MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of operations

	Quarter ended March 31,			
	2001		2002	
Revenues				
Sales	3,335	99.1%	2,847	99.3%
Equity share in income of affiliates	31	0.9%	20	0.7%
Total revenues	**3,366**	**100.0%**	**2,867**	**100.0%**
Costs and other reductions				
Operating expenses	(1,067)	(31.7%)	(1,053)	(36.7%)
Selling, general and administrative expenses	(459)	(13.6%)	(575)	(20.1%)
Depreciation, depletion and amortization	(208)	(6.2%)	(237)	(8.3%)
Taxes other than income taxes	(275)	(8,2%)	(377)	(13.1%)
Excise and export tariffs	(446)	(13.3%)	(212)	(7.4%)
Exploration expense	(19)	(0.6%)	(20)	(0.7%)
Loss on disposal and impairment of assets	(1)	0.0%	(22)	(0.8%)
Income from operating activities	**891**	**26.5%**	**371**	**12.9%**
Interest expense	(62)	(1.8%)	(67)	(2.3%)
Interest and dividend income	53	1.6%	32	1.1%
Currency translation (loss) gain	(44)	(1.3%)	(34)	(1.2%)
Other non-operating income	84	2.5%	21	0.7%
Minority interest	(22)	(0.7%)	(6)	(0.2%)
Income before income taxes	**900**	**26.7%**	**317**	**11.1%**
Current income taxes	(240)	(7.1%)	(108)	(3.8%)
Deferred income taxes	20	0.6%	34	1.2%
Net income	**680**	**20.2%**	**243**	**8.5%**
Basic earnings per share of common stock	0.95		0.30	
Diluted earnings per share of common stock	0.94		0.30	

First quarter ended 31 March, 2002 compared to first quarter ended 31 March, 2001

Sales

The following set out our sales volumes and realized prices for the quarters ended March 31, 2001 and 2002:

	Quarter ended March 31,	
Sales breakdown	**2001**	**2002**
	($ millions)	
Crude oil	1,094	1,048
Refined products	1,911	1,584
Other	330	215
Less excise and export tariffs	(446)	(212)
Total sales	**2,889**	**2,635**
Crude oil		
International sales	873	947
Domestic sales	221	101
Refined products		
International sales	1,239	1,054
Domestic sales	672	530
Sales volumes		
	(mmbls)	
Crude oil		
International sales	41,106	52,028
Domestic sales	30,333	21,917
Refined products	(millions of tones)	
International sales	4,747	5,431
Domestic sales	3,955	4,735

	2001		**2002**	
	(millions of barrels)	(millions of tonnes)	(millions of barrels)	(millions of tonnes)
Crude oil produced	127,933	17,453	131,548	17,947
Refined product produced		7,130		7,033

Our sales decreased by $488 million, or 14.6%, from 2001 to 2002. Our net sales (excluding excise and export tariff) decreased by 254 or 8.8%. Our revenues from the sales of crude oil decreased by $46 million, or 4.2%. Our revenues from the sale of refined products also decreased by $327, or 17.1%. Our revenues from other sales decreased by 115 or 34.8%. The major reason for the decrease was significantly lower prices in first quarter 2002 compared to first quarter 2001, however that factor was partially mitigated by increased volumes.

The proportion of our sales volumes represented by refined products increased slightly in first quarter 2002, from 47% to 50%, reflecting our strategy of increasing the proportion of our crude oil production that is refined.

The overall increase in our sales revenue was principally due to the following:

International crude oil

Our revenues from the sale of crude oil outside Russia increased by $74 million, or 8%. This was result of increase in volumes by 10,921 thousand barrels, or 28%, partially offset by decrease in average realized prices for our crude oil of $3.05 per barrel, or 14%, reflecting decrease in price of Urals crude oil.

Domestic crude oil
Our revenues from sale of crude oil on the domestic market decreased by $120 million, or 54%. This was a result of a decrease in the average realized price for crude oil sales in the domestic market of $2.67 per barrel, or 36% and decreased in volumes by 8,415 thousand barrels, or 28%. The decrease in our realized price was due to oversupply of oil that existed in the Russian market in the first quarter 2002.

International refined products
Our revenues from sales of refined products outside Russia decreased by $ 185 million, or 15%. This was a result of decrease in prices of $66.94 per tonne, or 26%, partially offset by net increase in volumes sold of 684 thousand tones, or 14%.

Domestic refined products
Our revenues from sales of refined products on the domestic market decreased by $142 million, or 21%. This was a result of decrease in prices on the domestic market by $58.04, or 34%, however that was partially offset by increase in volumes of 780 thousand tones, or 20%

Equity share in income from affiliates

There were no significant changes to the Group structure during these two periods. There was also not a significant change in the equity share in income from affiliates during the first quarter of 2002. Income from affiliates attributable to the Group reduced by $11 million or 30% in the first quarter of 2002 compared to first quarter 2001. The decrease was result of economic factors, described above which affected the results of our major affiliates: oil production company LUKOIL AIK and construction company LUKOIL Neftegazstroy.

Operating expenses

	2001	2002
	($ millions)	
Operating expense	1,067	1,053
Including: Extraction	371	397
Refining	125	98
Other operating expense and cost of purchased crude oil, refined products and other goods.	571	558

Our operating expenses decreased by $14 million, or 1.3% from 2001 to 2002. Operating expenses primarily include cost of purchased crude oil and petroleum products and direct operating and labour costs associated with our exploration and production and refining, marketing and distribution activities. As a proportion of revenues operating expenses increased from 2001 to 2002 by 5.0%, in particular as a result of decrease in revenue.

In our Exploration and Production segment average oil production cost per barrel extracted increased from $2.90 per barrel in 1st quarter of 2001 to $3.01 per barrel in 1st quarter of 2002. However, extraction costs in 1st quarter of 2002 decreased comparing to average extraction cost in 2001, which was $3.14 per barrel, and a peak of extraction cost in 3rd quarter of 2001, which was $3.35 per barrel.

In our refining operations, total cost of processing decreased by $27 million or 22% as a result of temporary shut down of operations of the Petrotel SA refinery in the second quarter 2001. The refinery remained closed as of the date of these financial statements.

In our reselling activity and sales of other goods total cost decreased by $13 million or 2.0%. The decrease was a result of decreased prices purchased crude and oil products, partially offset by increased volumes.

Selling, general and administrative expenses

Selling, general and administrative expenses are primarily costs relating to selling and marketing our products, as well as general business expenses, including business development and payroll costs. Our selling, general and administrative expenses increased by $116 million, or 25.0% from 2001 to 2002, which is primarily due to the following reasons:

- real appreciation of ruble against the dollar;
- an increase in transportation costs and port costs as a result of increase in volumes transported and significant increase in tariff rates;
- decrease in overhead expenses as a result of restructuring program commenced in 4^{th} quarter of 2001, offsetting the effect of abovementioned factors.

Depreciation, depletion and amortisation

Depreciation, depletion and amortisation expenses include depletion of assets fundamental to production, depreciation of other productive and non-productive assets and the amortisation of goodwill and intangible assets. Our depreciation, depletion and amortisation expenses increased by $29 million or 13.9% during the first quarter of 2002, compared to the first quarter of 2001, primarily due to substantial capital expenditures carried out in 2001 and accordingly increase in depreciable base by approximately 14.0%.

Taxes other than income taxes

Our taxes other than income taxes include royalty tax, mineral replacement tax, road user's tax, property tax and social taxes. The majority of our taxes other than income taxes are based on either revenue, sales volumes or the value of our assets. The expenditures increased by $102 million, or 37% in 2002 compared to 2001, primarily due to changes in tax legislation that replaced Royalty, Mineral replacement and oil excise taxes with one unified tax. The new royalty tax is based on international crude prices compared with old tax base that calculated on average domestic and international crude prices. As a result of this change we expect that total tax over then income expense will increase with a corresponding reduction of oil excise tax. However we expect that a total tax burden will increase.

Exploration expense

The costs we incur in our exploratory drilling efforts are capitalised to the extent that our exploration efforts are successful and otherwise are charged as an expense. Other exploratory expenditures, including geological and geophysical costs, are expensed as incurred. We expensed $20 million in 2002 and $19 million in 2001.

Loss on disposal and impairment of assets

Our loss on disposal and impairment of assets increased by $21 million, or 2100.0% in 2002, compared to 2001**.** The increase was due to losses incur on disposal of non-core assets.

Interest expense

The rise in interest expense from $62 million in 2001 to $67 million in 2002 was primarily due to the increase in short-term and long-term borrowings.

Interest and dividend income

Our interest and dividend income decreased by $21, or 39% from 2001 to 2002, primarily due to changes in cash balances and investments held.

Income taxes

Our effective income tax rate, defined as our income taxes divided by our income before income taxes, was 23% in first quarter 2002 and 24% in first quarter 2001. This slight change was due to a decrease in the maximum income tax rate from 35% to 24% and removal of limits on the deductibility of certain expenses considered to be in the normal course of business, which was offset by the removal of investment tax credits.

LIQUIDITY AND CAPITAL RESOURCES

The consolidated statement of cash flows excludes the effect of non-cash transactions. Non-cash transactions include barter transactions and mutual settlements.

Cash Flows

	Quarter ended March 31	
	2001	**2002**
Net cash provided by operating activities	603	208
Net cash used in investing activities	(884)	(605)
Net cash provided by financing activities	304	106

1 Cash flows provided by operating activities

Our primary source of cash flow is funds generated from our operations. Net funds generated from our operations for the first quarter 2002 and 2001 amounted to $208 and $603 million, respectively. In the first quarter 2002 cash and cash equivalents decreased in amount $303 million. Other major items contributing to cash flows provided by operating activities in the first quarter 2001 and 2002 were: depreciation of $208 and $237; increase in accounts and notes receivable of $52 and $65 million, respectively. A decrease in accounts payable reduce our cash flows by $145 million in the first quarter 2001 and $351 million in the first quarter 2002. Significant decrease in accounts payable in the first quarter 2002 was mainly concerned with operating activity within Russia.

2 Cash flows used in investing activity

In the first quarter 2002, net cash flows used in investing activities amounted to $605 million, as compared to $884 million in the first quarter 2001. The 31% decrease from the first quarter 2001 to the first quarter 2002 was primarily due to acquisition of OAO Arkhangelskgeoldobycha in the first quarter 2001 and absence of significant acquisitions in the first quarter 2002.

3 Cash flows provided by financing activities

In the first quarter 2002, net cash provided by financing activities amounted to $106 million, compared to $304 in the first quarter 2001. The change in net cash flows provided by financing activities in the first quarter 2002 was primarily due to reduction in the increase in short-term borrowings of $166 million, to reduction in the increase in long-term borrowings of $34 million and to a material increase in dividend paid of $70 million.

Working capital and liquidity

Our working capital (current assets less current liabilities) was $1.72 billion at March 31, 2002 and $1.85 billion at December 31, 2001. We believe that, having regard to our liquidity reserves, including credit facilitates available, we have sufficient working capital to meet our requirements for at least the next twelve month.

Capital expenditures

Set forth below are our capital expenditures and investments for the quarter ended March 31, 2001 and 2002:

			Quarter ended March 31	
			2001	**2002**
Exploration and production	- Russia	$	387	401
	- International		16	3
Total Exploration and Production			**403**	**404**
Refining, Marketing and Distribution	- Russia		142	98
	- International		23	36
Total Refining, Marketing and Distribution			**165**	**134**
Total cash and non-cash capital expenditures		$	**568**	**538**
Acquisitions and investments in affiliates				
Exploration and Production	- Russia	$	169	40
	- International		-	-
Total Exploration and Production			**169**	**40**
Refining, Marketing and Distribution	- Russia		9	15
	- International		18	-
Total Refining, Marketing and Distribution			**27**	**15**
Less cash acquired			-	-
Total		$	**196**	**55**

Exploration and production capital expenditures in the first quarter of 2002 was carried out in:

- Western Siberia in amount $93 million;
- Timan-Pechora in amount $87 million;
- European Russia in amount $205 million;
- Caspian in amount $16 million.

Capital expenditures totaled $538 million in the first quarter 2002 compared to $568 in the first quarter 2001. The increase of exploration and production capital expenditures in Russia of $14 million was due to increase in Timan-Pechora and European Russia of $28 and $51 million, respectively. Capital expenditures in Western Siberia decreased of $80 million. ZAO LUKOIL-Perm capital expenditures was dominating in European Russia. The increase of $13 million of international R,M&D capital expenditures was due to distribution and marketing companies.