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

The following represents management's analysis of the financial performance and condition of OAO LUKOIL and significant trends that may affect future performance. It should be read in conjunction with our interim consolidated financial statements and notes thereto.

References to "LUKOIL", "the Group", "the Company", "we" or "us" are references to OAO LUKOIL and its consolidated subsidiaries and associates.

All dollar amounts are in millions of US dollars, unless otherwise indicated. Tonnes of crude oil produced are translated into barrels using conversion rates characterizing the density of oil from each of our oilfields. Tonnes of crude oil purchased as well as other operational indicators expressed in barrels or barrels per day are translated into barrels using an average conversion rate of 7.33.

Forward-looking statements

This report contains forward-looking statements. Words such as "believes", "anticipates", "expects", "estimates", "intends", "plans", etc. reflect management's current estimates and beliefs, but are not guarantees of future results.

Financial highlights

	1st half of 2004	1st half of 2003	% change	**2nd quarter of 2004**	2nd quarter of 2003	% change
Sales (including excise and export tariffs)	**14,477**	10,142	42.7%	**7,965**	5,086	56.6%
Net Income	**1,696**	2,364	(28.3)%	**877**	1,544	(43.2)%
Net income excluding cumulative effect of change in accounting principle and gain from sale of share in Azeri, Chirag, Guneshli	**1,696**	1,102	53.9%	**877**	414	111.8%
EBITDA	**2,965**	3,178	(6.7)%	**1,553**	1,947	(20.2)%
Earnings per share of common stock (US dollars)						
Basic earnings	**2.07**	2.89	(28.4)%	**1.07**	1.89	(43.4)%
Diluted earnings	**2.05**	2.84	(27.8)%	**1.06**	1.85	(42.7)%
Crude oil production (thousands of tonnes)	**40,552**	36,292	11.7%	**20,378**	18,461	10.4%
Refined products (thousands of tonnes)	**19,722**	19,063	3.5%	**10,329**	9,412	9.7%

During the first half of 2004 net income was $1,696 million, which is $594 million more than in the same period of 2003 (excluding the cumulative effect of change in accounting principle and gain from sale of our share in Azeri, Chirag, Guneshli).

This resulted from favorable price conditions in the first half of 2004 and improved cost control. However, increased tax burden, appreciation of the ruble against the US dollar and an increase in transportation costs have restrained growth of our profit. These restraining factors as well as other drivers impacting the results of our operations are considered below in detail.

Segment information

Our operations are divided into three main business segments:

- **Exploration and Production** – which includes our exploration, development and production operations relating to crude oil and natural gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakhstan, the Middle East, Northern Africa and Colombia

- **Refining, Marketing and Distribution** – which includes marketing and trading of crude oil, natural gas and refined products, and refining and transport operations
- **Chemicals** – which include processing and trading of petrochemical products

Other businesses include banking and finance, construction and other activities. Each of our three main segments is dependent on the other, with a portion of the revenues of one segment being a part of the costs of the other. In particular, our Refining, Marketing and Distribution segment purchases crude oil from our Exploration and Production segment. As a result of certain factors considered in section "Domestic crude oil prices" on page 3, benchmarking crude oil market prices in Russia cannot be determined with certainty. Therefore, the prices set for inter-segment purchases of crude oil reflect a combination of market factors, primarily international crude oil market prices, transportation costs and need for investment resources at Group's oil producing companies. Accordingly, an analysis of either of these segments on a stand-alone basis could give a misleading impression of that segment's underlying financial position and results of operations. For this reason, we do not analyze either of our main segments separately in the discussion that follows, but we do present the financial data for each in Note 18 to our interim consolidated financial statements.

Recent developments

On January 26, 2004, a Group company entered into an agreement with ConocoPhillips to purchase 308 gas stations and contracts to supply petroleum products to an additional 471 gas stations in the Northeast of the United States of America for $270 million. The transaction was finalized in May 2004.

In March 2004, we entered into an agreement for exploration, development and production of non-associated gas and condensate in Saudi Arabia. In respect of this agreement, the Company has minimum exploration commitments of $215 million over the next 5 years.

In June 2004, we entered into an agreement for exploration, development and production of non-associated gas in Uzbekistan. In respect of this agreement, the Company has minimum exploration commitments of $16 million over next 3 years. The amount of recoverable reserves agreed upon under the terms of the contract is 250 bcm.

In June 2004, we put into operation the first stage of our reloading and distribution terminal in Vysotsk. The terminal's initial capacity is 4.7 million tonnes of crude oil and refined products a year. Through this terminal we will export light refined products to Western Europe and the United States. It is planned that the full capacity of approximately 12.0 million tonnes will be reached in 2005.

In June 2004, the Company made a decision to sell its 99% interest in Petrocommerce Bank for $214 million. The first phase of the transaction representing the sale of 78% of the Group's ownership interest for $169 million was completed on September 22, 2004. The second phase in which the Group will sell its remaining 21% of ownership interest in the Bank for $45 million will be completed by the end of June 2007. The decision to sell the shares was made pursuant to the Strategic Development Program of OAO LUKOIL with a view of increasing the investment attractiveness of the Company through divestiture of non-core assets from the Group.

Consolidation of the Group

By the end of 2003 we completed the restructuring of the Group's oil producing assets in the Perm region. ZAO "LUKOIL-Perm", our 100% subsidiary, merged with OOO "LUKOIL-Permneft", also a 100% subsidiary. Furthermore, oil producing assets of ZAO "LUKOIL-Perm" located in Western Siberia and the Komi Republic were transferred to the Group's companies operating in the respective regions. Thus, we created a single oil extraction company operating in the Perm region, namely OOO "LUKOIL-Perm". Within the bounds of this restructuring process we took certain measures, which allowed us to:

- optimize organizational structure
- dispose from the Group certain service companies and non-core businesses
- decrease general and administrative expenses
- introduce standardized organizational structure and management functions

During our optimization of the organizational structure we decreased the number of employees by more than 1,000. The consolidation of our oil producing assets will allow us to further increase our labor productivity and production output.

Main macroeconomic factors affecting our results of operations

Change in the price of crude oil and refined products

The price at which we can sell crude oil and refined products is the primary driver of our revenues. During 2003 crude oil prices were steadily high due to recommenced growth of the world economy (3.7% in 2003) and increased worldwide crude oil consumption (in 2003 worldwide crude oil consumption was 78.5 million barrels a day, or 1.9% more than in 2002). In 2004, due to the robust growth in demand in the USA and China, which had not been fully anticipated, certain geopolitical tensions, refining and distribution bottlenecks in some major consuming regions, crude oil prices rapidly escalated and in July and August reached their historical records (OPEC basket) in absolute terms. In responding to this and in order to ensure market stability, OPEC decided to increase daily level of production up to 26.0 million barrels a day by August 2004. However, based on OPEC's data, actual daily production in July already reached 27.6 million barrels a day excluding Iraq (or 29.6 million barrels a day including Iraq) – near to OPEC's full capacity. This situation can be viewed as an indicator that crude oil prices will remain steadily high in a medium-term perspective.

Substantially all of the crude oil that we sell for export is Urals blend. The following table shows the yearly average crude oil export prices for 2002, 2003 and 2004 and refined product prices based on Northern Europe averages:

	1st half of 2004	1st half of 2003	Change %	**2nd quarter 2004**	2nd quarter 2003	Change %
	(in US dollars per bbl, except for figures in percent)					
Brent crude	**33.66**	28.74	17.1%	**35.32**	26.04	35.6%
Urals crude (CIF Mediterranean)*	**30.74**	26.53	15.9%	**32.50**	23.88	36.1%
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam)	**147.42**	148.50	(0.7)%	**157.05**	133.64	17.5%
Diesel fuel (FOB Rotterdam)	**292.55**	259.36	12.8%	**311.26**	225.35	38.1%
High-octane gasoline (FOB Rotterdam)	**370.71**	297.64	24.5%	**408.19**	282.16	44.7%

Source: Platts, Cortes

* The Company sells crude oil on foreign markets on various delivery terms. Thus the average realized sale price of oil on international markets differs from the average price of Urals crude (CIF Mediterranean).

Domestic crude oil prices

Crude oil prices in Russia have remained below world levels primarily due to constraints on the ability of Russian oil companies to export their crude oil, which has led to large regional surpluses in Russia, increased domestic supplies and reduced domestic prices. We bear the Russian transportation costs on all of our export sales and most of our domestic sales. Transportation costs vary widely depending on the origin and destination of the crude oil.

Because substantially all crude oil is produced in Russia by vertically integrated oil companies such as ours, there is no concept of a benchmark domestic market price for crude oil. Most transactions are between affiliated entities with little regard to market considerations. There is also a market within Russia for residual crude oil that is produced but not refined or exported by one of the vertically integrated oil companies. Prices for this oil are generally determined on a transaction-by-transaction basis against a background of world market prices, but with no direct reference or correlation. At any time there may exist significant price differences between regions for similar quality crude as a result of the regional imbalances referred to above and competitive and economic conditions in those regions.

Domestic refined product prices

Domestic prices for refined products are determined to some extent by world market prices, but they are also directly affected by local demand, competition and prices imposed on government-directed sales. The portion of our domestic refined product sales is 54.4% (1st half of 2003: 54.8%) of total tonnes sold but represents 57.0% of our total sales revenue (1st half of 2003: 58.6%). In general, retail prices on refined products in Russia are comparable to those in the USA. For example, in the first half of 2004 the average retail price on regular gasoline in the USA was about 48 cents per liter. In central regions of

European Russia the average retail price on gasoline of the same quality (95 octane) in the first half of 2004 was 42 cents per liter. As compared to the same period of 2003 domestic gasoline and diesel fuel retail prices rose by more than 21%.

Changes in the US dollar-ruble exchange rate and inflation

A substantial part of our revenues are either denominated in US dollars or are correlated to some extent with US dollar crude oil prices, while most of our costs in the Russian Federation are settled in Russian rubles. Therefore, the movements of the ruble inflation and exchange rates can significantly affect the results of our operations. In particular, our operating margins are generally adversely affected by the real appreciation of the ruble against the US dollar, because this will generally cause our costs to increase in US dollar terms relative to our revenues. It should be noted that during 2003 and the first quarter of 2004 the exchange rate of the ruble to the US dollar was constantly increasing, rather than declining like in periods prior to 2003. However, in the second quarter of 2004 the ruble tended to devaluate against the US dollar.

The following table gives data on inflation in Russia, the nominal change in the ruble–dollar exchange rate, and the level of real appreciation.

	1st half of 2004	1st half of 2003	**2nd quarter 2004**	2nd quarter 2003
Ruble inflation (CPI)	6.3%	7.9%	2.5%	2.6%
Nominal appreciation/(devaluation) of the exchange rate (ruble to US dollar)	1.5%	4.5%	(1.9)%	3.3%
Real appreciation/(devaluation) of the exchange rate (ruble to US dollar)	7.8%	13.0%	0.6%	6.0%
Average exchange rate for the period (ruble to US dollar)	28.78	31.27	28.90	30.88
Exchange rate at the end of the period (ruble to US dollar)	–	–	29.03	30.35

Change in tax rates and export tariffs

		1st half of 2004*	1st half of 2003 *	Change %
Export tariffs on crude oil	$/tonne	35.15	31.57	11.3%
Export tariffs on refined products	$/tonne	30.60	28.41	7.7%
Excise on refined products				
High-octane gasoline	RUR/tonne	3,360.00	3,000.00	12.0%
Low-octane gasoline	RUR/tonne	2,460.00	2,190.00	12.3%
Diesel fuel	RUR/tonne	1,000.00	890.00	12.4%
Motor oils	RUR/tonne	2,732.00	2,440.00	12.0%
Mineral extraction tax	RUR/tonne	915.41	802.74	14.0%

* average values

In the first half of 2004 our tax burden rose significantly compared to the same period of the previous year. The average crude oil export tariffs increased in the first six months of 2004 compared to same period of 2003 by 11.3%. Export tariffs on gasoline, kerosene, jet fuel, diesel fuel, fuel oil and gasoils rose by 7.7%. Excise on refined products rose by approximately 12%.

Mineral extraction tax rate increased as compared to the first half of 2003 by 14.0% as a result of an increase of the Urals crude price (by 15.9%), increase of the base rate up to 347 Rubles per metric tonne extracted and as a result of a different spread of crude oil prices over the first half of 2004 as compared to the same period of 2003. These factors were partially offset by an increase in the exchange rate of the ruble against the US dollar of 8.0%.

		2nd quarter 2004 *	2nd quarter 2003 *	Change %
Export tariffs on crude oil	$/tonne	37.31	35.85	4.1%
Export tariffs on refined products	$/tonne	32.02	32.28	(0.8)%
Excise on refined products				
High-octane gasoline	RUR/tonne	3,360.00	3,000.00	12.0%
Low-octane gasoline	RUR/tonne	2,460.00	2,190.00	12.3%
Diesel fuel	RUR/tonne	1,000.00	890.00	12.4%
Motor oils	RUR/tonne	2,732.00	2,440.00	12.0%
Mineral extraction tax	RUR/tonne	982.41	679.34	44.6%

* average values

The mineral extraction tax rate is determined as follows. The base rate is set at 347 Rubles per metric tonne extracted (effective from January 1, 2004; prior to this the base rate was 340 rubles) and is adjusted depending on the international market price of the Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals international market price for a tax period is less than or equal to $8.00 per barrel. Each $1.00 per barrel increase in the international Urals price over the stated limit ($8.00 per barrel) effectively results in an increase of the tax rate by $1.38 per tonne extracted (or 18.79 cents per barrel extracted using a conversion factor of 7.33).

Crude oil export duties also depend on the international market price of the Urals blend. Before June 2004 the duties' rates have been calculated as follows (for a new method of the duties' rates calculation enacted from June 2004 see "Recent amendments to Russian tax legislation" below). The rates are zero when the average Urals international market price is less than or equal to approximately $15.00 per barrel ($109.50 per metric tonne). If the Urals price is in a layer between $15.00 and $25.00 per barrel ($182.50 per metric tonne), each $1.00 per barrel increase in the Urals price over the layer's lower bound results in increase of the crude oil export duty rate by $0.35 per barrel exported. If the Urals price is above $25.00 per barrel, each $1.00 dollar per barrel increase in the Urals price over this limit results in the increase of the crude oil export duty rate by $0.40 per barrel exported.

Export duty rates on export of refined products are set by the Russian government. Effective from January 2004 the upper bound for refined products export duties limited to 90% of the crude oil export duty was abolished. Crude oil and refined products exported to CIS countries, other than Ukraine, are not subject to export duties.

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

	1st half of 2004 *	1st half of 2003 *	Change %	2nd quarter 2004 *	2nd quarter 2003 *	Change %
			(in USD dollars per tonne)			
Excise on refined products						
High-octane gasoline	116.75	95.95	21.7%	116.27	97.15	19.7%
Low-octane gasoline	85.48	70.05	22.0%	85.12	70.92	20.0%
Diesel fuel	34.75	28.47	22.1%	34.60	28.82	20.1%
Motor oils	94.93	78.04	21.6%	94.54	79.01	19.7%
Mineral extraction tax	31.81	25.67	23.9%	33.99	22.00	54.5%

* average values

Recent amendments to Russian tax legislation

Effective from January 1, 2005 the formula underlying the mineral extraction tax calculation will be adjusted - the base rate is to be set at 419 Rubles per metric tonne extracted (instead of 400 Rubles as planned before) and the lower non-taxable threshold is to be increased up to $9.00 per barrel. As a result each $1.00 per barrel increase in the international Urals price over the threshold ($9.00 per barrel) will effectively result in an increase of the tax rate by $1.61 per tonne extracted (or 21.90 cents per barrel extracted using a conversion factor of 7.33). If the Urals blend price in 2005 will be between $22 – 28 per barrel the mineral extraction tax will increase by 7.6 – 10.8%.

Effective from June 2004 the Russian government reconsidered crude oil export duties rates. A three-layer progressive scale was introduced. If the Urals price is in a layer between $15.00 ($109.50 per metric tonne) and $20.00 per barrel ($146.00 per metric tonne), each $1.00 per barrel increase in the Urals price over the layer's lower bound results in an increase of the crude oil export duty rate by $0.35 per barrel exported. If the Urals price is in a layer between $20.00 and $25.00 per barrel ($182.50 per metric tonne), each $1.00 per barrel increase in the Urals price over the layer's lower bound results in an increase of the crude oil export duty rate by $0.45 per barrel exported. If the Urals price is above $25.00 per barrel, each $1.00 dollar per barrel increase in the Urals price over this limit results in the increase of the crude oil export duty rate by $0.65 per barrel exported. If the Urals blend price is between $22 – 28 per barrel the crude oil export duties will increase by 8.2 – 26.6%.

Operational highlights

Oil production

In line with our long term strategy we increased our total daily oil production (including the Company's share in equity associates) by 8.7% and produced 313.3 million barrels (42.3 million tonnes) in the period ended June 30, 2004.

	1st half of 2004	1st half of 2003	Change, %
Daily production, including Company's share in Equity associates (thousand barrels per day)	**1,721**	1,583	8.7%
Refinery throughput (thousand barrels per day)	**852**	836	1.9%

The main oil production region of the Company remains Western Siberia. In the oil fields of Western Siberia the Company produced 67.7% of its total production of crude oil in the first half of 2004 (67.3% in 2003). The increase of production in Western Siberia by 12.4% is a result of both acquisitions by the Group of new oil producing companies (primarily additional interest in LUKOIL-AIK), and improvement and optimization of oil production methods. The organic growth of oil production resulting from these improvements was 5.8%. The increase of production in the Komi Republic by 21.8% primarily resulted from the consolidation of our oil production companies – acquisitions of additional interests in OAO Tebukneft, OAO Ukhtaneft and ZAO RKM-Oil. The organic growth of the oil production in the Komi Republic was 1.6%. Commencement of oil production in new oil fields in the Nenetsky Autonomous District led to an increase of oil production in this region of Russia more than 1.5 times compared to 2003. Thus, the total organic growth of the oil production was 5.0%.

The following table represents our production by major regions excluding our shares in equity associates:

		Change to 2003			
(thousands tonnes)	**1st half of 2004**	Total %	Change in structure	Organic growth	1st half of 2003
Western Siberia	**27,457**	12.4%	1,625	1,412	24,420
Komi Republic	**4,737**	21.8%	784	63	3,890
Ural region	**4,981**	0.9%	–	46	4,935
Volga region	**1,476**	(0.4)%	–	(6)	1,482
Timano-Pechora (Nenetsky Autonomous District)	**664**	50.6%	–	223	441
Other in Russia	**640**	8.5%	29	21	590
Crude oil production in Russia	**39,955**	11.7%	2,438	1,759	35,758
Crude oil produced internationally	**597**	11.8%	–	63	534
Total crude oil produced	**40,552**	11.7%	2,438	1,822	36,292

Along with production we have been purchasing crude oil from third parties in Russia and on international markets. In Russia we primarily purchase crude oil from associated producing companies and other producers, including vertically integrated companies, which have lack of refining capacity or are unable to export their crude oil. Then, we either refine or export purchased crude oil. Crude oil purchased on international markets is used mostly for marketing activities, in swap transactions and, under certain conditions, for supplying our overseas refineries.

	1st half of			
	2004		2003	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil purchases in Russia	10,488	1,431	23,727	3,237
Crude oil purchases internationally	33,637	4,589	27,708	3,780
Total crude oil purchased	**44,125**	**6,020**	**51,435**	**7,017**

The volume of crude oil purchased in Russia in the first half of 2004 was 1,431 thousand tonnes, a 1,806 thousand tonnes decrease compared to the same period of 2003. The decrease occurred because in the first half of 2003 most of our purchases of crude oil in Russia were from associate companies, which later became fully consolidated subsidiaries. The volume of crude oil purchased internationally increased by 809 thousand tonnes, or by 21.4%, as a result of an increase in our marketing activity.

Refining and marketing

We operate four refineries located in European Russia and three refineries located overseas – in Bulgaria, Ukraine and Romania. Our Romanian refinery, Petrotel SA, is currently shut down undergoing upgrades. It is expected that Petrotel SA will resume its operations in the fourth quarter of 2004.

Production of refined products in the first half of 2004 increased by 3.5% as compared to the same period of 2003. Russian refineries increased production by 4.3%.

The following table represents volumes of refined products produced and purchased:

	1st half of	
	2004	2003
	(thousand of tonnes)	(thousand of tonnes)
Refined products produced at the Group refineries in Russia	16,494	15,807
Refined products produced at the Group refineries outside of Russia	3,228	3,256
Total refined products produced	**19,722**	**19,063**
Refined products purchased in Russia	891	618
Refined products purchased internationally	9,491	5,839
Total refined products purchased	**10,382**	**6,457**

In 2004 we continued to expand our marketing activities in Western Europe, South-East Asia, Northern and Central America. Our marketing activities mainly include wholesale and bunkering operations in Western Europe and South-East Asia. The total volume of refined products, which were purchased from third parties for resale, was 6,775 thousand tonnes or $1,681 million (3,815 thousand tonnes or $872 million in the first half of 2003).

In addition, the Group purchases refined products to supply our retail networks in the USA, Baltic states and some other regions. The total volume of refined products purchased in this activity from third parties during the first half of 2004 was 2,716 thousand tonnes or $1,223 million (2,024 thousand tonnes or $741 million in the first half of 2003).

In Russia we purchase refined products on occasion, primarily to manage supply chain bottlenecks.

Export of crude oil and refined products from Russia

Access to the Transneft crude oil export pipeline network is allocated quarterly, based on recent volumes produced and delivered through the pipeline and proposed export destinations. The Russian Government places restrictions on access to the Transneft export network, which limits our ability to export via this method because of a need to ensure that sufficient oil remains in Russia to meet domestic requirements and capacity constraints of the crude oil pipeline network.

At the same time additional access to international markets bypassing Transneft export routes is obtained through rail transport or by tankers. Moreover, in the second quarter of 2004 we put into operation the first stage of our Vysotsk terminal and loaded the first tankers with crude oil. In the first half of 2004 the Company exported 8.0% of crude oil produced (3,243 thousand tonnes) by means other than Transneft, including through our own export infrastructure. By these methods we were able to export crude oil produced in the Nenetsky Autonomous District and the Kaliningrad Region.

	1st half of			
	2004		**2003**	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Export of crude oil using Transneft export routs..................	143,960	19,640	114,583	15,632
Export of crude oil bypassing Transneft	23,772	3,243	18,310	2,498
Total crude oil export	**167,732**	**22,883**	**132,893**	**18,130**

In March 2004 capacity of the Baltic Pipeline System was increased up to 42 million tonnes of crude oil a year. This allowed us to increase the volume of crude oil exported via Primorsk terminal in the first half of 2004 by more that 5 times as compared to the same period of the previous year. In the period ended June 30, 2004 we exported via Primorsk 4.3 million tonnes of crude oil.

An increase in production of refined products in the first half of 2004 coupled with flat domestic sales and increased purchases of refined products in Russia allowed us to increase our export of refined products by 10.5% as compared to the same period of the previous year, or up to 7 million tonnes.

Six months ended June 30, 2004 compared to the six months ended June 30, 2003

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

	1st half of 2004		1st half of 2003	
Revenues				
Sales (including excise and export tariffs)	14,477	99.1%	10,142	99.1%
Equity share in income of associates	132	0.9%	91	0.9%
Total revenues	**14,609**	**100.0%**	**10,233**	**100.0%**
Costs and other deductions				
Operating expenses	(1,334)	(9.1)%	(1,361)	(13.3)%
Costs of purchased crude oil, petroleum and chemical products	(4,328)	(29.6)%	(2,665)	(26.0)%
Transportation expenses	(1,383)	(9.5)%	(939)	(9.2)%
Selling, general and administrative expenses	(922)	(6.3)%	(758)	(7.4)%
Depreciation, depletion and amortization	(514)	(3.5)%	(455)	(4.5)%
Taxes other than income taxes	(1,558)	(10.7)%	(1,140)	(11.1)%
Excise and export tariffs	(1,947)	(13.3)%	(1,329)	(13.0)%
Exploration expense	(87)	(0.6)%	(54)	(0.5)%
Gain from sale of interest in Azeri, Chirag, Guneshli	–	–	1,130	11.0 %
Loss on disposal and impairment of assets	(71)	(0.5)%	(68)	(0.7)%
Income from operating activities	**2,465**	**16.9%**	**2,594**	**25.3 %**
Interest expense	(143)	(1.0)%	(140)	(1.3)%
Interest and dividend income	99	0.7 %	63	0.6 %
Currency translation gain	19	0.1 %	84	0.8 %
Other non-operating income	4	0.0 %	64	0.7 %
Minority interest	(37)	(0.3)%	(19)	(0.2)%
Income before income taxes	**2,407**	**16.4%**	**2,646**	**25.9%**
Current income taxes	(712)	(4.9)%	(400)	(4.0)%
Deferred income taxes	1	0.1 %	(14)	(0.1)%
Total income tax expense	**(711)**	**(4.8)%**	**(414)**	**(4.1)%**
Income before cumulative effect of change in accounting principle	**1,696**	**11.6%**	**2,232**	**21.8%**
Cumulative effect of change in accounting principle, net of tax	–	–	132	1.3%
Net income	**1,696**	**11.6%**	**2,364**	**23.1%**
Per share of common stock (in US dollars)				
Income before cumulative effect of change in accounting principle				
Basic	2.07		2.73	
Diluted	2.05		2.68	
Net income				
Basic	2.07		2.89	
Diluted	2.05		2.84	

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

Sales revenues

Sales breakdown	1st half of 2004		2003	
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS	4,570	31.5%	2,856	28.2%
Export and sales to CIS	298	2.1%	250	2.4%
Domestic sales	101	0.7%	151	1.5%
	4,969	**34.3%**	**3,257**	**32.1%**
Refined products				
Export and sales on international markets				
Wholesale	4,835	33.4%	3,310	32.6%
Retail	1,488	10.3%	1,048	10.3%
Domestic sales				
Wholesale	1,416	9.8%	1,233	12.2%
Retail	514	3.6%	349	3.5%
	8,253	**57.1%**	**5,940**	**58.6%**
Petrochemicals				
Export and sales on international markets	451	3.1%	314	3.1%
Domestic sales	154	1.1%	84	0.8%
	605	**4.2%**	**398**	**3.9%**
Other	**650**	**4.4%**	**547**	**5.4%**
Total sales	**14,477**	**100.0%**	**10,142**	**100.0%**

Sales volumes	1st half of 2004		2003	
	(thousands of barrels)			
Crude oil				
Export and sales on international markets other than CIS	153,197		113,307	
Export and sales to CIS	16,903		18,704	
Domestic sales	7,550		24,592	
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than CIS	20,900	39.4%	15,458	32.7%
Export and sales to CIS	2,306	4.3%	2,552	5.4%
Domestic sales	1,030	1.9%	3,355	7.1%
	24,236	**45.6%**	**21,365**	**45.2%**
Refined products	(thousands of tonnes)			
Export and sales on international markets				
Wholesale	16,800	31.6%	13,569	28.7%
Retail	2,200	4.1%	1,800	3.8%
Domestic sales				
Wholesale	8,659	16.3%	9,476	20.0%
Retail	1,270	2.4%	1,100	2.3%
	28,929	**54.4%**	**25,945**	**54.8%**
Total sales volume of crude oil and refined products	**53,165**	**100.0%**	**47,310**	**100.0%**

Realized average sales prices	1st half of 2004		2003	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	29.83	218.64	25.20	184.73
Oil (CIS)	17.66	129.45	13.38	98.09
Refined products				
Wholesale		287.79		243.94
Retail		676.12		582.31
Average realized price within Russia				
Oil	13.37	98.03	6.14	45.01
Refined products				
Wholesale		163.54		130.08
Retail		405.01		317.60

In the first half of 2004 sales revenues increased by $4,335 million, or 42.7%, compared to the same period of 2003.

The total volume of crude oil and refined products sold amounted 53.2 million tonnes, which is 12.4% more than for the same period of 2003. Our revenues from crude oil sales increased by $1,712 million, or 52.6%. Our sales of refined products increased by $2,313 million, or 38.9%.

Sales of crude oil and refined products on the international market, including the CIS, accounted for 79.4% of total sales volume in the first half of 2004 compared to 70.6% in the same period of 2003.

The increase in sales was principally due to the following:

- favorable price conditions: international crude oil market price was at a ten-year high (see “Change in the price of crude oil and refined products” on page 3)
- increase in total volume of crude oil production (see “Oil production” on page 7)
- increase in marketing activities (see page 8)
- decrease of crude oil sales in Russia and increase in volumes exported on international markets (see “Export of crude oil and refined products from Russia” on pages 8-9)

Sales of crude oil

In the first half of 2004 the Company decreased its sales of crude oil on the domestic market compared to the same period in the previous year by 2,325 thousand tonnes, or 69.3%. This change was caused by an increase in volumes exported by the Company’s domestic producers by 4,753 thousand tonnes.

In the first half of 2004 we decreased our export sales on CIS markets by 246 thousand tonnes, or 9.6%, as compared to the same period of 2003. At the same time we increased exports of crude oil on international markets (other than CIS) by the Company’s domestic producers. The increase of the export sales, along with an increase in the average realized export price of crude oil on international markets (other than CIS) from $25.20 to $29.83 per barrel, allowed us to obtain an additional $1,061 million in revenues.

Sales of refined products

Sales of refined products made up 57.0% of our total sales revenues (54.4% in terms of volumes sold) compared to 58.6% in the same period of 2003 (54.8% in terms of volumes).

The average realized price on wholesale of refined products outside of Russia increased by $43.85 per tonne, or 18.0%. Volumes of refined products sold outside of Russia increased by 3,231 thousand tonnes, or 23.8% (see also “Refining and marketing” on page 8). As a result our revenues from wholesale of refined products outside of Russia increased by $1,525 million, or 46.1%.

In the first half of 2004 we increased sales of refined products by retail outside of Russia by 400 thousand tonnes, or by 22.2% as compared to the same period of 2003. The increase was a result of structural changes in the retail network we operate, in particular we acquired Beopetrol in Serbia, and continuing development of the existing retail chains in other regions. As of June 30, 2004 we operated 3,042 refueling stations outside of Russia compared to 2,188 as of June 30, 2003. Retail sales primarily include sales of gasoline, diesel oil and other refined products (heating oil, lubricants, etc.). Average retail prices increased up to $676.12 per tonne, or by 16.1%. As a result our revenues from retail sales increased by $440 million, or 42.0%. Revenue from retail sales were 23.5% of total sales of refined products outside of Russia in the first half of 2004.

Wholesale of refined products within Russia in the first half of 2004 decreased by 817 thousand tonnes, or 8.6%, as compared to the same period in 2003. The decrease was caused by an increase in retail sales and increase in export of refined products. It was compensated by an increase of the average domestic realized price on refined products of $33.45 per tonne, or 25.7%. As a result our revenues from wholesale of refined products on the domestic market increased by $183 million, or 14.9%.

Retail sales within Russia in the first half of 2004 increased by 170 thousand tonnes, or 15.5%, as compared to the same period of 2003. Average retail prices increased up to $405.01 per tonne, or by 27.5%. As a result our revenues from retail sales increased by $165 million, or 47.2%. Revenue from retail sales were 26.6% of total sales of refined products in Russia in the first half of 2004. As of June 30, 2004 we operated 1,196 refueling stations in Russia as compared to 1,209 as of June 30, 2003. The decrease was due to a reduction of leased refueling stations.

Sales of petrochemical products

Revenues from sales of petrochemical products increased by $207 million, or 52.0%, mainly as a result of an increase of production volume up to 1,082 thousand tonnes in the first half of 2004, or by 14.3% as compared to the same period of 2003, and an increase in average realized prices in the period ended June 30, 2004 compared to the same period of 2003.

Sales of other products

Other sales increased by $103 million, or 18.8%, as a result of sales of other products produced by the Company, and also increased activity in providing other services to third parties.

Equity share in income of affiliates

Our share in the income of affiliates was $132 million. This was $41 million more than in the same period of 2003.

Operating expenses

Operating expenses include the following types of costs:

	1st half of	
	2004	**2003**
	(millions of US dollars)	
Extraction expenses	752	694
Refining expenses	253	237
Petrochemical expenses	89	68
Other operating expenses	240	362
Total operating expenses	**1,334**	**1,361**
Costs of purchased crude oil and petroleum products	**4,328**	**2,665**

Compared to the same period of 2003, operating expenses decreased by $27 million, or 2.0%. Costs of purchased crude oil and petroleum products increased by $1,663 million, or 62.4%, compared to the same period of 2003 primarily as a result of increases in volumes of crude oil and petroleum products purchased for resale.

Our extraction expenses include expenditures related to current repairs of extraction equipment, labor costs, expenses of artificial stimulation of reservoirs, fuel and electricity costs and other similar costs.

Expenses of the Company's production enterprises related to the sale of services and goods (such as electricity, heat, etc.) that do not relate to core activities have been excluded from extraction expenses and are included in other operating costs.

Despite a 15.3% real ruble appreciation during the twelve month period ended June 30, 2004 (including 7.8% real ruble appreciation during the first half of 2004), our average extraction cost per barrel decreased from $2.59 to $2.53 per barrel, or 2.3%. The decrease was caused by an increase in an average daily oil flow per well from 9.41 tonnes a day in the first half of 2003 to 10.62 tonnes a day in the first half of 2004, or 12.9%, and restructuring of our oil producing assets in the Perm region. The increase in total extraction expenses resulted from an increase in volumes of oil produced by our subsidiaries from 36.3 million tonnes during the first half of 2003 to 40.6 million tonnes during the first half of 2004. Thus, total extraction expenses rose by $58 million, or 8.4%, as compared to the respective period of the previous year.

Refining expenses at our refineries increased by $16 million, or 6.8%, from the first half of 2003 to the first half of 2004.

Refining expenses of our domestic refineries increased by 13.7%, or $22 million. This was primarily caused by an appreciation in the exchange rate of the ruble to the US dollar.

Refining expenses of our international refineries decreased by 7.9%, or $6 million. This was primarily caused by a larger amount of a major overhaul and maintenance expenses incurred in the first half of 2003 as compared to the same period of 2004.

Operating expenses of petrochemical companies increased by $21 million, or 30.9%, compared to the same period of 2003, as result of an increase of volumes produced.

Other operating expenses include the costs of other services provided and goods not related to primary activities (such as electricity, heat, etc.) sold by our production companies, and operating expenses of other non-core businesses of the Group. Other operating expenses also include costs associated with the delivery of crude oil from the Group's exploration and production entities to the Group's refineries, as well as the amount of the change in crude oil and refined products inventory at the Group's marketing entities. Other operating expenses decreased by $122 million, or 33.7%, as compared to the same period of 2003 primarily as a result of change in crude oil and refined products inventory in the period ended June 30, 2004.

Costs of purchased crude oil and petroleum products increased by $1,663 million, or 62.4%, compared to the prior period primarily due to a significant increase in volumes of refined products purchased by 3,925 thousand tonnes.

Transportation expenses

The increase in the total volume of sales led to an increase in transportation expenses. However, the main factor in the increase of $444 million (47.3%) in these expenses compared to the period ended June 30, 2003 was the increase in the transportation tariffs.

During the twelve month period ended June 30, 2004, transportation tariffs increased as follows: pipeline transport – 39.8%, sea shipping – 34.4% (weighted average by volumes transported to different locations), railway transport – 26.3%. At the same time the volume of goods transported by sea tankers increased by 21.8%.

Selling, general and administrative expenses

Our other selling, general and administrative expenses increased by $164 million, or 21.6%, compared to the same period of 2003. The above-mentioned expenses include general business expenses, payroll costs (excluding extraction entities' and refineries' production staff cost), insurance costs, costs of maintenance of social infrastructure, movement in bad debt provision and other expenses.

The increase in other selling, general and administrative expenses was primarily caused by 15.3% real appreciation of the ruble during the twelve months period ended June 30, 2004. In addition, movement in the bad debt provision had an effect on selling, general and administrative expenses for the periods under consideration. In the first half of 2004 the bad debt provision increased by $27 million, thus increasing general expenses, while for the same period of 2003 the bad debt provision decreased by $2 million.

Selling, general and administrative expenses for the six months ended June 30, 2004 included $19 million of expenses related to subsidiaries acquired and incorporated after June 30, 2003.

Depreciation, depletion and amortization

Depreciation, depletion and amortization expenses include depletion of assets fundamental to production, depreciation of other productive and non-productive assets and certain intangible assets. Our depreciation, depletion and amortization expenses increased by $59 million, or 13.0%, in comparison to the same period of 2003. The increase is a result of the Company's capital expenditure program and corresponding growth of depreciable assets. This increase is partly compensated by upward revisions of the Company's proved reserves and, consequently, an increase in estimated useful economic life of fixed assets.

Taxes other than income taxes

Taxes other than income taxes include mineral extraction tax, road user's tax, property tax and social taxes.

	1st half of			
	2004		2003	
	in Russia	International	in Russia	International
	(millions of US dollars)			
Mineral extraction tax	1,275	–	906	–
Social security taxes and contributions	160	13	130	9
Property tax	61	9	51	8
Other taxes	27	13	20	16
	1,523	**35**	**1,107**	**33**
Total		**1,558**		**1,140**

The increase in taxes other than income taxes resulted primarily from a $369 million increase in mineral extraction tax, which is linked to international crude oil prices (see "Change in tax rates and export tariffs" on page 4). Social taxes and contributions increased by $34 million, or 24.5%, as compared to the same period of 2003.

Excise and export tariffs

Our excise and export tariffs include duties on sales of refined products and export tariffs on export of crude oil and refined products. Excise and export tariffs increased by $618 million, or 46.5%, compared to the previous reporting period. The increase in export tariff expenses resulted from an increase in export tariff rates (see "Change in tax rates and export tariffs" on page 4) and also an increase in volumes exported. The increase in international excise taxes on refined products resulted from an increase in excise taxes and fuel sales taxes and from an increase in volumes of products sold across our international group, primarily in the USA.

	1st half of			
	2004		2003	
	in Russia	International	in Russia	International
	(millions of US dollars)			
Excise tax and sales taxes on refined products	250	756	190	463
Export tariffs	935	6	672	4
	1,185	**762**	**862**	**467**
Total		**1,947**		**1,329**

Exploration expenses

The costs we incur in our exploratory drilling efforts are capitalized to the extent that our exploration efforts are successful and otherwise are charged to expenses of the current period. During the first half of 2004 the amount charged to exploration expense increased in comparison with the same period of 2003 by $33 million, or by 61.1%.

Loss on disposal and impairment of assets

Loss on disposal and impairment of assets in the first half of 2004 was $71 million compared to $68 million in the same period of 2003. In the second quarter of 2004 we recognized an impairment loss in relation to our decision to sell our ownership interests in OAO Bank Petrocommerce. The impairment loss is included in "Loss on disposal and impairments of assets" in the amount of $35 million dollars. For details please refer to Note 8 "Assets and liabilities of bank subject to disposition and assets held for sale" of the consolidated financial statements.

Interest expense

Interest expense in the first half of 2004 increased by $3 million, or 2.1%, as compared to the same period of 2003 primarily due to an increase in the Group's level of debt, including balances on customers' deposits at the Group's banks. As of June 30, 2003, the Group's total debt was $4,474 million, including customer deposits placed in banking subsidiaries of $845 million. By June 30, 2004, the Group's total debt increased to $5,085 million, including customer deposits placed in banking subsidiaries and liabilities of Bank Petrocommerce subject to disposition totaling $897 million.

Income taxes

Our total income tax expense increased by $297 million, or 71.7%, compared to the same period of 2003 while our income before income tax decreased by $239 million, or 9.0% (excluding gain on sale of interest in Azeri, Chirag, Guneshli, our income before income tax increased by $891 million, or 58.8%).

Our effective tax rate in the first half of 2004 was 29.5% (in the same period of 2003 it was 27.3%, excluding the effect of gain on sale of interest in Azeri, Chirag, Guneshli), which is higher than the maximum statutory rate for the Russian Federation (24%). This is attributable to the fact that some costs incurred during the year are not tax deductible or only deductible to a certain limit. Moreover, despite the impairment loss recorded in the consolidated financial statements, the disposal of OAO Bank Petrocommerce results in a taxable gain under Russian tax legislation. In the first half of 2004 income tax expense includes $17 million related to the disposal, thus increasing our effective tax rate.

Liquidity and capital resources

	1st half of 2004	1st half of 2003
	(million US dollars)	
Net cash provided by operating activities	1,360	1,025
Net cash used in investing activities	(2,141)	(822)
Net cash provided by financing activities	582	98
Net debt	4,139	2,902
Current ratio	1.43	1.27
Total debt to equity	28%	28%
Long term debt to long term debt and equity	12%	9%

Our primary source of cash flow is funds generated from our operations. In the first half of 2004 cash generated by operating activities was $1,360 million, an increase of $335 million from $1,025 million recorded in the same period of 2003. In the first half of 2004 cash inflow from operating activity was impacted by the following factors:

- increase in revenue
- increase in amount of income tax paid
- increase in volume of export sales and, consequently, prepayment of custom fees, export duties and transportation tariffs.

In the first half of 2004 the Company spent $2,141 million on capital investments, acquisitions of interests in other companies and other investments. Capital expenditures during the first half of 2004 amounted to $1,550 million ($1,297 million in the same period of 2003).

In the first half of 2004 cash provided from financing activities included $833 million from the issuance of long-term debt and $330 million from short-term borrowings. Cash used in financing activities during the first half of 2004 included $473 million of debt repayments and $352 million used for purchases of treasury stock.

Analysis of capital expenditures *

	1st half of 2004	1st half of 2003
	(millions of US dollars)	
Exploration and production		
Russia	949	741
International	72	201
Total exploration and production	1,021	942
Refining, marketing and distribution		
Russia	369	336
International	206	88
Total refining, marketing and distribution	575	424
Total capital expenditures	**1,596**	**1,366**
Acquisitions of subsidiaries **		
Exploration and production		
Russia	–	800
International	–	–
Total exploration and production	–	800
Refining, marketing and distribution		
Russia	5	–
International	1	–
Total refining, marketing and distribution	6	–
Less cash acquired	–	**(35)**
Total	**6**	**765**

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

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

	1st half of 2004	1st half of 2003
Income before income taxes	**2,407**	**2,646**
Add back:		
Depreciation and amortization	**514**	455
Interest expense	**143**	140
Interest and dividend income	**(99)**	(63)
EBITDA	**2,965**	**3,178**

Three months ended June 30, 2004 compared to three months ended June 30, 2003

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

	2nd quarter of 2004		2003	
Revenues				
Sales (including excise and export tariffs)	7,965	99.2%	5,086	99.0%
Equity share in income of associates	62	0.8%	49	1.0%
Total revenues	**8,027**	**100.0%**	**5 135**	**100.0%**
Costs and other deductions				
Operating expenses	(674)	(8.4)%	(693)	(13.5)%
Costs of purchased crude oil, petroleum and chemical products	(2,501)	(31.2)%	(1,386)	(27.0)%
Transportation expenses	(734)	(9.1)%	(503)	(9.8)%
Selling, general and administrative expenses	(451)	(5.6)%	(429)	(8.4)%
Depreciation, depletion and amortization	(266)	(3.3)%	(226)	(4.4)%
Taxes other than income taxes	(818)	(10.2)%	(530)	(10.3)%
Excise and export tariffs	(1,090)	(13.6)%	(788)	(15.3)%
Exploration expense	(57)	(0.7)%	(28)	(0.5)%
Gain from sale of interest in Azeri, Chirag, Guneshli	–	–	1,130	22.0 %
Loss on disposal and impairment of assets	(46)	(0.6)%	(28)	(0.5)%
Income from operating activities	**1,390**	**17.3%**	**1 654**	**32.2 %**
Interest expense	(75)	(0.9)%	(78)	(1.5)%
Interest and dividend income	57	0.7 %	47	0.9 %
Currency translation gain (loss)	(40)	(0.5)%	51	1.0 %
Other non-operating income	(42)	(0.5)%	28	0.5 %
Minority interest	(21)	(0.3)%	(12)	(0.2)%
Income before income taxes	**1,269**	**15.8%**	**1,690**	**32.9%**
Current income taxes	(401)	(5.0)%	(130)	(2.5)%
Deferred income taxes	9	0.1 %	(16)	(0.3)%
Total income tax expense	(392)	**(4.9)%**	**(146)**	**(2.8)%**
Net income	**877**	**10.9%**	**1,544**	**30.1%**
Per share of common stock (in US dollars)				
Income before cumulative effect of change in accounting principle				
Basic	1.07		1.89	
Diluted	1.06		1.85	
Net income				
Basic	1.07		1.89	
Diluted	1.06		1.85	

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

Sales revenues

Sales breakdown	2nd quarter of 2004		2003	
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS	2,481	31.2%	1,373	27.0%
Export and sales to CIS	130	1.6%	94	1.8%
Domestic sales	33	0.4%	100	2.0%
	2,644	**33.2%**	**1,567**	**30.8%**
Refined products				
Export and sales on international markets				
Wholesale	2,757	34.6%	1,744	34.3%
Retail	868	10.9%	537	10.6%
Domestic sales				
Wholesale	789	9.9%	546	10.7%
Retail	285	3.6%	197	3.9%
	4,699	**59.0%**	**3,024**	**59.5%**
Petrochemicals				
Export and sales on international markets	232	2.9%	154	3.0%
Domestic sales	82	1.0%	49	1.0%
	314	**3.9%**	**203**	**4.0%**
Other	**308**	**3.9%**	**292**	**5.7%**
Total sales	**7,965**	**100.0%**	**5,086**	**100.0%**

Sales volumes	2nd quarter of 2004		2003	
	(thousands of barrels)			
Crude oil				
Export and sales on international markets other than CIS	78,717		60,729	
Export and sales to CIS	7,073		8,254	
Domestic sales	2,280		16,668	
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than CIS	10,739	39.4%	8,285	33.0%
Export and sales to CIS	965	3.5%	1,126	4.4%
Domestic sales	311	1.1%	2,274	9.1%
	12,015	**44.0%**	**11,685**	**46.5%**
Refined products	(thousands of tonnes)			
Export and sales on international markets				
Wholesale	9,044	33.1%	7,775	30.9%
Retail	1,232	4.5%	933	3.7%
Domestic sales				
Wholesale	4,337	15.9%	4,136	16.5%
Retail	694	2.5%	593	2.4%
	15,307	**56.0%**	**13,437**	**53.5%**
Total sales volume of crude oil and refined products	**27,322**	**100.0%**	**25,122**	**100.0%**

Realized average sales prices	2nd quarter of 2004		2003	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	31.51	231.00	22.62	165.77
Oil (CIS)	18.44	135.18	11.33	83.07
Refined products				
Wholesale		304.76		224.26
Retail		705.03		575.87
Average realized price within Russia				
Oil	14.67	107.52	6.00	43.95
Refined products				
Wholesale		182.08		131.97
Retail		410.65		332.67

In the second quarter of 2004, sales revenues increased by $2,879 million or 56.6% compared to the second quarter of 2003.

The total volume of crude oil and refined products sold reached 27.3 million tonnes, which is 8.8% more than for the same period of 2003. Our revenues from sales of crude oil increased by $1,077 million, or 68.7%. Our sales of refined products increased by $1,675 million, or 55.4%.

Sales of crude oil and refined products on the international market, including the CIS, accounted for 80.4% of total sale volume in the second quarter of 2004, compared to 72.1% in the second quarter of 2003.

The increase in sales was principally due to the following:

- favorable price conditions: international crude oil market price was at a ten-year high (see “Change in the price of crude oil and refined products” on page 3)
- increase in total volume of crude oil production (see “Oil production” on page 7)
- increase in marketing activities (see page 8)
- decrease of crude oil sales in Russia and increase in volumes exported on international markets (see “Export of crude oil and refined products from Russia” on pages 8-9)

Sales of crude oil

In the second quarter of 2004 the Company decreased its sales of crude oil on the domestic market compared to the same period in the previous year by 1,963 thousand tonnes, or 86.3%. This change was caused by an increase in volumes exported by the Company’s domestic producers.

In the second quarter of 2004 we decreased our export sales on CIS markets by 161 thousand tonnes, or 14.3%, as compared to the same period of 2003. At the same time we increased exports of crude oil on international markets (other than CIS) by the Company’s domestic producers. The increase of the export sales, along with an increase in the average realized export price of crude oil on international markets (other than CIS) from $22.62 to $31.51 per barrel, allowed us to obtain an additional $596 million in revenues.

Sales of refined products

Sales of refined products made up 59.0% of our total sales revenues (56.0% in terms of volumes sold) compared to 59.5% in the same period of 2003 (53.5% in terms of volumes).

The average realized price on wholesale of refined products outside of Russia increased by $80.50 per tonne, or 35.9%. Volumes of refined products sold outside of Russia increased by 1,269 thousand tonnes, or 16.3% (see also “Refining and marketing” on page 8). As a result our revenues from wholesale of refined products outside of Russia increased by $1,013 million, or 58.1%.

In the second quarter of 2004 we increased sales of refined products by retail outside of Russia by 299 thousand tonnes, or 32.0%, as compared to the same period of 2003. The increase was a result of structural changes in the retail network we operate, in particular we acquired Beopetrol in Serbia, and its continuing development in other regions. Moreover, the results of the second quarter of 2004 include sales made through the retail network acquired from ConocoPhillips in May 2004. Retail sales primarily include sales of gasoline, diesel oil and other refined products (heating oil, lubricants, etc.). Average retail prices increased up to $705.03 per tonne, or by 22.4%. As a result our revenues from retail sales increased by $331 million, or 61.5%. Revenue from retail sales were 23.9% of total sales of refined products outside of Russia in the second quarter of 2004.

Wholesale of refined products within Russia in the second quarter of 2004 increased by 201 thousand tonnes, or 4.8%, as compared to the same period in 2003. The average domestic realized price on refined products increased by $50.10 per tonne, or 38.0%. As a result our revenues from wholesale of refined products on the domestic market increased by $243 million, or 44.5%.

Retail sales within Russia in the second quarter of 2004 increased by 101 thousand tonnes, or 17.1%, as compared to the same period of 2003. Average retail prices increased up to $410.65 per tonne, or by 23.4%. As a result our revenues from retail sales increased by $88 million, or 44.6%. Revenue from retail sales were 26.5% of total sales of refined products in Russia in the second quarter of 2004.

Sales of petrochemical products

Revenues from sales of petrochemical products increased by $111 million, or 54.7%, mainly as a result of an increase of production volume up to 529 thousand tonnes in the second quarter of 2004, or by 12.0% as compared to the same period of 2003, and an increase in average realized prices in the quarter ended June 30, 2004 compared to the same period of 2003.

Sales of other products

Other sales increased by $16 million, or 5.5%, as a result of sales of other products produced by the Company, and also increased activity in providing other services to third parties.

Equity share in income of affiliates

Our share in the income of affiliates was $62 million. This was $13 million more than in the same period of 2003.

Operating expenses

Operating expenses include the following types of costs:

	2nd quarter of 2004	2003
	(millions of US dollars)	
Extraction expenses	381	357
Refining expenses	123	121
Petrochemical expenses	44	33
Other operating expenses	126	182
Total operating expenses	**674**	**693**
Costs of purchased crude oil and petroleum products	**2,501**	**1,386**

Compared to the same period of 2003, operating expenses decreased by $19 million, or 2.7%. Costs of purchased crude oil and petroleum products increased by $1,115 million, or 80.4%, compared to the same period of 2003 primarily as a result of increases in volumes of crude oil and petroleum products purchased for resale.

Our extraction expenses include expenditures related to current repairs of extraction equipment, labor costs, expenses of artificial stimulation of reservoirs, fuel and electricity costs and other similar costs.

Expenses of the Company's production enterprises related to the sale of services and goods (such as electricity, heat, etc.) that do not relate to core activities have been excluded from extraction expenses and are included in other operating costs.

Despite a 15.3% real ruble appreciation during the twelve month period ended June 30, 2004 (including 0.6% real ruble appreciation during the second quarter of 2004), our average extraction cost per barrel decreased from $2.62 to $2.55 per barrel, or 2.7%. The decrease was caused by an increase in an average daily oil flow per well from 9.44 tonnes a day in the second quarter of 2003 to 10.69 tonnes a day in the second quarter of 2004, or 13.2%, and restructuring of our oil producing assets in the Perm region. The increase in total extraction expenses resulted from an increase in volumes of oil produced by our subsidiaries from 18.5 million tonnes during the second quarter of 2003 to 20.4 million tonnes during the same period of 2004. Thus, the total extraction expenses rose by $24 million, or 6.7%, as compared to the respective period of 2003.

Refining expenses at our refineries increased by $2 million, or 1.7%, from the second quarter of 2003 to the same period of 2004.

Refining expenses of our domestic refineries increased by 15.4%, or $12 million. This was primarily caused by an appreciation in the exchange rate of the ruble to the US dollar.

Refining expenses of our international refineries decreased by 23.3%, or $10 million. This was primarily caused by a larger amount of a major overhaul and maintenance expenses incurred in the second quarter of 2003 as compared to the same period of 2004.

Operating expenses of petrochemical companies increased by $11 million, or 33.3%, compared to the same period of 2003, as result of an increase of volume produced.

Other operating expenses include the costs of other services provided and goods not related to primary activities (such as electricity, heat, etc.) sold by our production companies, and operating expenses of other non-core businesses of the Group. Other operating expenses also include costs associated with the delivery of crude oil from the Group's exploration and production entities to the Group's refineries, as well as the amount of the change in crude oil and refined products inventory at the Group's marketing entities. Other operating expenses decreased by $56 million, or 30.8%, as compared to the same period of 2003 primarily as a result of change in crude oil and refined products inventory in the second quarter of 2004.

Costs of purchased crude oil and petroleum products increased by $1,115 million, or 80.4%, compared to the prior period primarily due to a significant increase in volumes of refined products purchased.

Transportation expenses

The increase in the total volume of sales led to an increase in transportation expenses. However, the main factor in the increase of $231 million (45.9%) in these expenses compared to the period ended June 30, 2003 was the increase in the transportation tariffs.

Selling, general and administrative expenses

Our other selling, general and administrative expenses increased in the second quarter of 2004 by $22 million, or 5.1%, compared to the same period of 2003. The above-mentioned expenses include general business expenses, payroll costs (excluding extraction entities' and refineries' production staff cost), insurance costs, costs of maintenance of social infrastructure, movement in bad debt provision and other expenses.

The increase in other selling, general and administrative expenses was primarily caused by 15.3% real appreciation of the ruble during the twelve months period ended June 30, 2004. It was compensated by a movement in the bad debt provision. In the second quarter of 2004 the bad debt provision increased by $5 million, thus increasing general expenses, while for the same period of 2003 the bad debt provision decreased by $7 million.

Depreciation, depletion and amortization

Depreciation, depletion and amortization expenses include depletion of assets fundamental to production, depreciation of other productive and non-productive assets and certain intangible assets. Our depreciation, depletion and amortization expenses increased by $40 million, or 17.7%, in comparison to the same period of 2003. The increase is a result of the Company's capital expenditure program and corresponding growth of depreciable assets. This increase is partly compensated by upward revisions of the Company's proved reserves and, consequently, an increase in estimated useful economic life of fixed assets.

Taxes other than income taxes

Taxes other than income taxes include mineral extraction tax, road user's tax, property tax and social taxes.

	2nd quarter of			
	2004		2003	
	in Russia	International	in Russia	International
	(millions of US dollars)			
Mineral extraction tax	680	–	409	–
Social security taxes and contributions	73	5	67	6
Property tax	30	5	26	4
Other taxes	18	7	9	9
	801	**17**	**511**	**19**
Total		**818**		**530**

The increase in taxes other than income taxes resulted primarily from a $271 million increase in mineral extraction tax, which is linked to international crude oil prices (see "Change in tax rates and export tariffs" on page 5).

Excise and export tariffs

Our excise and export tariffs include duties on sales of refined products and export tariffs on export of crude oil and refined products. Excise and export tariffs increased by $302 million, or 38.3%, compared to the previous reporting period. The increase in export tariff expenses resulted from the increase in export tariff rates (see "Change in tax rates and export tariffs" on page 5) and also the increase in volumes exported. The increase in international excise taxes on refined products resulted from an increase in excise taxes and fuel sales taxes and from an increase in volumes of products sold across our international group, primarily in the USA.

	2nd quarter of			
	2004		2003	
	in Russia	International	in Russia	International
	(millions of US dollars)			
Excise tax and sales taxes on refined products	132	436	122	263
Export tariffs	519	3	401	2
	651	**439**	**523**	**265**
Total		**1,090**		**788**

Exploration expenses

The costs we incur in our exploratory drilling efforts are capitalized to the extent that our exploration efforts are successful and otherwise are charged to expenses of the current period. During the second quarter of 2004 the amount charged to exploration expense increased in comparison with the same period of 2003 by $29 million, or 103.6%.

Loss on disposal and impairment of assets

Loss on disposal and impairment of assets in the second quarter of 2004 was $46 million compared to $28 million in the same period of 2003. In the second quarter of 2004 we recognized an impairment loss in relation to our decision to sell our ownership interests in OAO Bank Petrocommerce. The impairment loss is included in "Loss on disposal and impairments of assets" in the amount of $35 million dollars. For details please refer to Note 8 "Assets and liabilities of bank subject to disposition and assets held for sale" of the consolidated financial statements.

Interest expense

Interest expense in the second quarter of 2004 decreased by $3 million, or 3.8%, as compared to the same period of 2003.

Income taxes

Our total income tax expense in the second quarter of 2004 increased by $246 million, or 168.5%, compared to the same period of 2003 while our income before income tax decreased by $421 million, or 24.9% (excluding gain on sale of interest in Azeri, Chirag, Guneshli, our income before income tax increased by $709 million, or 126.6%).

Our effective tax rate in the second quarter of 2004 was 30.7% (in the same period of 2003 it was 26.1%, excluding the effect of gain on sale of interest in Azeri, Chirag, Guneshli), which is higher than the maximum statutory rate for the Russian Federation (24%). This is attributable to the fact that some costs incurred during the year are not tax deductible or only deductible to a certain limit. Moreover, despite the impairment loss recorded in the consolidated financial statements, the disposal of OAO Bank Petrocommerce results in a taxable gain under Russian tax legislation. In the second quarter of 2004 income tax expense includes $17 million related to the disposal, thus increasing our effective tax rate.

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

	2nd quarter of 2004	2nd quarter of 2003
Income before income taxes	**1,269**	**1,690**
Add back:		
Depreciation and amortization	**266**	226
Interest expense	**75**	78
Interest and dividend income	**(57)**	(47)
EBITDA	**1,553**	**1,947**