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.

Changes in accounting principle

Effective January 1, 2003, the Group adopted SFAS No. 143 "Accounting for asset retirement obligations". This new accounting standard applies to legal obligations associated with retirement of tangible long-lived assets. Under SFAS No. 143, the fair values of asset retirement obligations are recorded as liabilities on a discounted basis when they are incurred, which is typically at the time the assets are installed. A corresponding increase in the carrying value of the related long-lived asset is also recorded. Over time the liabilities are accreted for the change in their present value and the initial capitalized costs are depreciated over the useful lives of the related assets. Under previous accounting standards, the Group accrued site restoration and abandonment obligations on a unit-of-production basis and presented the provision in accumulated depreciation, depletion and amortization. As of January 1, 2003, the Group recorded a cumulative-effect adjustment resulting in an after-tax increase to net income of $132 million in relation to this change in accounting principle, including the Group's share of the effect of adoption by its equity associates. The effect of adoption also included an increase of net property, plant and equipment of $330 million, minority interest liability of $12 million, non-current deferred income tax assets and liabilities of a net $46 million and the establishment of an additional asset retirement obligation of $140 million.

Consolidation of the Group

In line with our strategy we continued the further consolidation of the Group:

- In June 2003, the Group acquired the remaining 27% of shares in ZAO LUKOIL-Perm from a related party, which was controlled by certain members of the Group's management, for $398 million, thereby increasing the Group's ownership stake in ZAO LUKOIL-Perm to 100%. The amount of consideration was based on an independent valuation. ZAO LUKOIL-Perm is an exploration and production company operating in European Russia. Proved reserves associated with the acquired interest were approximately 423 million barrels. The Company is also in process of merging ZAO LUKOIL-Perm with its other subsidiary, OOO "Permneft". The merger is expected to be finalized in the beginning of 2004.

- In June 2003, the Group acquired 39.4% of the outstanding shares in OAO Tebukneft and 55.4% of the outstanding shares in OAO Ukhtaneft, thereby increasing the Group's ownership stake in these companies to 85% and 85.5%, respectively. The Group also acquired 77.4% of outstanding shares in ZAO RKM-Oil. The total cost of the interests acquired in these companies was $134 million. Prior to these acquisitions, OAO Tebukneft and OAO Ukhtaneft were recorded as associated companies using the equity method of accounting. OAO Tebukneft, OAO Ukhtaneft and ZAO RKM-Oil are exploration and production companies operating in the Komi Republic of the Russian Federation. The annual oil production of OAO Tebukneft, OAO Ukhtaneft and ZAO RKM-Oil is 1.5 million tonnes. At the time of acquisition OAO Tebukneft, OAO Ukhtaneft and ZAO RKM-Oil had total proved reserves of approximately 242 million barrels.

- In June 2003, the Group acquired an additional 21.5% of OAO Komineft for $63 million, thereby increasing the Group's share in this company to 91.5%. OAO Komineft is an exploration and production company operating mainly in the Komi Republic of the Russian Federation.

- In April 2003, the Group acquired 80.8% of OAO Yaregskaya Nefte-Titanovaya Kompaniya ("YaNTK") for $240 million, thereby increasing the Group's share in this company to 98.8%. YaNTK is a company with substantial oil and titanium reserves operating in the Komi Republic of the Russian Federation. OAO Yaregskaya Nefte-Titanovaya Kompaniya has total proved oil reserves in the amount of 133 million barrels.

- In June 2003, the Group acquired 1.25% of ZAO LUKOIL-AIK for approximately $1 million, thereby increasing the Group's share in this company to 51%. Prior to this acquisition ZAO LUKOIL-AIK was recorded as an associated company using the equity method of accounting. ZAO LUKOIL-AIK is an exploration and production company operating in Western Siberia. During 2002, ZAO LUKOIL-AIK extracted 2.1 million tones of crude oil. At the time of acquisition ZAO LUKOIL-AIK had total proved oil reserves of approximately 171 million barrels.

- In August 2003, the Group acquired 25.5% of share capital of AGD in exchange for its 13.6% investment in ZAO Rosshelf and 30% investment in OOO Polar Lights Company. The carrying value of these investments as of June 30, 2003 was approximately $40 million. The acquisition increased the Group's ownership stake in AGD to 99.7%. AGD is a Russian oil and gas exploration company operating predominantly within the Timan-Pechora region of Northern Russia. Proved reserves associated with the acquired interest were approximately 337 million barrels.

In September 2003, the Group acquired 100% of the share capital of MV Properties for $121 million. MV Properties is a marketing and distribution company operating in Romania. MV Properties owns and operates 75 refueling stations and 7 refined products storages.

Sale of the Group's share in the PSA Azeri, Chirag, Guneshli

On December 20, 2002, a Group company entered into a contract with INPEX Corporation, a Japanese company, to sell the Group company's 10% interest in the PSA operated by the Azerbaijan International Operating Company. The purpose of this PSA is to explore and develop the Azeri and Chirag fields and the deep-water portion of the Guneshli field in the Azeri sector of the Caspian Sea. The sale was completed on April 28, 2003 for net $1,337 million cash, resulting in the recognition of a net gain of $1,130 million during the three months ended June 30, 2003.

Net income

In the first half of 2003, net income, including the cumulative effect of change in accounting principle, was $2,364 million, which is $1,524 million more than in the first half of 2002. Net income excluding the cumulative effect of change in accounting principle was $2,232 million, or $1,392 million higher than in the same period of 2002. Net income for the first half of 2003 includes a net gain on sale of our share in the Azeri, Chirag, Guneshli project in the amount of $1,130 million.

	1st half of 2003	1st half of 2002	Change %	**Q2 2003**	Q2 2002	Change %
Net income	**2,364**	**840**	**181.4%**	**1,544**	**597**	**158.6%**
Net income excluding cumulative effect of change in accounting principle and gain of sale of share in Azeri, Chirag, Guneshli	**1,102**	840	31.2%	**414**	597	-30.7%
EBITDA	**3,178**	1,663	91.1%	**1,947**	1,074	81.3%
Earnings per share of common stock (US dollars)						
Basic earnings	**2.89**	1.04	177.9%	**1.89**	0.73	158.9%
Diluted earnings	**2.84**	1.04	173.1%	**1.85**	0.73	153.4%

Segment information

Our operations are divided into three main business segments: (1) Exploration and Production; (2) Refining, Marketing and Distribution; (3) Chemicals. 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 15 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.

Main macroeconomic factors affecting our results of operations

Change in the price of crude oil and refined products*

	1st half of 2003	1st half of 2002	Change %	**Q2 2003**	Q2 2002	Change %
	(in US dollars per bbl, except for figures in percent)					
Brent crude	**28.74**	23.13	24.3%	**26.04**	25.07	3.9%
Urals crude (CIF Mediterranean)*	**26.53**	21.71	22.2%	**23.88**	23.60	1.2%
	(in US dollars per metric tonne, except for figures in percent)					
Fuel oil 3.5% (FOB Rotterdam)	**148.50**	120.84	22.9%	**133.64**	134.77	(0.8)%
Diesel fuel (FOB Rotterdam)	**259.36**	186.01	39.4%	**225.35**	199.95	12.7%
High-octane gasoline (FOB Rotterdam)	**297.64**	221.26	34.5%	**282.16**	250.94	12.4%

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).

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 real terms relative to our revenues. It should be noted that in contrast to previous periods, in the first half of 2003 this process was exacerbated by the fact that inflation was accompanied by an increase (rather than a decline) in the exchange rate of the ruble to 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 2003	1st half of 2002	**2nd quarter of 2003**	2nd quarter of 2002
Ruble inflation (CPI)	7.94%	9.11%	2.62%	3.44%
Nominal change in exchange rate (ruble to US dollar)	–4.52%	4.34%	–3.25%	1.05%
Real appreciation of the rate (ruble to US dollar)	12.82%	4.57%	5.96%	2.37%
Average exchange rate for the period (ruble to US dollar)	31.27	31.02	30.86	31.27
Exchange rate at the end of the period (ruble to US dollar)	–	–	30.35	31.45

Change in tax rates and export tariffs

		1st half of 2003*		1st half of 2002*
Export tariffs on crude oil	$/tonne	31.54	$/tonne	12.65
Export tariffs on oil products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	28.41	$/tonne	24.84
Liquid fuels (fuel oil)	$/tonne	28.41	$/tonne	12.03
Excise on oil products				
High-octane gasoline	RUR/tonne	3,000.00	RUR/tonne	2,072.00
Low-octane gasoline	RUR/tonne	2,190.00	RUR/tonne	1,512.00
Diesel fuel	RUR/tonne	890.00	RUR/tonne	616.00
Motor oils	RUR/tonne	2,440.00	RUR/tonne	1,680.00
Mineral extraction tax	RUR/tonne	803.42	RUR/tonne	577.25

		2nd quarter of 2003*		2nd quarter of 2002*
Export duties on crude oil	$/tonne	35.85	$/tonne	12.99
Export tariffs on oil products				
Light distillates (gasoline), middle distillates (jet fuel), diesel fuel and gasoils	$/tonne	32.28	$/tonne	23.00
Liquid fuels (fuel oil)	$/tonne	32.28	$/tonne	9.20
Excise on oil products				
High-octane gasoline	RUR/tonne	3,000.00	RUR/tonne	2,072.00
Low-octane gasoline	RUR/tonne	2,190.00	RUR/tonne	1,512.00
Diesel fuel	RUR/tonne	890.00	RUR/tonne	616.00
Motor oils	RUR/tonne	2,440.00	RUR/tonne	1,680.00
Mineral extraction tax	RUR/tonne	679.34	RUR/tonne	662.90

* average values

In the first half of 2003 the Group’s tax burden rose significantly compared to the previous period.

The average crude oil export tariffs increased compared to the first half of 2002 by 149%, reaching $31.54 per tonne. Export tariffs on gasoline, kerosene and jet fuel, diesel fuel, and gasoils rose by 14%. Export tariffs on fuel oil rose by 136%. Excise on oil products rose by 45%.

Six months ended June 30, 2003 compared to the six months ended June 30, 2002

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

	1st half of 2003		1st half of 2002	
Revenues				
Sales (including excise and export tariffs)	10,142	99.1%	6,641	99.5%
Equity share in income of associates	91	0.9%	35	0.5%
Total revenues	**10,233**	**100.0%**	**6,676**	**100.0%**
Costs and other deductions				
Operating expenses	(1,361)	(13.3)%	(1,243)	(18.6)%
Costs of purchased crude oil, petroleum and chemical products	(2,665)	(26.0)%	(908)	(13.6)%
Transportation expenses	(939)	(9.2)%	(605)	(9.1)%
Selling, general and administrative expenses	(758)	(7.4)%	(611)	(9.1)%
Depreciation, depletion and amortization	(455)	(4.4)%	(478)	(7.2)%
Taxes other than income taxes	(1,140)	(11.1)%	(808)	(12.1)%
Excise and export tariffs	(1,329)	(13.0)%	(785)	(11.8)%
Exploration expense	(54)	(0.5)%	(50)	(0.7)%
Gain from sale of interest in Azeri Chirag Guneshli	1,130	11.0 %	–	0.0 %
Loss on disposal and impairment of assets	(68)	(0.7)%	(26)	(0.4)%
Income from operating activities	**2,594**	**25.3 %**	**1,162**	**17.4%**
Interest expense	(140)	(1.4)%	(126)	(1.9)%
Interest and dividend income	63	0.6 %	68	1.0 %
Currency translation gain (loss)	84	0.8 %	(16)	(0.2)%
Other non-operating income	64	0.6 %	70	1.0 %
Minority interest	(19)	(0.2)%	(31)	(0.5)%
Income before income taxes	**2,646**	**25.9 %**	**1,127**	**16.9 %**
Current income taxes	(400)	(3.9)%	(356)	(5.3)%
Deferred income taxes	(14)	(0.1)%	69	1.0 %
Total income tax expense	**(414)**	**(4.0)%**	**(287)**	**(4.3)%**
Income before cumulative effect of change in accounting principle	**2,232**	**21.8%**	**840**	**12.6%**
Cumulative effect of change in accounting principle, net of tax	132	1.3%	–	–
Net income	**2,364**	**23.1%**	**840**	**12.6%**
Per share of common stock (in US dollars)				
Income before cumulative effect of change in accounting principle				
Basic	2.73		1.04	
Diluted	2.68		1.04	
Net income				
Basic	2.89		1.04	
Diluted	2.84		1.04	

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

Sales revenues

Sales breakdown	1st half of 2003		2002	
	(millions of US dollars)			
Crude oil				
Export and sales on international markets other than CIS..........	2,856	28.2%	1,923	30.0%
Export and sales to CIS..	250	2.4%	60	0.9%
Domestic sales	151	1.5%	235	3.5%
	3,257	**32.1%**	**2,218**	**33.4%**
Oil products				
Export and sales on international markets	4,358	43.0%	2,606	39.2%
Domestic sales	1,582	15.6%	1,156	17.4%
	5,940	**58.6%**	**3,762**	**56.6%**
Petrochemicals				
Export and sales on international markets	314	3.1%	184	2.8%
Domestic sales	84	0.8%	62	0.9%
	398	**3.9%**	**246**	**3.7%**
Other	**547**	**5.4%**	**415**	**6.3%**
Total sales	**10,142**	**100.0%**	**6,641**	**100.0%**

Sales volumes	1st half of 2003		2002	
	(thousands of barrels)			
Crude oil				
Export and sales on international markets other than CIS..........	113,307		93,902	
Export and sales to CIS..	18,704		6,839	
Domestic sales	24,592		37,295	
Crude oil	(thousands of tonnes)			
Export and sales on international markets other than CIS..........	15,458	32.7%	12,811	31.8%
Export and sales to CIS..	2,552	5.4%	933	2.3%
Domestic sales	3,355	7.1%	5,088	12.6%
	21,365	**45.2%**	**18,832**	**46.8%**
Refined products	(thousands of tonnes)			
Export and sales on international markets.................................	15,369	32.5%	12,080	30.0%
Domestic sales	10,576	22.3%	9,326	23.2%
	25,945	**54.8%**	**21,406**	**53.2%**
Total sales volume of crude oil and refined products...........	**47,310**	**100.0%**	**40,238**	**100.0%**

Realized average sales prices	1st half of 2003		2002	
	($ per barrel)	($ per tonne)	($ per barrel)	($ per tonne)
Average realized price international				
Oil (except CIS)	25.20	184.73	20.48	150.13
Oil (within CIS)	13.38	98.09	8.68	63.59
Refined products		283.56		215.72
Average realized price within Russia				
Oil	6.14	45.01	6.30	46.19
Refined products		149.58		123.96

In the first half of 2003, sales revenues increased by $3,501 million or 52.7% compared to the first half of 2002.

The total volume of crude oil and refined products sold reached 47.3 million tonnes, which is 17.6% more than for the same period of 2002. Our revenues from crude oil sales increased by $1,039 million, or 46.8%. Our sales of refined products increased by $2,178 million, or 57.9%.

Sales of crude oil and refined products on the international market, including the CIS, accounted for 70.6% of total sales in the first half of 2003, compared to 64.2% in the first half of 2002.

The increase in sales was principally due to the following:

- increase in crude oil prices and refined products prices;
- increase in volumes exported;
- change in sales mix – increase in share of refined products in total volumes sold;
- increase in total volume of production and refining;
- increase in marketing activities.

Increase in export and refining due to reduction in sales of crude oil on the domestic market

In the first half of 2003, the Company decreased its sales of crude oil on the domestic market compared to the same period in the previous year by 12.7 million barrels, or 34.1%. This change was caused by an increase in volumes exported by the Company's domestic producers by 25.6 million barrels and an increase in refining at the Company's domestic refineries by 0.5 million tonnes (including refining at OAO LUKOIL-Nizhegorodnefteorgsyntez).

The increase in export sales, along with an increase in the average realized export price of crude oil on international markets from $20.48 per barrel in the first half of 2002 to $25.20 per barrel in the first half of 2003 as well as an increase in the average realized price on CIS markets from $8.68 per barrel to $13.38 per barrel, allowed us to obtain an additional $505 million in revenues.

Increase in share of refined products in total sales volumes

Sales of refined products made up 54.8% of our total sales compared to 53.2% in the first half of 2002.

Our revenues from sales of refined products outside Russia increased by $1,752 million, or 67.2%. Volumes of refined products sold outside Russia increased by 3,289 thousand tonnes, or 27.2%. The average realized price on refined products also increased by $67.83 per tonne, or 31.4%.

The Company's revenues from refined product sales outside Russia in the first half of 2003 include revenues from retail sales of $994 million. Refined products sold at retail amounted to 1,707 thousand tonnes; the average realized price was $582.40 per tonne.

Our revenues from sales of refined products on the domestic market increased by $426 million, or 36.9%. Domestic refined products sales increased by 1,250 thousand tonnes, or 13.4%. The average realized price on refined products sold within Russia increased by $25.61 per tonne, or 20.7%.

The Company's revenues from refined product sales on the domestic market in the first half of 2003 include revenues from retail sales of $296 million. Refined products sold at retail amounted to 876 thousand tonnes; the average realized price was $338.30 per tonne.

Increase in total volume of production and refining

In line with our long term strategy we increased our total daily oil production (including the Company's share in equity associates, but excluding our share in Azeri-Chirag-Guneshli in 2002) by 3.5% and produced 287 million barrels (38.9 million tonnes) in the first half of 2003.

	1st half of 2003	1st half of 2002	Change, %
Daily production, including Company's share in Equity associates (thousand barrels per day)..	**1 583**	1 541	2.7%
Daily production, including Company's share in Equity associates, but excluding our share in Azeri-Chirag-Guneshli (thousand barrels per day) *..	**1 583**	1 530	3.5%
Refined products produced (thousand barrels per day) ....**	**772**	753	2.5%

* according to the sales agreement with INPEX, signed in December 2002, from January 1, 2003 all benefits, rights and obligations associated with Azeri-Chirag-Guneshli PSA project are to be transferred to and borne by INPEX.

** including refining at OAO LUKOIL-Nizhegorodnefteorgsyntez for the 6 months 2002.

Increase in sales of petrochemical products

Revenues from sales of petrochemical products increased by $152 million, or 61.8%, mainly as a result of an increase in sales volumes due to the acquisition of the LUKOR petrochemical plant in the third quarter of 2002 and an increase in average realized prices in the first half of 2003 compared to the same period of 2002. The increase in the output of petrochemical products at LUKOR for the first half of 2003 led to a revenue increase of $70 million.

Increase in sales of other products

Other sales increased by $132 million or 31.8% as a result of sales of other products produced by the Company, and also increased activity in providing services to third parties such as transportation, construction and consumer goods.

Increase in marketing activities

In line with our strategy, during 2003 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 2.8 million tonnes or $585 million (1.0 million 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 half of 2003 was 1.5 million tonnes or $512 million (0.7 million 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 $91 million. This is $56 million more than in the previous reporting period. This increase was mainly caused by significant profits earned by our exploration and production affiliates in the first half of 2003 as a result of higher crude oil and refined products prices.

Operating expenses

Operating expenses include the following types of costs:

	1st half of 2003	**2002**
	(millions of US dollars)	
Extraction expenses	694	668
Refining expenses	237	198
Processing costs at associated refineries	–	107
Petrochemical expenses	68	43
Other operating expenses	362	227
Total operating expenses	**1,361**	**1,243**
Costs of purchased crude oil and petroleum products	**2,665**	**908**

Compared to the first half of 2002, operating expenses increased by $118 million, or 9.5%. Costs of purchased crude oil and petroleum products increased $1,757 million, or 193.5%, compared to the previous period primarily as a result of the increase 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 oil products.

	1st half of			
	2003		2002	
	(thousands barrels)	(thousands tonnes)	(thousands barrels)	(thousands tonnes)
Crude oil produced by consolidated subsidiaries	267,454	36,292	259,295	35,292
Crude oil produced by associates, total	30,739	4,141	30,260	4,146
Crude oil purchased	51,435	7,017	27,898	3,806
Refined products produced at Group refineries		19,063		13,986
Refined products produced at associated refinery (LUKOIL-Nizhegorodnefteorgsintez)		–		4,610
Refined products purchased		6,457		2,923

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 17.7% real ruble appreciation during the twelve months period ended June 30, 2003 (including 12.8% real ruble appreciation in the first half of 2003), our **extraction expenses** increased by $26 million, or 3.9%, compared to the same period of the previous year. The average costs per barrel of extracted oil rose from $2.58 per barrel to $2.59 per barrel, or 0.4%. The increase in average costs per barrel was primarily the result of a stronger ruble–dollar exchange rate.

Refining expenses at our refineries increased by $39 million, or 19.7%, from the first half of 2002 to the same period of 2003. This was primarily caused by a 2.5% increase in volumes refined and the fact that refining expenses of the LUKOIL-Nizhegorodnefteorgsintez refinery were included in the Company's total refining expenses starting from July 2002, when it became a consolidated subsidiary. Prior to this period processing fees due to LUKOIL-Nizhegorodnefteorgsintez were accounted for as processing costs at an associated refinery. The expenses of LUKOIL-Nizhegorodnefteorgsintez for the first half of 2003 were $27 million.

Operating expenses of petrochemical companies increased by $25 million, or 58.1%, compared to the first half of 2002. The increase resulted from the acquisition of the LUKOR petrochemical plant in the third quarter of 2002. The costs of the LUKOR refinery in the first half of 2003 were $30 million.

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 increased by $135 million, or 59.5%, as compared to the same period of 2002 as a result of increase in other sales, increase in delivery costs and increase in crude oil and refined products inventory in the first half of 2003.

Costs of purchased crude oil and petroleum products increased by $1,757 million, or 193.5%, in comparison with the prior period primarily due to a significant increase in volumes purchased (crude oil by 23.5 million barrels, refined products by 3.5 million tonnes) and an increase in purchase prices.

Transportation expenses

The increase in the total volume of sales and the change in their structure (increase in the share of refined products) lead to an increase in transportation expenses. However, the main factor in the increase of $334 million (55.0%) in these expenses compared to the first half of 2002 was the increase in the transportation tariffs.

During the twelve months period ended June 30, 2003, transportation tariffs increased as follows: pipeline transport – 15%, sea shipping – 97% (weighted average by volumes transported to different locations), railway transport – 16%. At the same time the volume of goods transported by sea tankers decreased by 20%, through railways – increased by 64% and by inland river tankers – increased by 18%.

Selling, general and administrative expenses

Our other selling, general and administrative expenses increased by $147 million, or 24.1%, in comparison with the first half of 2002. 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 and other expenses.

The increase in other selling, general and administrative expenses was primarily caused by 17.7% real appreciation of the ruble during the twelve months period ended June 30, 2003. In addition, as a result of a significant increase in the Company's share price in the second quarter of 2003, the Company accrued compensation to management of approximately $30 million in relation to the share-based compensation program.

Depreciation 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 and provision for abandonment and site restoration costs in the first half of 2002. Our depreciation, depletion and amortization expenses decreased by $23 million, or 4,8%, in comparison to the same period of 2002. This decrease resulted from a decrease in applied depletion rates resulting from upward revisions of the Company's proved reserves.

Taxes other than income taxes

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

	1st half of			
	2003		**2002**	
	in Russia	**International**	**in Russia**	**International**
	(millions of US dollars)			
Extraction tax	906	–	569	–
Social security taxes and contributions	130	9	99	3
Road taxes	4	–	49	–
Property tax	51	8	40	6
Other taxes	16	16	17	25
	1,107	**33**	**774**	**34**
Total		**1,140**		**808**

The increase in taxes other than income taxes resulted primarily from a $337 million increase in mineral extraction tax, which is linked to international crude oil prices. The $37 million increase in social taxes and contributions was compensated by the abolition of road taxes starting January 1, 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 $544 million, or 69.3%, compared to the previous reporting period. The increase in export tariffs 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 as well as the increase in our refining.

Effective January 1, 2003, domestic tax legislation was amended in terms of payment of excises on refined products. Starting from January 1, 2003, excises are paid by our marketing companies if they sell refined products to the end customer. If refined products are sold to another retailer or a wholesaler, the seller is not subject to excise. In the first half of 2003 domestic excise rates rose by more than 45% as compared to the first half of 2002.

	1st half of			
	2003		2002	
	in Russia	International	in Russia	International
	(millions of US dollars)			
Excise tax and sales taxes on refined products	190	463	134	346
Export tariffs	672	4	305	–
	862	**467**	**439**	**346**
Total		**1,329**		**785**

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 2003, the amount charged to exploration expense increased in comparison with the same period of 2002 by $4 million, primarily due to a higher level of drilling.

Loss on disposal and impairment of assets

Loss on disposal and impairment of assets in the first half of 2003 was $68 million (excluding gain on sale of interest in Azeri, Chirag, Guneshli) compared to $26 million in the first half of 2002.

Interest expense

Interest expense in the first half of 2003 increased by $14 million, or 11.1%, compared to the first half of 2002 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, 2002 the Group's total debt was $3,554 million, including customers' deposits of $420 million. By June 30, 2003 the Group's total debt increased to $4,474 million, including customers' deposits of $845 million.

Income taxes

Our total income tax expense increased by $127 million, or 44.3%, compared to the first half of 2002 while our income before income tax increased by $1,519 million, or 134.8% (excluding gain on sale of interest in Azeri, Chirag, Guneshli, by $389 million, or 34.5%).

Our effective tax rate in the first half of 2003, excluding the effect of gain on sale of interest in Azeri, Chirag, Guneshli, was 27.3% (in the first half of 2002 it was 25.5%), 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. The gain on sale of interest in Azeri, Chirag, Guneshli was not subject to income tax.

Liquidity and capital resources

	1st half of	
	2003	2002
	(million US dollars)	
Net cash provided by operating activities	1,025	863
Net cash used in investing activities	(822)	(1,081)
Net cash provided by financing activities	98	279
Net debt	2,902	2,340
Current ratio	1.27	1.57
Total debt to equity	28%	27%
Long term debt to long term debt and equity	9%	14%

Our primary source of cash flow is funds generated from our operations. In the first half of 2003 cash generated by operating activities was $1,025 million, an increase of $162 million from $863 million recorded in the first half of 2002.

In the first half of 2003, the Company spent $822 million on capital investments, acquisitions of interests in other companies and other investments. Capital expenditures in the first half of 2003 amounted to $1,297 million. The Company also spent $765 million on acquisitions of interests in other companies and minority interests in some of its subsidiaries. These acquisitions were partially financed from sale proceeds of $1,337 million received on sale of the Company's share in PSA Azeri, Chirag, Guneshli. Remaining investing activity was financed by funds generated by our operating activities.

In the first half of 2003, cash provided from financing activities included $386 million from the issuance of long-term debt and $244 million from short-term borrowings. Cash used in financing activities in the first half of 2003 included $507 million of debt repayments and $86 million used for purchases of treasury stock.

Analysis of capital expenditures

	1st half of 2003	1st half of 2002
	(millions of US dollars)	
Exploration and production		
Russia	741	498
International	201	82
Total exploration and production	942	580
Refining, marketing and distribution		
Russia	336	233
International	88	92
Total refining, marketing and distribution	424	325
TOTAL capital expenditures	**1,366**	**905**
Acquisitions of subsidiaries		
Exploration and production		
Russia	800	70
International	–	1
Total exploration and production	800	71
Refining, marketing and distribution		
Russia	–	15
International	–	30
Total refining, marketing and distribution	–	45
Less cash acquired	**(35)**	**(1)**
TOTAL	**765**	**115**

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

	1st half of 2003	**1st half of 2002**
Income before income taxes	**2,646**	**1,127**
Add back:		
Depreciation and amortization	455	478
Interest expense	140	126
Interest and dividend income	(63)	(68)
EBITDA	**3,178**	**1,663**

Three months ended June 30, 2003 compared to three months ended June 30, 2002

The table below details certain income and expense items from our consolidated statements of income for the periods indicated. All items are presented in millions of US dollars, except for earnings per share data and the items expressed as a percentage of revenues.

	2nd quarter of			
	2003		**2002**	
Revenues				
Sales (including excise and export tariffs)	5,086	99.0%	3,794	99.6%
Equity share in income of associates	49	1.0%	15	0.4%
Total revenues	**5 135**	**100.0%**	**3,809**	**100.0%**
Costs and other deductions				
Operating expenses	(693)	(13.5)%	(586)	(15.4)%
Costs of purchased crude oil, petroleum and chemical products	(1,386)	(27.0)%	(512)	(13.4)%
Transportation expenses	(503)	(9.8)%	(337)	(8.8)%
Selling, general and administrative expenses	(429)	(8.4)%	(304)	(8.0)%
Depreciation, depletion and amortization	(226)	(4.4)%	(241)	(6.3)%
Taxes other than income taxes	(530)	(10.3)%	(431)	(11.3)%
Excise and export tariffs	(788)	(15.3)%	(573)	(15.0)%
Exploration expense	(28)	(0.5)%	(30)	(0.8)%
Gain from sale of interest in Azeri, Chirag, Guneshli	1,130	22.0 %	–	0.0 %
Loss on disposal and impairment of assets	(28)	(0.5)%	(4)	(0.1)%
Income from operating activities	**1 654**	**32.2 %**	**791**	**20.8 %**
Interest expense	(78)	(1.5)%	(59)	(1.5)%
Interest and dividend income	47	0.9 %	36	0.9 %
Currency translation gain	51	1.0 %	18	0.5 %
Other non-operating income	28	0.5 %	49	1.3 %
Minority interest	(12)	(0.2)%	(25)	(0.6)%
Income before income taxes	**1,690**	**32.9%**	**810**	**21.3%**
Current income taxes	(130)	(2.5)%	(248)	(6.5)%
Deferred income taxes	(16)	(0.3)%	35	0.9 %
Total income tax expense	**(146)**	**(2.8)%**	**(213)**	**(5.6)%**
Net income	**1,544**	**30.1%**	**597**	**15.7%**
Per share of common stock (in US Dollars)				
Net income				
Basic	1.89		0.73	
Diluted	1.85		0.73	

Sales revenues

Sales breakdown	2nd quarter of 2003		2002	
	(millions of US dollars)			
Oil				
Export and sales on international markets other than CIS	1,373	27.0%	1,022	26.9%
Export and sales in the CIS	94	1.8%	14	0.4%
Domestic sales	100	2.0%	134	3.5%
	1,567	**30.8%**	**1,170**	**30.8%**
Refined products				
Export and sales on international markets	2,281	44.9%	1,618	42.6%
Domestic sales	743	14.6%	626	16.5%
	3,024	**59.5%**	**2,244**	**59.1%**
Petrochemicals				
International sales	154	3.0%	91	2.4%
Domestic sales	49	1.0%	32	0.9%
	203	**4.0%**	**123**	**3.3%**
Other products	**292**	**5.7%**	**257**	**6.8%**
Total sales	**5,086**	**100.0%**	**3,794**	**100.0%**

Sales volumes	2nd quarter of 2003		2002	
Crude oil	(thousands of barrels)			
Export and sale on international markets other than CIS	60,729		47,279	
Export and sales in the CIS	8,254		1,437	
Domestic sales	16,668		15,378	
Crude oil	(thousands of tonnes)			
Export and sale on international markets other than CIS	8,285	33.0%	6,450	31.8%
Export and sales in the CIS	1,126	4.4%	196	1.0%
Domestic sales	2,274	9.1%	2,098	10.3%
	11,685	**46.5%**	**8,744**	**43.1%**
Refined products	(thousands of tonnes)			
Export and sales on international markets	8,708	34.7%	6,769	33.4%
Domestic sales	4,729	18.8%	4,770	23.5%
	13,437	**53.5%**	**11,539**	**56.9%**
Total sales of crude oil and refined products	**25,122**	**100.0%**	**20,283**	**100.0%**

Realized average sales prices	2nd quarter of 2003		2002	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
Oil (except CIS)	22.62	165.77	21.62	158.51
Oil (in CIS)	11.33	83.07	9.42	69.04
Refined products		261.95		239.01
Average realized price within Russia				
Oil				
Refined products	6.00	43.95	8.71	63.87
		157.13		131.23

In the second quarter of 2003, sales revenues increased by $1,292 million or 34.1% compared to the second quarter of 2002.

The total volume of crude oil and refined products sold reached 25.1 million tonnes, which is 23.9% more than for the same period of 2002. Our revenues from sales of crude oil increased by $397 million, or 33.9%. Our sales of refined products increased by $780 million, or 34.8%.

The share of sales of crude oil and refined products on the international market, including the CIS in the total volume of sales was 72.1% in the second quarter of 2003, compared to 66.2% in the second quarter of 2002.

The increase in sales was principally due to the following:

- increase in crude oil prices and refined products prices;
- increase in volumes exported;
- increase in sales of refined products
- increase in total volume of production and refining;
- increase in marketing activities.

Increase in exports and crude oil prices

Increase in export sales by 6.1 million barrels, along with an increase in the average realized export price of crude oil on international markets from $21.62 per barrel in the second quarter of 2002 to $22.62 per barrel in the second quarter of 2003 and increase in the average realized price on CIS markets from $9.42 per barrel to $11.33 per barrel, allowed us to obtain additional $69 million in revenues.

Increase in refined product volume

Sales of refined products made up 53.5% of total sales, compared to 56.9% in the second quarter of 2002.

Our revenues from sales of refined products outside Russia increased by $663 million, or 41.0%. Volumes of refined products sales outside Russia increased by 1,939 thousand tonnes, or 28.6%. The average sale price on refined products also increased by $22.94 per tonne, or 9.6%.

The Company’s revenues from refined product sales outside Russia in the second quarter of 2003 included revenues from retail sales of $515 million. Refined products sold at retail amounted to 899 thousand tonnes; the average sale price was $573.50 per tonne.

Our revenues from sales of refined products on the domestic market increased by $117 million, or 18.7%. Volumes of domestic refined products sales decreased by 41 thousand tonnes, or 0.9%. The average realized price on refined products sold within Russia increased by $25.77 per tonne, or 19.6%.

The Company’s revenues from refined product sales on the domestic market in the second quarter of 2003 included revenues from retail sales of $179 million. Refined products sold at retail amounted to 488 thousand tonnes; the average sale price was $367.77 per tonne.

Increase in total volume of production and refining

We increased our total daily oil production (including the Company’s share in equity associates, but excluding our share in Azeri, Chirag, Guneshli in 2002) by 4.3% and produced 145 million barrels (19.7 million tonnes) in the second quarter of 2003.

	2nd quarter of 2003	2nd quarter of 2002	Change, %
Daily crude oil production, including Company’s share in Equity associates (thousand barrels per day)	**1 589**	1 535	3.5%
Daily crude oil production, including Company’s share in Equity associates, but excluding our share in Azeri, Chirag, Guneshli (thousand barrels per day)*	**1 589**	1 524	4.3%
Refined products produced (thousand barrels per day)	**758**	770	–1.6%

* according to the sales agreement with INPEX, signed in December 2002, from 1 January 2003 all benefits, rights and obligations associated with Azeri, Chirag, Guneshli PSA project are to be transferred to and borne by INPEX.

Increase in sales of petrochemical products

Sales of petrochemicals increased by $80 million, or 65%, due to an increase in volumes of petrochemical products sold internationally and corresponding increase in realized sales prices, as well as the acquisition of LUKOR petrochemical refinery in the third quarter of 2002.

Increase in sales of other products

Other sales increased by $35 million or 13.6% as a result of sales of other products, and increased activity of providing services to third parties such as transportation, construction and consumer goods.

Operating expenses

	2nd quarter of 2003	2nd quarter of 2002
	(millions of US dollars)	
Extraction expenses	357	329
Refining expenses	121	100
Processing costs at associated refineries	–	62
Petrochemical expenses	33	26
Other operating expenses	182	69
Total operating expenses	**693**	**586**
Costs of purchased crude oil and petroleum products	**1,386**	**512**

Compared to the second quarter of 2002, operating expenses increased by $107 million, or 18.3%. Costs of purchased crude oil and petroleum products increased $874 million, or 170.7%, in comparison with the previous period as a result of the increase in volumes of crude oil and petroleum products purchased for resale.

In addition, the increase in operating expenses is related to an increase in production and refining.

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

	2nd quarter of 2003		2nd quarter of 2002	
	(thousands barrels)	(thousands tonnes)	(thousands barrels)	(thousands tonnes)
Crude oil produced by consolidated subsidiaries	135,812	18,461	129,895	17,674
Crude oil produced by associates, total	14,791	1,992	15,114	2,069
Crude oil purchases	25,574	3,489	17,812	2,430
Refined products produced at Group refineries		9,412		7,096
Refined products produced at associated refinery (LUKOIL-Nizhegorodnefteorgsintez)		–		2,467
Refined products purchased		3,514		2,206

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 activity have been eliminated from production expenses and are included in other operating costs.

Despite a 17.7% real ruble appreciation during the twelve months period ended June 30, 2003 (including 12.8% real ruble appreciation in the first half of 2003), our extraction expenses increased by $28 million, or 8.5%, compared to the same period of the previous year (including 4.5% increase resulting from increase in volumes of oil produced). The average costs per barrel of extracted oil rose from $2.55 per barrel to $2.62 per barrel, or 2.7%. The increase in average costs per barrel was the result of a stronger ruble–dollar exchange rate.

Refining expenses at our refineries increased by $21 million, or 21.0%, from the second quarter of 2002 to the same period of 2003. This was primarily caused by an increase in volumes refined and the fact that refining expenses of the LUKOIL-Nizhegorodnefteorgsintez refinery were included in the Company's total refining expenses starting from July 2002, when it became a consolidated subsidiary. Prior to this period processing fees due to LUKOIL-Nizhegorodnefteorgsintez were accounted for as processing costs at an associated refinery. The expenses of LUKOIL-Nizhegorodnefteorgsintez for the second quarter of 2003 were $13 million.

Operating expenses of petrochemical companies increased by $7 million, or 26.9%, compared to the second quarter of 2002. The increase resulted from the acquisition of the LUKOR petrochemical plant in the third quarter of 2002. The costs of the LUKOR refinery in the second quarter of 2003 were $13 million.

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. Other operating expenses increased by $113 million.

Costs of purchased crude oil and petroleum products increased by $874 million, or 170.7%, in comparison with the prior period primarily due to a significant increase in volumes purchased (crude oil by 7.8 million barrels, refined products by 1.3 million tonnes) and increase in purchase prices.

Transportation expenses

Compared to the second quarter of 2002, transportation expenses increased by $166 million, or 49.3%. The increase in expenses is attributable primarily to the increase in all transportation tariffs, and also to the increase in sales volumes analyzed above and changes in the product mix – an increase in the share of refined products in total sales.

Selling, general and administrative expenses

Our other selling, general and administrative expenses increased by $125 million, or 41.1%, in comparison with 2002. 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 and other expenses.

The increase in other selling, general and administrative expenses was primarily caused by 17.7% real appreciation of the ruble in the twelve months period ended from June 30, 2003. In addition, as a result of a significant increase in the Company's share price in the second quarter of 2003, the Company accrued compensation to management of approximately $30 million in relation to the share-based compensation program.

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 and provision for abandonment and site restoration costs in the second quarter of 2002. Our depreciation, depletion and amortization expenses decreased by $15 million, or 6.2%, in comparison to the same period of 2002. This reduction is related to the increase in proven reserves.

Taxes other than income taxes

Taxes other than income taxes include mineral extraction tax, road user's tax, property tax and social taxes. The increase in taxes other than income taxes resulted primarily from a $111 million increase in mineral extraction tax, which is linked to international crude oil prices. The $22 million increase in social taxes and contributions was compensated by the abolition of road taxes from January 1, 2003.

	2nd quarter of			
	2003		2002	
	Russia	International	Russia	International
	(millions of US dollars)			
Extraction tax	409	–	298	–
Social security taxes and contributions	67	6	49	2
Road taxes	1	–	28	–
Property tax	26	4	19	3
Other taxes	8	9	9	23
	511	**19**	**403**	**28**
Total		**530**		**431**

Excise and export tariffs

Our excise and export tariffs include taxes on the sale of refined products and export tariffs on the export of crude oil and refined products. Excise and export tariffs increased by $215 million, or 37.5%, compared to the previous reporting period. The increase in export tariffs expenses resulted from the increase in world oil prices 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 as well as the increase in our refining.

Effective January 1, 2003, domestic tax legislation was amended in terms of payment of excises on refined products. Prior to that date excises on refined products were paid by refineries. Starting from 2003, excises are paid by our marketing companies if they sell refined products to the end customer. If refined products are sold to another retailer or a wholesaler, the seller is not subject to excise, and excise is not included in selling price. In 2003 domestic excise rates rose by more than 45% as compared to the second quarter of 2002.

	2nd quarter of			
	2003		2002	
	in Russia	International	in Russia	International
	(millions of US dollars)			
Excise tax and sales taxes on refined products	122	263	102	280
Export tariffs	401	2	191	–
	523	**265**	**293**	**280**
Total		**788**		**573**

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. During the second quarter of 2003, the amount charged to exploration expense decreased in comparison with the same period of 2002 by $2 million, primarily due to a higher level of drilling.

Loss on disposal and impairment of assets

Loss on disposal and impairment of assets in the second quarter of 2003 was $28 million (excluding gain on sale of interest in Azeri, Chirag, Guneshli) compared to $4 million in the second quarter of 2002.

Interest expense

Interest expense in the second quarter of 2003 increased by $19 million, or 32.2%, compared to the second quarter of 2002 primarily due to an increase in the Group's debt level, including balances on customers' deposits at the Group's banks.

Income taxes

Our total income tax expense decreased by $67 million, or 31.5%, compared to the second quarter of 2002 while our income before income tax (excluding gain on sale of interest in Azeri, Chirag, Guneshli) decreased by $250 million, or 30.9%.

Our effective tax rate in the second quarter of 2003, excluding the effect of gain on sale of interest in Azeri, Chirag, Guneshli, was 26.1% (in the second quarter of 2002 – 26.3%). This rate was higher than the 24% maximum statutory rate for the Russian Federation because some costs incurred during the year are not tax deductible or only deductible to a certain limit, thus increasing the effective tax rate.

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

	2nd quarter of 2003	**2nd quarter of 2002**
Income before income taxes	**1,690**	**810**
Add back:		
Depreciation and amortization	226	241
Interest expense	78	59
Interest and dividend income	(47)	(36)
EBITDA	**1,947**	**1,074**