MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS
FOR THE SIX MONTHS ENDED 30 JUNE 2004

You should read the following management's discussion in conjunction with our unaudited consolidated interim condensed financial information as of and for the three and six months ended 30 June 2004. The interim condensed financial information has been prepared in accordance with International Accounting Standard 34 "Interim financial reporting" ("IAS 34"). These financial statements should be read together with the consolidated financial statements for the year ended 31 December 2003 prepared in accordance with International Financial Reporting Standards ("IFRS").

OVERVIEW

We are the world's largest natural gas company, and the world's largest publicly-traded hydrocarbons company, in terms of reserves, transportation and production volumes. Our revenues are primarily derived from sales of natural gas to western and central Europe, Russia and other former Soviet Union countries.

We divide our operations into the following four main business segments:

- Production: exploration, development and production operations relating to natural gas and other hydrocarbons. These activities are primarily located within Russia.
- Refining: processing and refining of natural gas, gas condensate and other hydrocarbons (including crude oil), and sales of hydrocarbon products. Operations relating to refining of natural gas, gas condensate and oil significantly increased in the six months ended 30 June 2004 due to acquisition in 2003 of additional controlling interests in a number of Russian petrochemical companies affiliated with OAO AK Sibur ("Sibur").
- Transportation: transportation of natural gas through the world's largest high-pressure trunk pipeline system (151,600 km). We own and operate a single centrally controlled system for natural gas production, processing, transportation, storage and deliveries. Beginning in the late 1990s, we began acquiring interests in regional gas distribution companies that own and operate medium-and low-pressure pipelines.
- Distribution: domestic and export sale of gas. We are the world's largest exporter of natural gas.

Other businesses primarily comprise banking, insurance, construction and media. These businesses are not separately reflected in our financial information because they do not represent individually material segments.

Our four main business segments are mutually dependent, with a significant portion of the revenues of one segment being a part of the costs of another segment. In particular, our Distribution and Refining segments purchase natural gas from our Production segment and transportation services from our Transportation segment. We establish internal transfer prices to provide funding requirements of the individual segments. Accordingly, the results of operations of these segments on a stand-alone basis do not necessarily represent that segment's underlying financial position and results of operations as if it was a stand-alone business. For this reason, we do not analyze any of our main segments separately in the discussion that follows.

RESULTS OF OPERATIONS

(RR' millions)	Six months ended 30 June 2004	Six months ended 30 June 2003
Sales (net of excise tax, VAT and customs duties)	471,474	421,827
Operating expenses	(346,582)	(279,374)
Operating profit	**124,892**	**142,453**
Net finance (costs) income	(616)	2,419
Share of net income of associated undertakings	2,719	2,554
Gains (losses) on available-for-sale investments	2,177	(2,633)
Profit before profit tax and minority interest	**129,172**	**144,793**
Current profit tax expense	(26,179)	(24,469)
Deferred profit tax expense	(12,382)	(15,767)
Profit tax expense	(38,561)	(40,236)
Profit before minority interest	**90,611**	**104,557**
Minority interest	(647)	(796)
Net profit	**89,964**	**103,761**

The following tables set out our volumes and realized prices for the six months ended 30 June 2004 and 2003.

(RR' millions, unless indicated otherwise)	Six months ended 30 June 2004	2003
Europe		
Gross sales	293,439	299,262
Excise tax	(1,067)	(65,183)
Customs duties	(76,431)	(11,744)
Net sales	215,941	222,335
Volumes in billion cubic meters (bcm)	78.8	72.7
Gross average price, RR per mcm [1] (including excise tax and customs duties)	3,722.1	4,117.5
Net average price, RR per mcm [1] (net of excise tax and customs duties)	2,739.1	3,059.1
FSU		
Gross sales (net of value added tax (VAT))	40,015	31,263
Excise tax	(470)	(5,432)
Customs duties	(9,856)	(1,349)
Net sales	29,689	24,482
Volumes in bcm	29.4	23.2
Gross average price, RR per mcm [1] (including excise tax and customs duties, net of VAT)	1,363.1	1,346.4
Net average price, RR per mcm [1] (net of excise tax, VAT and customs duties)	1,011.4	1,054.3
Russia		
Gross sales (net of VAT)	134,890	110,807
Excise tax	(1,418)	(11,223)
Net sales	133,472	99,584
Volumes in bcm	163.0	166.2
Gross average price, RR per mcm [1] (including excise tax, net of VAT)	827.5	666.7
Net average price, RR per mcm [1] (net of excise tax and VAT)	818.9	599.1
Total sales of gas		
Gross sales (net of VAT)	468,344	441,332
Excise tax	(2,955)	(81,838)
Customs duties	(86,287)	(13,093)
Net sales	379,102	346,401
Volumes in bcm	271.2	262.1
Sales of gas condensate and oil and gas products (net of excise tax, VAT and customs duties)	54,968	39,129
Gas transportation sales (net of excise tax and VAT)	15,297	13,168
Other sales (net of VAT)	22,107	23,129
Total sales (net of excise tax, VAT and customs duties)	**471,474**	**421,827**

[1] Mcm is the equivalent of thousand cubic meters.

Net sales revenues increased by RR49,647 million, or 12%, to RR471,474 million in the six months ended 30 June 2004 compared to the six months ended 30 June 2003. Net sales of gas accounted for 80% of total sales in the six months ended 30 June 2004 (82% in the six months ended 30 June 2003) and were RR32,701 million, or 9%, higher than in the same period of 2003.

Net sales of natural gas to Europe decreased by RR6,394 million, or 3%, to RR215,941 million in the six months ended 30 June 2004 compared to the six months ended 30 June 2003. This was primarily due to a 10% decrease in net prices in RR terms, which more than offset an 8%, or 6.1 bcm, increase in sales volumes. Average net prices in RR terms decreased as a result of average realized U.S. dollar export gas prices (including excise and customs duties) remaining almost flat; the 8% appreciation of the RR against the U.S. dollar; and the increase in the customs duties rate from 5% to 30% effective 1 January 2004, the effect of which more than offset the decrease in excise tax as a result of the abolishment of excise tax on natural gas produced after 1 January 2004. The increase in sales volumes was primarily due to increased volumes sold to Germany, Italy and France under existing long-term contracts, an additional short-term contract on gas supplies to France signed in the six months ended 30 June 2004, and increased sales to the United Kingdom.

Net sales of natural gas to FSU countries increased by RR5,207 million, or 21%, to RR29,689 million in the six months ended 30 June 2004 compared to the six months ended 30 June 2003. This was due to a 27%, or 6.2 bcm, increase in volumes, which more than offset a 4% decrease in net prices in RR terms to RR1,011.4 for mcm. The 4% decrease in the net average RR prices resulted primarily from the 8% appreciation of the RR against the U.S. dollar for the six months ended 30 June 2004 compared to the six months ended 30 June 2003 and the increase in customs duties, which together more than offset a 10% increase in average realized U.S. dollar price (including excise tax and customs duties), and the effect of excise tax being abolished. The increase in volumes of gas sold to FSU countries was primarily due to a 3.1 bcm increase in shipments of gas to Ukraine, a 2.4 bcm increase in shipments of gas to Kazakhstan and 1.7 bcm of shipments to Armenia, Georgia and Azerbaijan, which more than offset a 1.7 bcm reduction in sales volumes to Belarus due to contract disputes. In 2004, we continued to restrict our shipments to Ukraine to those required to cover transportation services, so called “transit-gas”, which mitigates our collection risk.

Net sales of natural gas in the domestic market increased by RR33,888 million, or 34%, to RR133,472 million in the six months ended 30 June 2004 compared to the six months ended 30 June 2003. This was primarily due to the increase in domestic gas tariffs set by the Federal Tariffs Service, which was slightly offset by the 2%, or 3.2 bcm, decrease in sales volumes. Average domestic prices, including excise tax, increased by 24%, however, as excise tax was abolished for natural gas produced after 1 January 2004, net average domestic prices increased by 37%, from RR599.1 per mcm in the six months ended 30 June 2003 to RR818.9 per mcm in the six months ended 30 June 2004. The 2% decrease in domestic sales volumes was primarily due to the warmer winter.

Total excise taxes on natural gas sales decreased by RR78,883 million, or 96%, to RR2,955 million in the six months ended 30 June 2004 from RR81,838 million in the six months ended 30 June 2003, representing 1% and 19% of gross sales of natural gas (including excise tax and customs duties and net of VAT), respectively. The decrease was due to the fact that excise tax on natural gas produced after 1 January 2004 was abolished. This decrease more than offset the RR73,194 million increase in customs duties to RR86,287 million in the six months ended 30 June 2004 compared to RR13,093 million in the six months ended 30 June 2003.

Sales of gas condensate and oil and gas products increased by RR15,839 million, or 40%, to RR54,968 million in the six months ended 30 June 2004 compared to RR39,129 million in the six months ended 30 June 2003. This increase was primarily due to the consolidation of additional petrochemical companies in the six months ended 31 December 2003 and increased volumes and prices for sales on the domestic market. Sibur and our other petrochemical companies accounted for 61% and 59% of sales of gas condensate and oil and gas products in the six months ended 30 June 2004 and 2003, respectively.

Gas transportation sales increased by RR2,129 million, or 16%, to RR15,297 million in the six months ended 30 June 2004 from RR13,168 million in the six months ended 30 June 2003. This was primarily due to a RR2,054 million increase in transportation sales to Trans Nafta who provided gas to Belarus during our contract disputes with Belarus, and increased prices for gas transportation sales to a number of Russian gas producers, which together more than offset a reduction in the average realized tariff and volume of transportation services for gas transportation sales to Eural Trans Gas.

Other sales decreased by RR1,022 million, or 4%, to RR22,107 million in the six months ended 30 June 2004 compared to RR23,129 million in the six months ended 30 June 2003. Other sales represent activities including media, construction works, refinery services, and sales of other services and goods.

Operating expenses

Operating expenses increased by 24% in the six months ended 30 June 2004 to RR346,582 million from RR279,374 million in the six months ended 30 June 2003. Operating expenses as a percentage of sales increased from 66% in the six months ended 30 June 2003 to 74% in the six months ended 30 June 2004. The table below presents a breakdown of operating expenses in each period:

(RR' millions)	Six months ended 30 June 2004	2003
Staff costs	60,066	45,276
Depreciation	56,527	50,318
Transit costs	53,936	55,007
Taxes other than on income	39,492	17,960
Purchased gas	29,894	19,892
Materials	25,439	16,925
Repairs and maintenance	14,332	12,632
Electricity	13,781	9,266
Cost of goods for resale, including refined products	9,851	8,773
Transportation services	5,941	2,719
Social expenses	5,226	3,910
Provisions for liabilities and charges	2,998	1,702
Processing services	2,281	12,398
Provisions for impairment of assets	645	1,200
Other	26,173	21,396
Total operating expenses	**346,582**	**279,374**

Staff costs

Staff costs increased by 33% to RR60,066 million in the six months ended 30 June 2004 from RR45,276 million in the six months ended 30 June 2003. The increase was primarily due to the increase in the number of employees following the acquisition of controlling interests in a number of petrochemical companies in 2003 and the increase in average base salaries in June 2003, December 2003 and April 2004.

Depreciation

Depreciation increased by 12% or RR6,209 million to RR56,527 million in the six months ended 30 June 2004 from RR50,318 million in the six months ended 30 June 2003. The increase primarily resulted from our growing fixed assets base.

Transit costs

Transit costs decreased by 2% to RR53,936 million in the six months ended 30 June 2004 from RR55,007 million in the six months ended 30 June 2003. Transit costs relate principally to fees charged by Ukraine, Poland and other Eastern Europe and Central Asian countries for the transit of gas to markets in Europe. The decrease primarily resulted from a decrease in transit costs for transportation of gas across the Ukraine and Poland primarily due to the appreciation of the RR against U.S. dollar, as these costs are U.S. dollar denominated, and for Poland, a lower U.S. dollar denominated effective average gas transportation tariff which decreased from U.S.$2.68 per mcm per 100km to U.S.$2.34 per mcm per 100km from January 2004. The factors decreasing transit costs more than offset an increase in the transit costs through Belarus due to the increased volume of gas exports and an increase in the tariff as agreed through intergovernmental agreements in May 2004.

Taxes other than on income

Taxes other than on income consist of:

(RR' millions)	Six months ended 30 June 2004	2003
Natural resources production tax	31,313	10,447
Property tax	5,519	4,933
Other taxes	2,660	2,580
Taxes other than on income	**39,492**	**17,960**

Taxes other than on income increased by 120% to RR39,492 million in the six months ended 30 June 2004 from RR17,960 million in the six months ended 30 June 2003. The increase was primarily attributable to the change in tax legislation. From 1 January 2004, the natural resources production tax rate changed from 16.5% of the value of natural gas produced to a fixed rate of 107 roubles per mcm, and for gas condensate – from 16.5% of the value of gas condensate produced from gas condensate fields and RR 340 per ton of gas condensate produced from oil and gas condensate fields (the latter rate was subject to adjustments depending on fluctuations of oil prices and the RR exchange rate) to a single rate of 17.5% of the value of gas condensate produced. Also, effective 1 January 2004, the maximum property tax rate increased from 2.0% to 2.2%.

Purchased gas

Cost of purchased gas increased by 50% or RR10,002 million to RR29,894 million in the six months ended 30 June 2004 from RR19,892 million in the six months ended 30 June 2003. The increase was primarily related to purchases of gas by Sibur and purchases of Central Asian gas, both in Central Asia and in Europe, for resale to customers in Western Europe and FSU. Purchases of gas from Eural Trans Gas, WINGAS GmbH and Gas de France accounted for approximately RR4,876 million, RR2,356 million and RR2,222 million, respectively, of the total increase of RR10,002 million. A RR2,852 million increase in the cost of gas purchased by Sibur related primarily to gas purchased for resale to Belarus.

Materials

Cost of materials increased by 50% million to RR25,439 million in the six months ended 30 June 2004 from RR16,925 million in the six months ended 30 June 2003. The increase was primarily related to the acquisition of controlling interests in a number of petrochemical companies in 2003 and higher prices of materials.

Repairs and maintenance

Cost of repairs and maintenance increased by 13% million to RR14,332 million in the six months ended 30 June 2004 from RR12,632 million in the six months ended 30 June 2003. The increase was primarily related to increased repair and maintenance activities in the transportation segment due to our ageing pipeline network.

Electricity

Electricity expense increased by 49% or RR4,515 million to RR13,781 million in the six months ended 30 June 2004 from RR9,266 million in the six months ended 30 June 2003, primarily resulting from the consolidation of a number of petrochemical companies in 2003 and higher electricity tariffs, set by the Federal Tariffs Service, in the six months ended 30 June 2004 compared to the six months ended 30 June 2003.

Transportation services

Transportation services expense increased by 118% or RR3,222 million to RR5,941 million in the six months ended 30 June 2004 from RR2,719 million in the six months ended 30 June 2003, primarily resulting from the acquisition of controlling interests in a number of petrochemical companies in the second half of 2003.

Provisions for liabilities and charges

Provisions for liabilities and charges increased by 76%, or RR1,296 million, to RR2,998 million in the six months ended 30 June 2004 compared to RR1,702 million in the six months ended 30 June 2003. The increase was primarily a result of a higher expense for pension liabilities. Pension liabilities represent our obligations under our defined benefit plan, which is administered by our subsidiary, NPF Gazfund. The increase was primarily due to a decrease in the assumed discount rate from the end of 2003, which resulted from the decline in corporate and government debt yields in Russia, and a voluntary increase by us in vested pensions to provide an inflationary increase in pensions for our current pensioners.

Processing services

Processing services decreased by 82% to RR2,281 million in the six months ended 30 June 2004 from RR12,398 million in the six months ended 30 June 2003. Processing services primarily pertain to the operations of Sibur. The decrease in the cost of processing services was due to the consolidation of a number of petrochemical companies in 2003, cost of processing services of which was previously external to our Group.

Provisions for impairment of assets

Provisions for impairment of assets decreased by 46%, or RR555 million, to RR645 million in the six months ended 30 June 2004 compared to RR1,200 million in the six months ended 30 June 2003. The decrease was primarily the result of a decrease in the impairment provision for accounts receivable and prepayments and a net release in the impairment provision for assets under construction, which more than offset the impairment provision for investments and other long-term assets.

We recognized a net release in the impairment provision for assets under construction of RR1,602 million in the six months ended 30 June 2004 compared to an impairment provision expense of RR2,576 million in the six months ended 30 June 2003. Releases in the impairment provision in the six months ended 30 June 2004 primarily reflect the strategy of management to focus on priority projects in a systematic way and once again fund projects, which had previously been frozen. The impairment provision expense in the six months ended 30 June 2003 was primarily due to changes in the investment program which had reduced funding for certain projects.

Because of our operating cycle, certain significant decisions about capital construction projects are made after the end of our fiscal year. Accordingly, we typically have larger impairment charges in the fourth quarter of our fiscal year as compared to other quarters.

The impairment provision for accounts receivable and prepayments decreased by RR1,038 million, or 38%, to RR1,659 million in the six months ended 30 June 2004 compared to RR2,697 million in the six months ended 30 June 2003. The decrease was primarily a result of lower provisions for non-recurring items mainly related to other debtors, which offset increased provisions against older domestic gas receivables. As of 30 June 2004, the aggregated provision related to accounts receivable was RR139,086 million or 27% of the gross receivable balance.

The impairment provision for investments and other long-term assets changed from a provision release of RR2,053 million in the six months ended 30 June 2003 to a provision expense of RR1,185 million in the six months ended 30 June 2004. The provision expense in the six months ended 30 June 2004 primarily relates to certain equity investments in petrochemical companies against which bankruptcy procedures were initiated in 2004.

Other expenses

Other expenses increased by 22% or RR4,777 million to RR26,173 million in the six months ended 30 June 2004 from RR21,396 million in the six months ended 30 June 2003. The increase was primarily related to increases in rental expenses, cost of equipment maintenance services and other services.

Net finance (costs) income

	Six months ended 30 June	
(RR' millions)	**2004**	**2003**
Net exchange gain	5,164	9,191
Interest income	6,180	6,338
Interest expense	(12,466)	(16,313)
Gains on and extinguishment of restructured liabilities	506	3,203
Net finance (costs) income	**(616)**	**2,419**

We recognized a net exchange gain of RR5,164 million in the six months ended 30 June 2004 compared to RR9,191 million in the six months ended 30 June 2003. The change reflects primarily the impact on foreign currency denominated borrowings of lower appreciation of the RR against the U.S. dollar, which decreased from 5% in the six months ended 30 June 2003 to 1% in the six months ended 30 June 2004.

Interest expense decreased by RR3,847 million to RR12,466 million in the six months ended 30 June 2004 compared to RR16,313 in the six months ended 30 June 2003 primarily due to the reduction of average borrowing rates and decreased interest expense on promissory notes as we continue to reduce the use of promissory notes. These factors more than offset the impact of the 7%, RR34,428 million, increase in average total debt for the six months ended 30 June 2004 increased compared to the six months ended 30 June 2003, primarily as a result of proceeds from the long-term borrowings.

Share of net income of associated undertakings

Share in net income of associates increased by RR165 million to RR2,719 million in the six months ended 30 June 2004 compared to RR2,554 million in the six months ended 30 June 2003. The increase was primarily due to higher net profits recorded by WINGAZ GmbH and associated undertakings of AB Gazprombank (ZAO), and the release of impairment provisions against certain other associated undertakings, primarily ZAO KB Olimpiisky, which were partially offset by lower net profits recorded by EuRoPol GAZ S.A. and Turusgaz.

Gains (losses) on available-for-sale investments

We recognized a gain on available-for-sale investments of RR2,177 million in the six months ended 30 June 2004 compared to a loss of RR2,633 million in the six months ended 30 June 2003. In the six months ended 30 June 2003 the loss primarily related to the sale of third party promissory notes held by our subsidiaries. The gain of RR2,177 million recognized in the six months ended 30 June 2004 primarily relates to the release of impairment provisions for certain promissory notes held by our subsidiaries, as certain promissory notes approach maturity and estimated fair values increase.

Profit tax

Profit tax expense decreased by RR1,675 million, or 4%, to RR38,561 million in the six months ended 30 June 2004 compared to RR40,236 million in the six months ended 30 June 2003.

Our current profit tax expense increased by RR1,710 million, or 7%, to RR26,179 million in the six months ended 30 June 2004 from RR24,469 million in the six months ended 30 June 2003. Our effective current profit tax rate increased to 20% in the six months ended 30 June 2004 compared to 17% for the six months ended 30 June 2003 primarily as a result of fully utilizing the tax loss carry forward of OAO Gazprom in the six months ended 30 June 2004 and an increase in non-deductible expenses, primarily social expenses, in the six months ended 30 June 2004 compared to the six months ended 30 June 2003.

Our overall effective profit tax rate increased to 30% in the six months ended 30 June 2004, from 28% in the six months ended 30 June 2003, primarily as a result of an increase in non-deductible expenses in the six months ended 30 June 2004 compared to the six months ended 30 June 2003 and certain non-recurring non-taxable gains on the extinguishment of restructured liabilities recognized in the six months ended 30 June 2003.

Net profit

As a result of the factors discussed above, our net profit decreased by RR13,797 million, or 13%, from RR103,761 million in the six months ended 30 June 2003 to RR89,964 million in the six months ended 30 June 2004.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes the statements of cash flows for the six months ended 30 June 2004 and 2003.

	Six months ended 30 June	
(RR' millions)	2004	2003
Net cash provided by operating activities	83,562	67,722
Net cash used for investing activities	(95,006)	(58,773)
Net cash provided by financing activities	45,536	668

Net cash provided from operating activities

Net cash provided by operating activities amounted to RR83,562 million in the six months ended 30 June 2004 compared to RR67,722 million in the six months ended 30 June 2003. This was primarily due to lower negative changes in our net working capital position in the six months ended 30 June 2004 compared to the six months ended 30 June 2003, which more than offset lower operating profit generated by our gas sales and higher profit tax paid. The increase in our working capital position as of 30 June 2004 compared to 31 December 2003 primarily reflected an increase in cash and cash equivalents, accounts receivable and prepayments, inventories and other current assets and a decrease in taxes payable, current portion of long-term borrowings and short-term promissory notes payable, which more than offset an increase in accounts payable and accrued charges and short-term borrowings and a decrease in restricted cash, short-term investments and recoverable VAT.

Net cash flows from investing activities

Net cash used for investing activities amounted to RR 95,006 million in the six months ended 30 June 2004 compared to RR58,773 million in the six months ended 30 June 2003. This was primarily due to the acquisition of a 5.2% interest in RAO UES in January 2004 and an increase in cash capital expenditures reflecting our ability to utilize higher cash flows generated by our operating and financing activities during the six months ended 30 June 2004 for a number of major construction projects.

Net cash flows from financing activities

Net cash provided by financing activities amounted to RR45,536 million in the six months ended 30 June 2004 compared to RR668 million in the six months ended 30 June 2003. This was primarily due to net proceeds from short-term borrowings, a net cash inflow from the purchase and sale of treasury shares, higher proceeds from long-term borrowings and a reduction of cash restricted on borrowings in the six months ended 30 June 2004, partially offset by higher repayments of long-term borrowings and redemption of promissory notes.

Capital expenditures

Total capital expenditures (including cash advances to contractors and suppliers, which are recorded within other long-term assets, and excluding the effect of acquisitions of subsidiaries and reclassifications) increased by RR2,985 million, or 3%, from RR99,241 million in the six months ended 30 June 2003 to RR102,226 million in the six months ended 30 June 2004. Our cash capital expenditures increased by RR8,165 million, or 12%, from RR67,743 million in the six months ended 30 June 2003 to RR75,908 million in the six months ended 30 June 2004 in line with our strategy to continue to decrease our non-cash settlements.

Most of our capital expenditures during these periods were for transportation infrastructure and production assets. Capital expenditures on the transportation infrastructure comprised RR38,213 million, or 37% of total capital expenditure in the six months ended 30 June 2004, increasing from RR33,669 million, or 34% of total capital expenditure in the six months ended 30 June 2003. Budgeted capital expenditure for 2004 indicates our renewed focus on investing in our transportation network. Our primary transportation capital projects in the six months ended

30 June 2004 were for the construction of a pipeline from the northern region of the Tyumen Oblast to Torzhok and construction of a pipeline from the Pestsovoe field to the Yamburg trunk pipeline. In the six months ended 30 June 2004 capital expenditure on production assets were RR49,235 million, or 48% of total capital expenditure in the six months ended 30 June 2004, decreasing from RR53,739 million, or 54% in the six months ended 30 June 2003. The decrease in production segment capital expenditures was primarily due to the completion of major construction projects in the development of the Zapolyarnoe and Yamburgskoe fields.

Total capital expenditures by segment for the six months ended 30 June 2004 and 2003 and budgeted total capital expenditure by segment for the year ending 31 December 2004 (excluding expenditures for Sibur, OAO Vostokgazprom and ZAO Purgaz) are as follows:

(RR' millions)	**Six months ended 30 June** 2004	2003	**Budget for the year ending 31 December 2004**[(1) (4)]
Production	49,235	53,739	71,600
Transportation	38,213	33,669	111,600
Refining	3,810	3,745	2,380
Distribution	3,157	1,044	- [(2)]
Other [(3)]	7,811	7,044	6,760
Total	102,226 [(5)]	99,241	192,340

[(1)]The Board of Directors approved a capital expenditure budget for 2004 of RR192,340 million, including RR38,941 million for construction of a pipeline from the northern region of the Tyumen Oblast to Torzhok, RR12,531 million for the development of the Pestsovoye field, RR10,681 million for the development of the Zapolyarnoye gas field, RR6,506 million for the development of the Aneryakhenskoye field, RR5,880 million for construction of the Zapolyarnoye-Urengoy pipeline.

[(2)]For 2004 included within other segments.

[(3)]Primarily includes expenditures for service activities such as drilling and automobile transport and repair.

[(4)]Includes VAT

[(5)]Includes RR1,209 million related to Sibur, Vostokgazprom and Purgaz.

The actual amount and timing of capital expenditures made are subject to change depending on economic and political conditions. Management cannot rule out strategic acquisitions if opportunities arise.

Debt obligations

Our net debt balance (defined as the sum of short-term borrowings, current portion of long-term borrowings, short-term promissory notes payable, long-term borrowings, long-term promissory notes payable and restructured tax liabilities, net of cash and cash equivalents and balances of cash and cash equivalents restricted as to withdrawal under the terms of certain borrowings and other contractual obligations) increased by RR596 million, from RR425,910 million as of 31 December 2003 to RR426,506 million as of 30 June 2004. The repayment of current portion of long-term borrowings and short-term and long-term promissory notes payable was more than offset by the new long-term borrowings, primarily U.S.$1,200 million of Loan Participation Notes issued in April 2004 and a U.S.$1,100 million loan from Calyon (the corporate banking unit for Credit Lyonnais S.A. and Credit Agricole Indosuez), and proceeds from short-term borrowings.