>
<td>1,521</td>
<td></td>
</tr>
</tbody>
</table>

### Calculation of Adjusted Net Income Margin before Minority Interest

<table>
<thead>
<tr>
<th></th>
<th>For the year ended 31 December</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income (USD millions, except %)</td>
<td>3,533</td>
<td>4,159</td>
<td>837</td>
<td></td>
</tr>
<tr>
<td>Minority interest in subsidiaries’ earnings</td>
<td>92</td>
<td>446</td>
<td>66</td>
<td></td>
</tr>
<tr>
<td>Gain on disposal of share in CJSC Sevmorneftegaz</td>
<td>—</td>
<td>(1,303)</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Tax on gain on disposal of share in CJSC Sevmorneftegaz</td>
<td>—</td>
<td>313</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Adjusted net income before minority interest in subsidiaries’ earnings</td>
<td>3,625</td>
<td>3,615</td>
<td>903</td>
<td></td>
</tr>
</tbody>
</table>

---

1. Does not include licence acquisition costs.
2. Cash interest payments, whether capitalised or expensed, as reflected in the statement of cash flows.
3. Unwinding of discount related to asset retirement obligations.
4. These items are excluded because they are unusual both in terms of their magnitude and nature.
### For the year ended 31 December

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenues</td>
<td>33,099</td>
<td>23,863</td>
<td>5,262</td>
</tr>
<tr>
<td>Adjusted net income margin before minority interest in subsidiaries’ earnings</td>
<td>11.0%</td>
<td>15.1%</td>
<td>17.2%</td>
</tr>
</tbody>
</table>

### Calculation of Return on Average Capital Employed (ROACE)

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating income</td>
<td>5,604</td>
<td>5,522</td>
<td>1,206</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>(540)</td>
<td>(1,609)</td>
<td>(298)</td>
</tr>
<tr>
<td>Income tax on gain on disposal of share in CJSC Sevmorneftegaz</td>
<td>—</td>
<td>313</td>
<td>—</td>
</tr>
<tr>
<td>Return used for calculation of ROACE</td>
<td>5,064</td>
<td>4,226</td>
<td>908</td>
</tr>
<tr>
<td>Average capital employed</td>
<td>27,874</td>
<td>19,451</td>
<td>12,055</td>
</tr>
<tr>
<td>ROACE</td>
<td>18.2%</td>
<td>21.7%</td>
<td>7.5%</td>
</tr>
</tbody>
</table>

### Calculation of Return on Average Equity (ROAE)

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2005</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted net income before minority interest in subsidiaries’ earnings</td>
<td>3,625</td>
<td>3,615</td>
<td>903</td>
</tr>
<tr>
<td>Average equity, including minority interest</td>
<td>15,697</td>
<td>7,582</td>
<td>4,611</td>
</tr>
<tr>
<td>ROAE</td>
<td>23.1%</td>
<td>47.7%</td>
<td>19.6%</td>
</tr>
</tbody>
</table>

---

1 Average equity including minority interest is calculated as a simple average of the equity including minority interest at the start and end of the given period.
2 The average capital employed is calculated as a simple average of the capital employed at the start and end of the given period. In 2004, the acquisition of Yuganskneftegaz took place at the end of the year and this acquisition significantly increased the capital employed at 31 December 2004 and hence the average capital employed in 2004 shown in the above table.
3 This item is excluded because it is unusual both in terms of its magnitude and nature.

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Note: As described above, the average capital employed in 2004 increased because of the acquisition of Yuganskneftegaz at the end of the year. As Yuganskneftegaz made no contribution to Rosneft’s consolidated income in 2004, ROACE shown in the above table for 2004 is accordingly reduced by this effect.
Policies and Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to select appropriate accounting policies and to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. For a full description of Rosneft’s significant accounting policies, please refer to Note 2 of the Financial Statements. Certain of these accounting policies involve judgements and uncertainties to such an extent that there is a reasonable likelihood that materially different amounts would have been reported under different conditions, or if different assumptions had been used, and actual amounts may differ from these estimates. The following critical accounting policies require significant judgements, assumptions and estimates and should be read in conjunction with the Annual Financial Statements.

Oil and Gas Accounting

Accounting for oil and gas exploratory activity is subject to special accounting rules that are unique to the oil and gas industry.

Oil and gas properties and the related expenses are reflected pursuant to the successful efforts method in accordance with SFAS 19, Financial Accounting and Reporting by Oil and Gas Producing Companies. In accordance with the said method, expenses for the exploration of an oil field, inclusive of the expenses on prospecting, geological and geophysical work, as well as drilling dry wells, are charged to expense when incurred. The costs of exploratory wells that find oil and gas reserves are capitalised pending determination of whether proved reserves have been found. If proved reserves are not found, exploratory well costs are expensed as a dry hole.

Acquisition costs of unproved reserves are not amortised. Such costs are reclassified into expenses related to the proved reserves as of the date of respective reserve reclassification. Costs related to the purchase of the title to unproved reserves are subject to review with respect to impairment. If such impairment is recognised, the expenses must be written off as expenses of the respective period.

Costs, including “internal” costs relating to drilling and equipping of development wells, including development dry holes, as well as costs required for drilling and equipping of injection wells in the process of oil and gas reserves development, are capitalised. These costs are included in oil and gas properties in the consolidated balance sheet.

Depletion expense of acquisition costs of proved oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalised costs related to oil and gas production is calculated using the unit-of-production method based on proved developed reserves. Management of the Company considers each extraction division as the appropriate level for these calculations.

Oil and Gas Reserves

The process of estimating reserves is inherently judgemental. SEC standard proved oil and gas reserves are estimated quantities of crude oil and gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions (i.e., prices and costs as of the date that the estimate is made). Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon judgements about future conditions. Actual prices and costs are subject to change due, in significant part, to factors beyond Rosneft’s control. These factors include world oil prices, energy costs and increases or decreases of oil field service costs. Due to inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to changes over time as additional information becomes available.

The determination of estimated proved reserves is a significant element in arriving at the results of operations of exploration and production activities. The Company uses independent reservoir engineers, D&M, to estimate all of its oil and gas reserves. D&M prepared two Reserves Reports in accordance with SEC definitions, the first reporting proved reserves through the economic lives of Rosneft’s fields and the second reporting proved reserves through the expiration of Rosneft’s licences. For purposes of the Financial Statements, proved reserves are considered to be those through the economic lives of the fields, as discussed more fully below. The estimates of proved reserves impact well capitalisation, undeveloped lease impairments and the depreciation rates of proved properties, wells and equipment. Reduction in reserve estimates may result in the need for impairments of proved properties and related assets. The data in the relevant Reserves Report was also used for the assessment of impairment of long-lived assets and for the required supplemental disclosure of oil and gas activities.

The Company’s oil and gas fields are located principally on the territory of the Russian Federation. The Company obtains licences from the governmental authorities to explore and produce oil and gas from these fields. The Company’s existing production licences generally expire during
the period from 2009 to 2031. Expiration dates of licences for the most significant fields are between 2013 and 2019, and the licence for the largest field, Priobskoye, expires in 2019. The economic lives of the licenced fields extend significantly beyond these dates. Under Russian law, the Company is entitled to renew the licences to the end of the economic lives of the fields, provided certain conditions are met. Article 10 of the Subsoil Law, Concerning Subsurface Resources, provides that a licence to use a field “shall be” extended at its scheduled termination at the initiative of the subsoil user if necessary to finish production of the field, provided that there are no violations of the conditions of the licence.

The legislative history of Article 10 indicates that the term “shall” replaced the term “may” in August 2004, clarifying that the subsoil user has an absolute right to extend the licence term so long as it has not violated the conditions of the licence. In 2006, no licences came up for renewal. In 2005, the Company extended the terms of 39 of its production licences for the period equivalent to the expected life of the fields. There were no unsuccessful licence renewal applications.

The Company’s current production plans are based on the assumption, which management considers to be reasonably certain, that the Company will be able to extend all other existing licences. These plans have been designed on the basis that the Company will be producing crude oil through the economic lives of the fields and not with a view to exploiting the Company’s reserves to maximum effect only through the licence expiration dates. Accordingly, management has included in proved reserves in the supplementary information on oil and gas exploration and production activities of the consolidated financial statements as of and for the year ended 31 December 2006 all reserves that otherwise meet the statutory requirements for being characterised as “proved” and that the Company estimates it can produce through the economic lives of its licenced fields.

Proved reserves should generally be limited to those volumes that can be produced through the licence expiration date unless there is a long and clear track record which supports the conclusion that extension of the licence will be granted as a matter of course. The Company believes that extension of the licences will occur as a matter of course, as described above.

Business Acquisitions

Accounting for the acquisition of a business requires the allocation of the purchase price to the various assets and liabilities of the purchased business. For most assets and liabilities, purchase price allocation is accomplished by recording the asset or liability at its estimated fair value. The most difficult estimations of individual fair values are those involving properties, plants and equipment and identifiable intangible assets. Determining the fair value of assets purchased and liabilities assumed requires judgement by management and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, licence and other asset lives and market multiples. Management of the Company uses all available information to make these fair value determinations and, for major business acquisitions, typically engages an outside appraisal firm to assist in the fair value determination of the purchased long-lived assets. The Company has, if necessary, up to one year after the acquisition closing date to finish these fair value determinations and finalise the purchase price allocation.

Income Tax

The computation of income tax expense requires the interpretation of complex tax laws and regulations and the use of judgement in determining the nature and timing of accounting for differences between financial reporting and income tax reporting. This is particularly evident in the Russian Federation where tax legislation is constantly changing (specifically, the statutory profits tax rate) and is subject to interpretation by the tax authorities. Changes in the Russian statutory tax rate can significantly affect deferred tax liability. As prescribed by U.S. GAAP, any changes to the statutory tax rate are recognised in the period the tax law is enacted rather than the effective date of the change.

A valuation allowance for a deferred tax asset is recorded when management believes that it is more likely than not that this tax asset will not be realised.

Recognition of Obligations Related to the Retirement of Assets

The Company has conditional obligations related to the retirement of assets used in prospecting and extraction activities. The Company’s activities in the sphere of prospecting, development and extraction of oil and natural gas are connected with the use of the following assets: oil wells, equipment and nearby areas, installations for the collection and primary refining of oil, the tanker pool and pipeline connections to the main pipeline. As a rule, licences and other regulatory documents stipulate requirements with respect to the retirement of such assets after the completion of extraction. The said requirements oblige the Company to retire oil wells, dis-
mantle the equipment, restore the sites and undertake other related actions. The Company’s estimates of these obligations are based on current regulatory or licence requirements, as well as actual dismantlement and other related costs. The Company calculates obligations related to the retirement of assets pursuant to SFAS 143, Accounting for Asset Retirement Obligations.

Environmental Liabilities

Environmental expenditures are expensed or capitalised, depending upon their future economic benefit. Expenditures that relate to an existing condition caused by past operations and do not have a future economic benefit are expensed. Liabilities for these expenditures are recorded on an undiscounted basis when environmental assessments or clean-ups are probable and the costs can reasonably be estimated.

Guarantees

The fair value of a guarantee is determined and recorded as a liability at the time when the guarantee is issued. The initial guarantee amount is subsequently remeasured to reflect the changes in the underlying liability. The expense is included in the related line items of the consolidated income statement, based on the nature of the guarantee. When the likelihood of performing on a guarantee becomes probable, a liability is accrued, provided it is reasonably determinable on the basis of the facts and circumstances at that time.

Accounting for Contingencies

Certain conditions may exist as of the date of financial statements which may further result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company’s management makes an assessment of such contingent liabilities which is based on assumptions and is a matter of opinion. In assessing loss contingencies related to legal or tax proceedings that involve the Company or unasserted claims that may result in such proceedings, the Company after consultation with legal or tax advisors evaluates the perceived merits of any legal or tax proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a loss will be incurred and the amount of the liability can be estimated, then the estimated liability is accrued in the Company’s consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Recognition of Revenues

Revenues are recognised when title passes from the seller to the customer, the contract price is fixed or determinable and collectability of the receivable is reasonably assured. Specifically, domestic sales of crude oil and gas, as well as petroleum products and materials are recognised when title passes. For export sales, title generally passes at the border of the Russian Federation, and the Company covers transportation expenses, duties and taxes on those sales. Revenues include excise taxes and custom duties.

Sales of support services are recognised as services performed, provided that the service price can be determined and no significant uncertainties regarding the receipt of revenues exist.

Revenues are shown net of value added tax.

Impairment of Long-Lived Assets

Long-lived assets, including blocks with proved crude oil and gas reserves, are assessed for potential impairment in accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

Crude oil and gas properties are assessed whenever events or circumstances indicate potential impairment.

If the carrying value of crude oil and gas properties is not recoverable through undiscounted cash flows, impairment is recognised. The impairment is determined on the basis of the estimated fair value of crude oil and gas properties, which, in turn, is measured by discounting future net cash flows or with reference to current market prices of crude oil and gas properties, if available. Discounted future cash flows from crude oil and gas fields are based on management estimates of future prices that rely on recent actual prices and published prices for forward transactions; such prices are applied to forecast production volumes at particular fields, with further discounting for the expected risk level.

Such estimates also involve assessment of ability to renew licences and lease of production equipment and wells.
Quantitative and Qualitative Disclosures about Market Risk

Prices for Crude Oil, Gas and Petroleum Products Risk

Rosneft’s operating results and financial condition depend substantially upon prevailing prices of crude oil, gas and petroleum products. Historically, prices for oil have fluctuated widely for many reasons, including:

- Global and regional supply and demand, and expectations regarding future supply and demand, for crude oil and petroleum products;
- Geopolitical uncertainty;
- Weather conditions and natural disasters;
- Access to pipelines, railways and other means of transporting crude oil, gas and petroleum products;
- Prices and availability of alternative fuels;
- The ability of the members of OPEC, and of other crude oil producing nations, to set and maintain specified levels of production and prices;
- Political, economic and military developments in oil producing regions, particularly the Middle East;
- Russian and foreign governmental regulations and actions, including export restrictions and taxes; and
- Global and regional economic conditions.

Substantially all of Rosneft’s crude oil and petroleum products are sold on the spot market or under short-term contracts at market sensitive prices. Market prices for export sales of crude oil and petroleum products are subject to volatile trading patterns in the commodity futures market as discussed above in more detail. Average selling prices can differ from quoted market prices due to the effects of uneven volume distributions during the period, quality differentials, different delivery terms compared to quoted benchmarks, different conditions in local markets and other factors. Domestic prices generally follow the trend of world market prices but are volatile due to the nature of the Russian market. Rosneft does not use any derivative instruments to hedge its production in order to decrease its price risk exposure.

Foreign Currency Risk

Over the past ten years, the rouble has fluctuated dramatically against the U.S. dollar. In the majority of instances, the rouble has depreciated against the U.S. dollar, although in each of the past three years, it has generally appreciated modestly against the U.S. dollar. Historically, the CBR has imposed various currency trading restrictions in attempts to support the rouble or to maintain a rate of devaluation in line with inflation.

The functional and reporting currency of Rosneft is the U.S. dollar. Rosneft’s principal exchange rate risk involves changes in the value of the U.S. dollar relative to the rouble and, to a much lesser extent, relative to other currencies, including the euro. In addition, all of Rosneft’s export revenues, including the exports of crude oil and petroleum products, are denominated in U.S. dollars or are correlated with U.S. dollar denominated prices for crude oil and petroleum products.

As of 31 December 2006, approximately USD 4,071 million of Rosneft’s indebtedness was denominated in roubles (out of USD 13,829 million of its total indebtedness at that date). Decreases in the value of the U.S. dollar relative to the rouble will increase the cost in U.S. dollars of Rosneft’s rouble denominated costs and expenses and of its debt service obligations for rouble-denominated indebtedness. A depreciation of the U.S. dollar relative to the rouble will also result in foreign exchange losses as the U.S. dollar value of Rosneft’s rouble-denominated indebtedness is increased.

A hypothetical, instantaneous and unfavourable 100 basis points change in currency exchange rates on 31 December 2006 would have resulted in additional interest expense of approximately USD 33 million per year, reflecting the increased costs in U.S. dollars of servicing Rosneft’s rouble denominated indebtedness held as of 31 December 2006. A hypothetical, instantaneous and unfavourable 100 basis points change in currency exchange rates as of 31 December 2006 would have resulted in an estimated foreign exchange loss of approximately USD 41 million on rouble denominated indebtedness held as of 31 December 2006.

Starting from January 2007, the Company entered into agreements for forward sale of U.S. dollar-denominated revenue at fixed exchange rate in order to hedge currency risk. Monthly sale volumes are USD 200 million starting from March 2007. The counterparty’s credit rating is BBB-.

Liquidity Risk

Liquidity risk arises when the maturity of assets and liabilities do not match. The Company has had negative working capital as of recent balance sheet dates, principally due to the increase in short-term debt arising out of the acquisition of Yuganskneftegaz combined with the significant write-down of Yuganskneftegaz’s accounts receivable. While the Company presently has no com-
mitted liquidity facilities in place, the Company believes that it will be able to meet its liquidity needs.

Credit Risk

Rosneft’s financial instruments that are potentially exposed to concentrations of credit risk consist primarily of accounts receivable, cash and cash equivalents, VAT recoverable by Rosneft as well as loans receivable and advances. A significant portion of Rosneft’s trade accounts receivable is due from domestic and export trading companies. Rosneft does not generally require collateral to limit the exposure to loss; however, often letters of credit and prepayments are used. Although collection of these receivables could be influenced by economic factors affecting these entities, Rosneft believes there is no significant risk of loss to Rosneft beyond allowances already recorded.

Rosneft deposits available cash primarily with financial institutions in Russia. Deposit insurance of deposits of legal entities is not offered to financial institutions operating in Russia. To manage this credit risk, Rosneft allocates available cash across a variety of Russian banks and Russian affiliates of international banks. Management periodically reviews the creditworthiness of the banks in which it deposits cash.

VAT recoverable, representing amounts paid to suppliers, is recoverable from the tax authorities via offset against VAT payable to the tax authorities on revenue or direct cash receipts from the tax authorities. Management periodically reviews the recoverability of the balance of prepaid VAT and believes it is fully recoverable within one year.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. Rosneft does not believe that its off-balance sheet instruments are material.

Interest Rate Risk

Rosneft is exposed to interest rate risk on its indebtedness that bears interest at floating rates and, to a lesser extent, on its indebtedness that bears interest at fixed rates. As of 31 December 2006, Rosneft had loans and borrowings outstanding with a principal amount of approximately USD 12,175 million of which approximately USD 9,588 million bore interest at fixed rates and approximately USD 2,587 million bore interest at floating rates determined by reference to the London inter-bank offered rate (“LIBOR/ EURIBOR”) for U.S. dollar deposits.

Rosneft undertakes debt obligations to support general corporate purposes including capital expenditures, acquisitions financing and working capital needs. Upward fluctuations in interest rates increase the cost of new debt and the interest cost of outstanding variable rate borrowings. Fluctuations in interest rates can also lead to significant fluctuations in the fair value of Rosneft’s debt obligations. A hypothetical, instantaneous and unfavourable change of 100 basis points in the interest rate applicable to floating-rate financial liabilities held as of 31 December 2006 would have resulted in additional net interest expense of approximately USD 96 million per year. The above sensitivity analysis is based on the assumption of an unfavourable 100 basis point movement of the interest rates applicable to each homogenous category of financial liabilities. A homogenous category is defined according to the currency in which financial liabilities are denominated and assumes the same interest rate movement within each homogenous category (e.g., U.S. dollars, roubles).

As it relates to fixed rate financial liabilities, a hypothetical, instantaneous 100 basis points decrease in interest rates would have resulted in a USD 7.5 million increase in the fair value of long-term debt outstanding as of 31 December 2006. However, Rosneft’s sensitivity to decreases in interest rates and corresponding increases in the fair value of its debt portfolio would unfavorably affect results and cash flows only to the extent that it elected to repurchase or otherwise retire all or a portion of its fixed-rate debt portfolio at prices above carrying value.

Rosneft currently does not use financial instruments, such as interest rate swaps and forward rate agreements, to manage these market risks. The Company plans to use interest rate swaps starting from 2007.