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 quarter of 2004	% change	1st quarter of 2003	2003
Sales (including excise and export tariffs)	**6,512**	28.8%	5,056	21,118
Net Income	**819**	0.1%	820	3,701
Net income excluding cumulative effect of change in accounting principle	**819**	19.0%	688	3,569
EBITDA	**1,412**	14.7%	1,231	5,630
Earnings per share of common stock (US dollars)				
Basic earnings	1.00	0.00%	1.00	4.52
Diluted earnings	0.99	0.00%	0.99	4.45
Crude oil production (thousands of tonnes)	**20,174**	13.1%	17,831	76,072
Refined products (thousands of tonnes)	**9,393**	(3.2)%	9,699	39,233

During the 1st quarter of 2004 net income, was $819 million, which is $131 million more than in the same period of 2003 (excluding the cumulative effect of change in accounting principle).

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. The prices set for these purchases reflect a combination of factors, including our need for investment capital at different entities in the Exploration and Production segment, our tax planning initiatives, the rights of minority shareholders in those entities where minority interests remain and, to a more limited extent, market factors. 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 17 to our interim consolidated financial statements. Due to the prices we set, we believe the profitability of our Exploration and Production segment may be understated and the profits of our Refining, Marketing and Distribution segment may be overstated in that presentation.

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-associate gas in Uzbekistan. In respect of this agreement, the Company has minimum exploration commitments of $16 million over next 3 years. Amount of recoverable reserves agreed upon under the terms of the contract is 250 bcm.

In June 2004, we put in operation the first stage of the terminal in Vysotsk. The terminal's initial capacity reached 4.7million tonnes of crude oil and refined products a year. Through this reloading and distribution 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.

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 Komi Republic were transferred to the Group's companies operating in 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 number of personnel employed;
- decrease levels of management;
- dispose out of 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. 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 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 OPEC reaffirmed its intention to maintain oil price between $22-$28 per barrel for OPEC's basket. However, due to the robust growth in demand in the USA and China, which have not been fully anticipated, certain geopolitical tensions, refining and distribution bottleneck in some major consuming regions, crude oil prices rapidly escalated in the first half of 2004. In responding to this, OPEC decided to increase daily level of production up to 26.0 million barrels a day by August 2004 as compared to 24.5 million barrels a day as of January 1, 2004, in order to ensure market stability.

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 quarter of 2004	1st quarter of 2003	Change %	**2003**	2002	Change %
	(in US dollars per bbl, except for figures in percent)					
Brent crude	**32.03**	31.48	1.7%	**28.71**	24.98	14.9%
Urals crude (CIF Mediterranean)*	**29.00**	29.24	(0.8)%	**27.03**	23.68	14.1%
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam)	**138.23**	162.89	(15.1)%	**148.37**	128.89	15.0%
Diesel fuel (FOB Rotterdam)	**274.72**	292.29	(6.0)%	**253.53**	208.84	21.4%
High-octane gasoline (FOB Rotterdam)	**334.98**	312.62	7.2%	**296.13**	243.62	21.6%

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 19.0% (1st quarter of 2003: 26.4%) of total tonnes sold but represents 13.1% of our total sales revenue (1st quarter of 2003: 16.6%). In general, retail prices on refined products in Russia are comparable to those in the USA. Thus, for example, in the first quarter of 2004 the average retail price on regular gasoline in the USA was about 38 cents per liter. In central regions of European Russia the average retail price on gasoline of the same quality (95 octane) in the first quarter of 2004 was 41 cents per liter.

Access to markets

The Russian Government places restrictions on access to the Transneft crude oil export pipeline 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.

Access to the crude oil export pipeline network is allocated quarterly, based on recent volumes produced and delivered through the pipeline and proposed export destinations. Additional access to international markets bypassing Transneft export routes is obtained through rail transport or by tankers. In the first quarter of 2004 the Company exported 7.5% of crude oil produced (1,504 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 Nenetsky Autonomous District and Kaliningrad Region.

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 the exchange rate of the ruble to the US dollar was constantly increasing, rather than declining like in periods prior to 2003. The increase of the exchange rate continued in the first quarter of 2004.

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 quarter of 2004	1st quarter of 2003	**2003**	2002
Ruble inflation (CPI)	3.6%	5.2%	12.0%	15.1%
Nominal change in exchange rate (ruble to US dollar)	(3.3)%	(1.3)%	(7.3)%	5.5%
Real appreciation of the rate (ruble to US dollar)	7.1%	6.5%	20.2%	9.1%
Average exchange rate for the period (ruble to US dollar)	28.67	31.65	30.69	31.35
Exchange rate at the end of the period (ruble to US dollar)	28.49	31.38	29.45	31.78

Change in tax rates and export tariffs

		1st quarter of 2004*		1st quarter of 2003*
Export tariffs on crude oil	$/tonne	32.98	$/tonne	27.24
Export tariffs on refined products	$/tonne	29.18	$/tonne	24.51
Excise on refined products				
High-octane gasoline	RUR/tonne	3,360.00	RUR/tonne	3,000.00
Low-octane gasoline	RUR/tonne	2,460.00	RUR/tonne	2,190.00
Diesel fuel	RUR/tonne	1,000.00	RUR/tonne	890.00
Motor oils	RUR/tonne	2,732.00	RUR/tonne	2,440.00
Mineral extraction tax	RUR/tonne	848.40	RUR/tonne	927.52

* average values

In the first quarter 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 three months of 2004 compared to same period of 2003 by 21.1%, reaching $32.98 per tonne. Export tariffs on gasoline, kerosene, jet fuel, diesel fuel, fuel oil and gasoils rose by 19.1%. Excise on refined products rose by 12.0%.

Mineral extraction tax rate decreased as compared to the 1st quarter of 2003 by 8.5% as a result of a slight decrease of Urals crude price (by 0.8%), decrease of ruble-dollar exchange rate (by 9.2%) and as a result of a different spread of crude oil prices over the 1st quarter of 2004 as compared to the same period of 2003. These factors were partially offset by the increase of the base rate up to 347 Rubles per metric tonne.

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. The duties' 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 quarter of 2004*		1st quarter of 2003*
Excise on refined products				
High-octane gasoline	$/tonne	117.21	$/tonne	94.77
Low-octane gasoline	$/tonne	85.82	$/tonne	69.18
Diesel fuel	$/tonne	34.88	$/tonne	28.12
Motor oils	$/tonne	95.31	$/tonne	77.08
Mineral extraction tax	$/tonne	29.60	$/tonne	29.30

* average values

Recent amendments to Russian tax legislation

Effective from January 1, 2005 a formula underlying mineral extraction tax calculation will be adjusted - the base rate is to be set at 400 Rubles per metric tonne extracted 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 $1.53 per tonne extracted (or 20.91 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 2.7 - 5.7%.

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%.

Three months ended March 31, 2004 compared to three months ended March 31, 2003

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

	1st quarter of			
	2004		2003	
Revenues				
Sales (including excise and export tariffs)	6,512	98.9%	5,056	99.2%
Equity share in income of associates	70	1.1%	42	0.8%
Total revenues	**6,582**	**100.0%**	**5,098**	**100.0%**
Costs and other deductions				
Operating expenses	(660)	(10.0)%	(668)	(13.1)%
Costs of purchased crude oil, petroleum and chemical products	(1,827)	(27.8)%	(1,279)	(25.1)%
Transportation expenses	(649)	(9.9)%	(436)	(8.6)%
Selling, general and administrative expenses	(471)	(7.1)%	(329)	(6.4)%
Depreciation, depletion and amortization	(248)	(3.8)%	(229)	(4.5)%
Taxes other than income taxes	(740)	(11.2)%	(610)	(12.0)%
Excise and export tariffs	(857)	(13.0)%	(541)	(10.6)%
Exploration expense	(30)	(0.5)%	(26)	(0.5)%
Loss on disposal and impairment of assets	(25)	(0.4)%	(40)	(0.8)%
Income from operating activities	**1,075**	**16.3%**	**940**	**18.4 %**
Interest expense	(68)	(1.0)%	(62)	(1.2)%
Interest and dividend income	42	0.6%	16	0.3 %
Currency translation gain	59	0.9%	33	0.6 %
Other non-operating income	46	0.7%	36	0.7 %
Minority interest	(16)	(0.2)%	(7)	(0.1)%
Income before income taxes	**1,138**	**17.3%**	**956**	**18.8 %**
Current income taxes	(311)	(4.7)%	(270)	(5.3)%
Deferred income taxes	(8)	(0.1)%	2	0.0 %
Total income tax expense	**(319)**	**(4.8)%**	**(268)**	**(5.3)%**
Income before cumulative effect of change in accounting principle	**819**	**12.5%**	**688**	**13.5%**
Cumulative effect of change in accounting principle, net of tax	-	-	132	2.6%
Net income	**819**	**12.5%**	**820**	**16.1%**
Per share of common stock (in US dollars)				
Income before cumulative effect of change in accounting principle				
Basic	1.00		0.84	
Diluted	0.99		0.83	
Net income				
Basic	1.00		1.00	
Diluted	0.99		0.99	

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

Sales revenues

Sales breakdown	1st quarter of 2004		2003	
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS	2,089	32.1%	1,482	29.3%
Export and sales to CIS	168	2.6%	157	3.1%
Domestic sales	68	1.0%	51	1.0%
	2,325	**35.7%**	**1,690**	**33.4%**
Refined products				
Export and sales on international markets				
Wholesale	2,079	31.9%	1,566	31.0%
Retail	619	9.5%	511	10.1%
Domestic sales				
Wholesale	627	9.6%	687	13.6%
Retail	229	3.5%	152	3.0%
	3,554	**54.5%**	**2,916**	**57.7%**
Petrochemicals				
Export and sales on international markets	219	3.4%	160	3.2%
Domestic sales	72	1.1%	35	0.7%
	291	**4.5%**	**195**	**3.9%**
Other	**342**	**5.3%**	**255**	**5.0%**
Total sales	**6,512**	**100.0%**	**5,056**	**100.0%**

Sales volumes	1st quarter of 2004		2003	
	(thousands of barrels)			
Crude oil				
Export and sales on international markets other than CIS	74,480		52,584	
Export and sales to CIS	9,830		10,445	
Domestic sales	5,270		7,924	
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than CIS	10,161	39.3%	7,174	32.3%
Export and sales to CIS	1,341	5.2%	1,425	6.4%
Domestic sales	719	2.8%	1,081	4.9%
	12,221	**47.3%**	**9,680**	**43.6%**
Refined products	(thousands of tonnes)			
Export and sales on international markets				
Wholesale	7,756	30.1%	5,794	26.1%
Retail	969	3.7%	867	3.9%
Domestic sales				
Wholesale	4,322	16.7%	5,340	24.1%
Retail	576	2.2%	507	2.3%
	13,623	**52.7%**	**12,508**	**56.4%**
Total sales volume of crude oil and refined products	**25,844**	**100.0%**	**22,188**	**100.0%**

Realized average sales prices	1st quarter of 2004		2003	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (excluding CIS)	28.05	205.57	28.19	206.63
Oil (CIS)	17.10	125.32	15.00	109.95
Refined products				
Wholesale		268.00		270.34
Retail		639.37		589.23
Average realized price within Russia				
Oil	12.81	93.93	6.40	46.89
Refined products				
Wholesale		144.93		128.62
Retail		398.22		300.00

In the first quarter of 2004 sales revenues increased by $1,456 million or 28.8% compared to the same period of 2003.

The total volume of crude oil and refined products sold amounted 25.8 million tonnes, which is 16.4% more than for the same period of 2003. Our revenues from crude oil sales increased by $635 million, or 37.6%. Our sales of refined products increased by $638 million, or 21.9%.

Sales of crude oil and refined products on the international market, including the CIS, accounted for 78.3% of total sales volume in the first quarter of 2004 compared to 68.8% in the same period of 2003.

The increase in sales was principally due to the following:

- increase in total volume of production
- increase in volumes exported on international markets other than CIS
- increase in marketing activities

Increase in export due to reduction in sales of crude oil on the domestic and CIS markets

In the first 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 2,654 million barrels, or 33.5%. This change was caused by an increase in volumes exported by the Company's domestic producers by approximately 19 million barrels.

In the first quarter of 2004 we decreased our export sales on CIS markets by 84 thousand tonnes, or 5.9%, as compared to the same period of 2003. At the same time we increased export of crude oil by the Company's domestic producers. The increase allowed us to obtain an additional $491 million in revenues, despite a decrease of international (other than CIS) average realized price by 0.5%. The average realized crude oil prices in CIS increased from $15.00 to $17.10 per barrel.

Sales of refined products

Sales of refined products made up 54.5% of our total sales revenues (52.7% in terms of volumes sold) compared to 57.7% in the same period of 2003 (56.4% in terms of volumes).

The average realized price on wholesale refined products outside of Russia decreased by $2.34 per tonne, or 0.9%. However, volumes of refined products sold outside of Russia increased by 1,962 thousand tonnes, or 33.9% (see also "Increase in marketing activities" on page 10). As a result our revenues from wholesale of refined products outside of Russia increased by $513 million, or 32.8%.

In the first quarter of 2004 we sold 969 thousand tonnes of refined products by retail outside of Russia, an increase by 11.8% 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. As of March 31, 2004 we operated 2,814 refueling stations outside of Russia compared to 2,361 as of March 31, 2003. Retail sales primarily include sales of gasoline, diesel oil and other refined products (heating oil, lubricants, etc.). Average retail prices increased up to $639.37 per tonne, or by 8.5%. As a result our revenues from retail sales increased by $108 million, or 21.1%. Revenue from retail sales constitutes 22.9% of total sales of refined products outside of Russia in the first quarter of 2004.

Wholesale refined products within Russia in the first quarter of 2004 decreased by 1,018 thousand tonnes, or 19.1%, as compared to the same period in 2003. The decrease was caused by slight lowering of our domestic refining throughput, 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 by $16.31 per tonne, or 12.7%. As a result our revenues from wholesale of refined products on the domestic market decreased by $60 million, or 8.7%.

Retail sales within Russia in the first quarter of 2004 increased by 69 thousand tones, or 13.6%, as compared to the same period of 2003. Average retail prices increased up to $398.22 per tonne, or by 32.7%. As a result our revenues from retail sales increased by $77 million, or 50.7%. Revenue from retail sales constitutes 26.8% of total sales of refined products in Russia in the first quarter of 2004. As of March 31, 2004 we operated 1,244 refueling stations in Russia as compared to 1,205 as of March 31, 2003.

Increase in total volume of production

In line with our long term strategy we increased our total daily oil production (including the Company's share in equity associates) by 7.8% and produced 155 million barrels (20.9 million tonnes) in the period ended March 31, 2004.

	1st quarter of 2004	1st quarter of 2003	Change, %
Daily production, including Company's share in Equity associates (thousand barrels per day)	**1,706**	1,583	7.8%
Refinery throughput (thousand barrels per day)	**818**	834	(2.0)%

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 quarter of 2004 (67.1% in 2003). The increase of production in Western Siberia by 14.2% 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 6.1%. The increase of production in the Komi Republic by 22.3% 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 Komi Republic was 2.6%. Commencement of oil production in new oil fields in 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 5.5%.

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

(thousands tonnes)	**1st quarter of 2004**	Change to 2003			1st quarter of 2003
		Total %%	Change in structure	Organic growth	
Western Siberia	**13,651**	14.2%	957	736	11,958
Komi Republic	**2,360**	22.3%	380	50	1,930
Ural region	**2,497**	1.5%	–	38	2,459
Volga region	**736**	0.1%	–	1	735
Timano-Pechora (Nenetsky Autonomous District)	**305**	55.6%	–	109	196
Other in Russia	**319**	13.1%	21	16	282
Crude oil production in Russia	**19,868**	13.1%	1,358	950	17,560
Crude oil produced internationally	**306**	12.9%	–	35	271
	20,174	13.1%	1,358	985	17,831

Increase in sales of petrochemical products

Revenues from sales of petrochemical products increased by $96 million, or 49.2%, mainly as a result of an increase of production volume up to 553 thousand tonnes in the first quarter of 2004, or by 16.7% as compared to the same period of 2003, and an increase in average realized prices in the period ended March 31, 2004 compared to the same period of 2003.

Increase in sales of other products

Other sales increased by $87 million or 34.1% as a result of sales of other products produced by the Company, and also increased activity in providing other services to third parties.

Increase in marketing activities

In line with our strategy, during 2004 the Group continued penetration into new international markets and development of the LUKOIL brand name around the world. We significantly expanded our marketing activities in developed markets. In particular, the Group commenced trading on different markets in Western Europe, South-East Asia, Northern and Central America. The total volume of refined products, which were purchased from third parties for resale, was 2,220 thousand tonnes or $509 million (980 thousand tonnes or $213 million in the first quarter of 2003).

In addition, the Group purchased refined products in the USA in order to supply its retail sales chain. Total volume of refined products purchased in this activity from third parties during the first quarter of 2004 was 805 thousand tonnes or $320 million (738 thousand tonnes or $270 million in the first quarter of 2003).

Increase in the equity share in income of affiliates

Our share in the income of affiliates was $70 million. This is $28 million more than in the previous reporting period.

Operating expenses

Operating expenses include the following types of costs:

	1st quarter of 2004	1st quarter of 2003
	(millions of US dollars)	
Extraction expenses	371	337
Refining expenses	130	116
Petrochemical expenses	45	36
Other operating expenses	114	179
Total operating expenses	**660**	**668**
Costs of purchased crude oil and petroleum products	**1,827**	**1,279**

Compared to the same period of 2003, operating expenses decreased by $8 million, or 1.2%. Costs of purchased crude oil and petroleum products increased by $548 million, or 42.8%, compared to the same period of 2003 primarily as a result of increases in volumes of crude oil and petroleum products purchased for resale.

The following table summarizes our oil production and refining data, and also data on purchased oil and refined products.

	1st quarter of 2004		1st quarter of 2003	
	(thousand of barrels)	(thousand of tonnes)	(thousand of barrels)	(thousand of tonnes)
Crude oil produced by consolidated subsidiaries	149,231	20,174	131,630	17,831
Crude oil purchased	20,683	2,822	25,860	3,528
Refined products produced at Group refineries		9,393		9,699
Refined products purchased		4,700		2,943

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 21.2% real ruble appreciation during the twelve month period ended March 31, 2004 (including 7.1% real ruble appreciation during the first quarter of 2004), our **average extraction cost per barrel** decreased from $2.56 to $2.51 per barrel, or 1.9%. The decrease was caused by an increase in an average daily oil flow per well from 9.40 tonnes a day in the first quarter of 2003 to 10.46 tonnes a day in the first quarter of 2004, or 11.3%, and restructuring of our oil producing assets in Perm region. The increase in total extraction expenses resulted from an increase in volumes of oil produced by our subsidiaries from 17.8 million tonnes during the first quarter of 2003 to 20.2 million tonnes during the same period of 2004. Thus, the total extraction expenses rose by $34 million, or 10.1%, as compared to the respective period of the previous year.

Refining expenses at our refineries increased by $14 million, or 12.1%, from the first quarter of 2003 to the same period of 2004.

Refining expenses of our domestic refineries increased by 12.0%, or $10 million. This was primarily caused by an appreciation in the exchange rate of the ruble to the US dollar.

In addition, refining expenses of our international refineries increased by 14.8%, or $4 million. This was primarily caused by an appreciation in the exchange rate of Bulgarian lev to the US dollar. The exchange rate of Bulgarian lev is tied to Euro and, therefore, it appreciated against the US dollar by 11.1% during the twelve month period ended March 31, 2004.

Operating expenses of petrochemical companies increased by $9 million, or 25.0%, 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 $65 million, or 36.3%, as compared to the same period of 2003 primarily as a result of increase in other sales and change in crude oil and refined products inventory in the period ended March 31, 2004.

Costs of purchased crude oil and petroleum products increased by $548 million, or 42.8%, in comparison with the prior period primarily due to a significant increase in volumes of refined products purchased by 1,757 thousand tonnes as compared to the same period of 2003.

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 $213 million (48.9%) in these expenses compared to the period ended March 31, 2003 was the increase in the transportation tariffs.

During the twelve month period ended March 31, 2004, transportation tariffs increased as follows: pipeline transport – 32.4%, sea shipping – 31.6% (weighted average by volumes transported to different locations), railway transport – 27.1%. At the same time the volume of goods transported by sea tankers increased by 18.6%.

Selling, general and administrative expenses

Our other selling, general and administrative expenses increased by $142 million, or 43.2%, 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 21.2% real appreciation of the ruble during the twelve months period ended March 31, 2004. Also, the Company accrued compensation to management of approximately $17 million based upon share appreciation rights on the Company's common stock. In addition, movement in bad debt provision had an effect on selling, general and administrative expenses for the periods under consideration. For the first quarter of 2004 bad debt provision expense amounted $22 million as compared to $5 million in the same period of 2003.

Selling, general and administrative expenses for the three months ended March 31, 2004 included $16 million of expenses related to subsidiaries acquired and incorporated during 2003 after the end of the first quarter.

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 $19 million, or 8.3%, 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 extraction tax, road user's tax, property tax and social taxes.

	1st quarter of			
	2004		2003	
	in Russia	**International**	**in Russia**	**International**
	(millions of US dollars)			
Extraction tax	595	–	497	–
Social security taxes and contributions	87	8	63	3
Property tax	31	4	25	4
Other taxes	9	6	11	7
	722	**18**	**596**	**14**
Total		**740**		**610**

The increase in taxes other than income taxes resulted primarily from a $98 million increase in mineral extraction tax, which is linked to international crude oil prices. Social taxes and contributions increased by $29 million, or 43.9%, 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 $316 million, or 58.4%, compared to the previous reporting period. The increase in export tariff expenses resulted from the increase in export tariff rates 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.

	1st quarter of			
	2004		2003	
	in Russia	**International**	**in Russia**	**International**
	(millions of US dollars)			
Excise tax and sales taxes on refined products	118	320	68	200
Export tariffs	416	3	271	2
	534	**323**	**339**	**202**
Total		**857**		**541**

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 quarter of 2004 the amount charged to exploration expense increased in comparison with the same period of 2003 by $4 million.

Loss on disposal and impairment of assets

Loss on disposal and impairment of assets in the first quarter of 2004 was $25 million compared to $40 million in the same period of 2003.

Interest expense

Interest expense in the first quarter of 2004 increased by $6 million, or 9.7%, 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 March 31, 2003, the Group's total debt was $4,208 million, including customers' deposits and other borrowings of banking subsidiaries of $692 million. By March 31, 2004, the Group's total debt increased to $5,055 million, including customers' deposits and other borrowings of banking subsidiaries of $893 million.

Income taxes

Our total income tax expense increased by $51 million, or 19.0%, compared to the same period of 2003 while our income before income tax increased by $182 million, or 19.0%.

Our effective tax rate in the first quarter of 2004 was 28.0% (in the same period of 2003 it was 28.0%), 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.

Liquidity and capital resources

	1st quarter of 2004	1st quarter of 2003
	(million US dollars)	
Net cash provided by operating activities	409	594
Net cash used in investing activities	(1,013)	(900)
Net cash (used in) provided by financing activities	282	38
Net debt	3,921	3,219
Current ratio	1.60	1.30
Total debt to equity	28%	28%
Long term debt to long term debt and equity	13%	9%

Our primary source of cash flow is funds generated from our operations. In the first quarter of 2004 cash generated by operating activities was $409 million, a decrease of $185 million from $594 million recorded in the same period of 2003. In the first quarter of 2004 cash inflow from operating activity was reduced due to the following factors:

- increase in amount of income tax paid
- increase in volume of export sales and, consequently, prepayment of custom fees, export duties and transportation tariffs. The prepayment is related to export sales to be made in the second quarter thus increasing cash flows from operating activities in that period
- seasonal increase in trade account receivable
- decrease of balances on customers' accounts in the banking subsidiaries

In the first quarter of 2004 the Company spent $1,013 million on capital investments, acquisitions of interests in other companies and other investments. Capital expenditures during the first quarter of 2004 amounted to $737 million ($550 million in the same period of 2003).

In the first quarter of 2004 cash provided from financing activities included $419 million from the issuance of long-term debt. Cash used in financing activities during the first quarter of 2004 included $248 million of debt repayments and $310 million used for purchases of treasury stock.

Analysis of capital expenditures *

	1st quarter of 2004	1st quarter of 2003
	(millions of US dollars)	
Exploration and production		
Russia	467	321
International	41	70
Total exploration and production	508	391
Refining, marketing and distribution		
Russia	162	139
International	91	38
Total refining, marketing and distribution	253	177
Total capital expenditures	**761**	**568**
Acquisitions of subsidiaries **		
Exploration and production		
Russia	–	252
International	–	–
Total exploration and production		252
Refining, marketing and distribution		
Russia	–	–
International	–	–
Total refining, marketing and distribution	–	–
Less cash acquired	**–**	**(1)**
Total	**–**	**251**

* 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 quarter of 2004	1st quarter of 2003
Income before income taxes	**1,138**	**956**
Add back:		
Depreciation and amortization	**248**	229
Interest expense	**68**	62
Interest and dividend income	**(42)**	(16)
EBITDA	**1,412**	**1,231**