MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS FOR THE THREE MONTHS ENDED 31 MARCH 2004

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

OVERVIEW

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

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

- Production: exploration, development and production operations relating to natural gas and other hydrocarbons. These activities are primarily located within Russia.
- Refining: processing and refining of natural gas, gas condensate and other hydrocarbons (including crude oil), and sales of hydrocarbon products. Operations relating to refining of natural gas, gas condensate and oil significantly increased in the three months ended 31 March 2004 due to acquisition in 2003 of additional controlling interests in a number of Russian petrochemical companies affiliated with OAO AK Sibur ("Sibur").
- Transportation: transportation of natural gas through the world's largest high-pressure trunk pipeline system (151,600 km). We own and operate a single centrally controlled system for natural gas production, processing, transportation, storage and deliveries. Beginning in the late 1990s, we began acquiring interests in regional gas distribution companies that own and operate medium-and low-pressure pipelines.
- Distribution: domestic and export sale of gas. We are the world's largest exporter of natural gas.

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

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

RESULTS OF OPERATIONS

(RR' millions)	Three months ended 31 March 2004	2003
Sales (net of excise tax, VAT and customs duties)	255,845	232,250
Operating expenses	(175,604)	(157,472)
Operating profit	**80,241**	**74,778**
Net finance income (costs)	6,329	(2,798)
Share of net income of associated undertakings	2,033	962
Gains on available-for-sale investments	942	3,117
Profit before profit tax and minority interest	**89,545**	**76,059**
Current profit tax expense	(15,471)	(14,096)
Deferred profit tax expense	(7,450)	(5,799)
Profit tax expense	(22,921)	(19,895)
Profit before minority interest	**66,624**	**56,164**
Minority interest	(582)	(192)
Net profit	**66,042**	**55,972**

The following tables set out our volumes and realized prices for the three months ended 31 March 2004 and 2003.

(RR' millions, unless indicated otherwise)	Three months ended 31 March 2004	2003
Europe		
Gross sales	153,030	155,873
Excise tax	(380)	(34,903)
Customs duties	(42,278)	(4,776)
Net sales	110,372	116,194
Volumes in billion cubic meters (bcm)	43.0	39.4
Gross average price, RR per mcm [1] (including excise tax and customs duties)	3,559.0	3,956.2
Net average price, RR per mcm [1] (net of excise tax and customs duties)	2,566.9	2,949.1
FSU		
Gross sales (net of value added tax (VAT))	18,117	18,623
Excise tax	(469)	(3,337)
Customs duties	(5,274)	(660)
Net sales	12,374	14,626
Volumes in bcm	12.6	13.6
Gross average price, RR per mcm [1] (including excise tax and customs duties, net of VAT)	1,441.2	1,371.4
Net average price, RR per mcm [1] (net of excise tax, VAT and customs duties)	984.3	1,077.0
Russia		
Gross sales (net of VAT)	86,872	70,970
Excise tax	(1,367)	(6,760)
Net sales	85,505	64,210
Volumes in bcm	105.4	108.1
Gross average price, RR per mcm [1] (including excise tax, net of VAT)	824.2	656.5
Net average price, RR per mcm [1] (net of excise tax and VAT)	811.0	594.1
Total sales of gas		
Gross sales (net of VAT)	258,019	245,466
Excise tax	(2,216)	(45,000)
Customs duties	(47,552)	(5,436)
Net sales	208,251	195,030
Volumes in bcm	161.0	161.1
Sales of gas condensate and oil and gas products (net of excise tax, VAT and customs duties)	27,323	19,119
Gas transportation sales (net of excise tax and VAT)	9,528	6,888
Other sales (net of VAT)	10,743	11,213
Total sales (net of excise tax, VAT and customs duties)	**255,845**	**232,250**

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

Net sales revenues increased by RR23,595 million, or 10%, to RR 255,845 million in the three months ended 31 March 2004 compared to the three months ended 31 March 2003. Net sales of gas accounted for 81% of total sales in the three months ended 31 March 2004 (84% in the three months ended 31 March 2003) and were RR13,221 million, or 7%, higher than in the same period of 2003.

Net sales of natural gas to Europe decreased by RR5,822 million, or 5%, to RR110,372 million in the three months ended 31 March 2004 compared to the three months ended 31 March 2003. This was primarily due to a 13% decrease in net prices in RR terms, slightly offset by a 9%, or 3.6 bcm, increase in sales volumes. Average net prices in RR terms for export gas to Europe decreased by 13% to RR2,566.9 per mcm primarily as a result of the 9% appreciation of the RR against the U.S. dollar for the three months ended 31 March 2004 compared to the three months ended 31 March 2003; and the fact that the customs duties rate increased from 5% to 30% effective 1 January 2004, the effect of which more than offset the decrease in excise tax as a result of excise tax on natural gas produced after 1 January 2004 abolished.

Net sales of natural gas to FSU countries decreased by RR2,252 million, or 15%, to RR12,374 million in the three months ended 31 March 2004 compared to the three months ended 31 March 2003. This was due to a 9% decrease in net prices in RR terms and a 7%, or 1.0 bcm, decrease in volumes. The 9% decrease in the net average RR price of gas to RR984.3 per mcm resulted from the 9% appreciation of the RR against the U.S. dollar for the three months ended 31 March 2004 compared to the three months ended 31 March 2003 and the increase in customs duties, which together more than offset a 16% increase in average realized U.S. dollar price (including excise tax and customs duties), and the effect of excise tax being abolished. The decrease in volumes of gas sold to FSU countries was primarily due to a 3.4 bcm reduction in sales volumes to Belarus due to contract disputes, which more than offset a 1.3 bcm increase in shipments of gas to Ukraine and 0.9 bcm of shipments to Armenia, Georgia and Azerbaijan. In 2004 we continued to restrict our shipments to Ukraine to those required to cover transportation services, so called "transit-gas". Shipments to Ukraine in the three months ended 31 March 2004 were 8.3 bcm compared to 7.0 bcm in the three months ended 31 March 2003.

Net sales of natural gas in the domestic market increased by RR21,295 million, or 33%, to RR85,505 million in the three months ended 31 March 2004 compared to the three months ended 31 March 2003. This was due to the increase in domestic gas tariffs set by the Federal Energy Commission (from March 2004 – Federal Tariffs Service), which was slightly offset by the 2%, or 2.7 bcm, decrease in sales volumes. Average domestic prices, including excise tax, increased by 26%, however, as excise tax was abolished for natural gas produced after 1 January 2004, net average domestic prices increased by 37%, from RR594.1 per mcm in the three months ended 31 March 2003 to RR811.0 per mcm in the three months ended 31 March 2004. The 2% decrease in domestic sales volumes, which decreased by 2.7 bcm to 105.4 bcm in the three months ended 31 March 2004 compared to the three months ended 31 March 2003, was primarily due to warmer winter.

Total excise taxes on natural gas sales decreased by RR42,784 million, or 95%, to RR2,216 million in the three months ended 31 March 2004 from RR45,000 million in the three months ended 31 March 2003, representing 1% and 18% of gross sales of natural gas, respectively. The decrease was due to the fact that excise tax on natural gas produced after 1 January 2004 was abolished. This decrease was offset by the RR42,116 million increase in customs duties to RR47,552 million in the three months ended 31 March 2004 compared to RR5,436 million in the three months ended 31 March 2003.

Sales of gas condensate and oil and gas products increased by RR8,204 million, or 43%, to RR27,323 million in the three months ended 31 March 2004 compared to RR19,119 million in the three months ended 31 March 2003. This increase was primarily due to consolidation of additional petrochemical companies in the three months ended 30 June and 30 September 2003. Sibur and our other petrochemical companies accounted for 62% and 57% of sales of gas condensate and oil and gas products in the three months ended 31 March 2004 and 2003, respectively.

Gas transportation sales increased by RR2,640 million, or 38%, to RR9,528 million in the three months ended 31 March 2004 from RR6,888 million in the three months ended 31 March 2003. This was primarily due to RR1,742 million increase in transportation sales to Trans Nafta who provided gas to Belarus during our contract disputes with Belarus.

Other sales decreased by RR470 million, or 4%, to RR10,743 million in the three months ended 31 March 2004 compared to RR11,213 million in the three months ended 31 March 2003. Other sales represent activities including media, construction works, refinery services and sales of other services and goods.

Operating expenses

Operating expenses increased by 12% in the three months ended 31 March 2004 to RR175,604 million from RR157,472 million in the three months ended 31 March 2003. Operating expenses as a percentage of sales remained almost unchanged, increasing from 68% in the three months ended 31 March 2003 to 69% in the three months ended 31 March 2004. The table below presents a breakdown of operating expenses in each period:

(RR' millions)	Three months ended 31 March 2004	2003
Staff costs	33,494	26,305
Depreciation	31,906	31,460
Transit costs	26,301	29,310
Taxes other than on income	20,799	9,551
Purchased gas	14,300	6,671
Materials	11,188	10,769
Electricity	7,581	5,507
Repairs and maintenance	7,506	5,197
Social expenses	2,241	2,029
Cost of goods for resale, including refined products	1,988	3,015
Processing services	1,167	5,266
Provisions	546	6,686
Other	16,587	15,706
Total operating expenses	**175,604**	**157,472**

Staff costs

Staff costs increased by 27% to RR33,494 million in the three months ended 31 March 2004 from RR26,305 million in the three months ended 31 March 2003. The increase was primarily due to the increase in the number of employees following the acquisition of controlling interests in a number of petrochemical companies in 2003 and the increase in average base salaries.

Transit costs

Transit costs decreased by 10% to RR26,301 million in the three months ended 31 March 2004 from RR29,310 million in the three months ended 31 March 2003. Transit costs relate principally to fees charged by Ukraine, Poland and other Eastern Europe and Central Asian countries for the transit of gas to markets in Europe. The decrease primarily resulted from a decrease in transit costs related to transportation of gas across Ukraine, Belarus and Poland. The decrease in transit costs through the territory of Ukraine was mainly caused by the appreciation of the RR against U.S. dollar as these costs are U.S. dollar denominated.

Taxes other than on income

Taxes other than on income consist of:

(RR' millions)	Three months ended 31 March 2004	2003
Natural resources production tax	16,363	5,578
Property tax	3,013	2,467
Other taxes	1,423	1,506
Taxes other than on income	**20,799**	**9,551**

Taxes other than on income increased by 118% to RR20,799 million in the three months ended 31 March 2004 from RR9,551 million in the three months ended 31 March 2003. The increase was primarily attributable to the change in tax legislation. From 1 January 2004, the natural resources production tax rate changed from 16.5% of the value of natural gas produced to a fixed rate of 107 roubles per mcm, and for gas condensate – from 16.5% of the value of gas condensate produced from gas condensate fields and RR 340 per ton of gas condensate produced from oil and gas condensate fields (the latter rate was subject to adjustments depending on fluctuations of oil prices and the RR exchange rate) to a single rate of 17.5% of the value of gas condensate produced. Also, effective 1 January 2004 maximum property tax increased from 2.0% to 2.2%

Purchased gas

Cost of purchased gas increased by 114% or RR7,629 million to RR14,300 million in the three months ended 31 March 2004 from RR6,671 million in the three months ended 31 March 2003. The increase was primarily related to purchases of gas from Central Asia for resale to customers in Western Europe, which commenced in January 2003. Purchases of gas from Naftogaz Ukraine and Eural Trans Gas in Europe accounted for approximately RR538 million and RR3,243 million, respectively, of the total increase of RR7,669 million.

Materials

Cost of materials increased by 4% million to RR11,188 million in the three months ended 31 March 2004 from RR10,769 million in the three months ended 31 March 2003. The increase was primarily related to higher prices of materials.

Electricity

Electricity expense increased by 38% or RR2,074 million to RR7,581 million in the three months ended 31 March 2004 from RR5,507 million in the three months ended 31 March 2003 primarily resulting from the consolidation of a number of petrochemical companies in 2003 and higher electricity tariffs, set by the Federal Energy Commission (from March 2004 – Federal Tariffs Service), in the three months ended 31 March 2004 compared to the three months ended 31 March 2003.

Repairs and maintenance

Cost of repairs and maintenance increased by 44% million to RR7,506 million in the three months ended 31 March 2004 from RR5,197 million in the three months ended 31 March 2003. The increase was primarily related to increased repair and maintenance activities in the transportation segment due to the ageing of pipeline assets.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products, decreased by 34% to RR1,988 million in the three months ended 31 March 2004 from RR3,015 million in the three months ended 31 March 2003. The decrease was primarily due to the consolidation of a number of petrochemical companies in 2003.

Processing services

Processing services decreased by 78% to RR1,167 million in the three months ended 31 March 2004 from RR5,266 million in the three months ended 31 March 2003. Processing services primarily pertain to the operations of Sibur. The decrease in the cost of processing services was due to the consolidation of a number of petrochemical companies in 2003, cost of processing services of which was previously external to our Group.

Provisions

Provision expense decreased by RR6,140 million to RR546 million in the three months ended 31 March 2004 compared to RR6,686 million in the three months ended 31 March 2003. The decrease was primarily a result of the absence of impairment provisions for accounts receivable and assets under construction in the three months ended 31 March 2004 compared to the three months ended 31 March 2003.

We recognized an impairment provision expense for accounts receivable of RR 4,084 million in the three months ended 31 March 2003, which primarily related to prepayments and other debtors. As of 31 March 2004, the aggregated provision related to accounts receivable was RR138,877 million or 28% of the gross receivable balance.

We recognized impairment provision expense of RR1,590 million in the three months ended 31 March 2003. The impairment provision expense in the three months ended 31 March 2003 was primarily due to changes in the current investment program which have reduced funding for certain projects. These projects include the development of the Kharasaveiskoye and Bovanenkovskoye fields, construction of part of the Obskaya-Bovanenkovskoye railroad, and parts of the Novy Urengoi Chemical Complex. Although these projects have not been abandoned, under the current investment program we do not believe they will generate sufficient positive cash flows in the future to recover all costs incurred.

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

Net finance income (costs)

(RR' millions)	Three months ended 31 March 2004	2003
Net exchange gain	9,198	2,014
Interest income	2,361	2,815
Interest expense	(5,523)	(7,627)
Gains on and extinguishment of restructured liabilities	293	-
Net finance income (costs)	**6,329**	**(2,798)**

We incurred a net exchange gain of RR9,198 million in the three months ended 31 March 2004 compared to RR2,014 million in the three months ended 31 March 2003. The change reflects primarily the impact on foreign currency denominated borrowings of a 3% appreciation of the RR against the U.S. dollar and 6% appreciation of the RR against the Euro in the three months ended 31 March 2004 compared to a 1% appreciation of the RR against the U.S. dollar and 1% depreciation of the RR against the Euro in the three months ended 31 March 2003.

Interest expense decreased by RR2,104 million to RR5,523 million in the three months ended 31 March 2004 compared to RR7,627 the three months ended 31 March 2003 primarily due the reduction of average borrowing rates and the reduction of total debt as of 31 March 2004 compared to 31 December 2003.

Share of net income of associated undertakings

Share in net income of associates increased by RR1,071 million to RR2,033 million in the three months ended 31 March 2004 compared to RR962 million in the three months ended 31 March 2003. The increase was primarily due to higher net profits recorded by Moldovagaz and WINGAZ GmbH and the release of impairment provisions against certain other associated undertakings.

Gains on available-for-sale investments

Gain on available-for-sale investments decreased by RR2,175 million to RR942 million in the three months ended 31 March 2004 compared to RR3,117 million in the three months ended 31 March 2003. The change was primarily due to a reduction in the release of provisions related to third party promissory notes and as a result of dispositions.

Profit tax

Profit tax expense increased by RR3,026 million, or 15%, to RR22,921 million in the three months ended 31 March 2004 compared to RR19,895 million in the three months ended 31 March 2003.

Our current profit tax expense increased by RR1,375 million, or 10%, to RR15,471 million in the three months ended 31 March 2004 from RR14,096 million in the three months ended 31 March 2003. Our effective current profit tax rate decreased to 17% in the three months ended 31 March 2004 compared to 18% for the three months ended 31 March 2003.

Our overall effective profit tax rate of 26% remained unchanged in the three months ended 31 March 2004 compared to the three months ended 31 March 2003.

Minority interests

Minority interest expense increased by RR390 million to RR582 million expense in the three months ended 31 March 2004 compared to RR192 million in the three months ended 31 March 2003, which was primarily due to increased earnings of Purgaz and Sibur.

Net profit

As a result of the factors discussed above, our net profit increased by RR10,070 million, or 18%, from RR55,972 million in the three months ended 31 March 2003 to RR66,042 million in the three months ended 31 March 2004.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes the statements of cash flows for the three months ended 31 March 2004 and 2003.

(RR' millions)	Three months ended 31 September 2004	2003
Net cash provided by operating activities	69,663	56,058
Net cash used for investing activities	(62,384)	(30,671)
Net cash provided by financing activities	4,085	4,940

Net cash provided from operating activities

Net cash provided by operating activities amounted to RR69,663 million in the three months ended 31 March 2004 compared to RR56,058 million in the three months ended 31 March 2003. This was primarily due to higher operating income generated by our gas sales during the three months ended 31 March 2004 and lower negative changes in our net working capital position in the three months ended 31 March 2004 compared to the three months ended 31 March 2003. The increase in our working capital position as of 31 March 2004 compared to 31 December 2003 primarily reflected an increase in accounts receivable and prepayments and cash and cash equivalents and a decrease in the current portion of long-term borrowings, short-term promissory notes payable and taxes payable, which more than offset an increase in accounts payable and accrued charges and a decrease in restricted cash, inventories, short-term investments and other current assets.

Net cash flows from investing activities

Net cash used for investing activities amounted to RR 62,384 million in the three months ended 31 March 2004 compared to RR30,671 million in the three months ended 31 March 2003. This was primarily due to the acquisition of a 5.2% interest in RAO UES in January 2004 and an increase in cash capital expenditures reflecting our ability to utilize higher cash flows generated by our operating and financing activities during the three months ended 31 March 2004 for a number of major construction projects.

Net cash flows from financing activities

Net cash provided by financing activities amounted to RR4,085 million in the three months ended 31 March 2004 compared to RR4,940 million in the three months ended 31 March 2003. This was primarily due to the decrease in proceeds from long-term borrowings and redemption of promissory notes in the three months ended 31 March 2004, partially offset by higher net proceeds from short-term borrowings, a reduction in restricted cash and net cash inflow from the purchase and sale of treasury shares.

Capital expenditures

Total capital expenditures (including cash advances to contractors and suppliers, which are recorded within other long-term assets, and excluding the effect of acquisitions of subsidiaries and reclassifications) increased by RR2,357 million, or 5%, from RR48,063 million in the three months ended 31 March 2003 to RR50,420 million in the three months ended 31 March 2004. Our cash capital expenditures increased by RR7,660 million, or 22%, from RR35,381 million in the three months ended 31 March 2003 to RR43,041 million in the three months ended 31 March 2004 were in line with our strategy to continue to decrease our non-cash settlements.

Most of our capital expenditures during these periods were for transportation infrastructure and production assets. Capital expenditures on the transportation infrastructure comprised RR23,942 million, or 47% of total capital expenditure in the three months ended 31 March 2004, increasing from RR17,264 million, or 36% of total capital expenditure in the three months ended 31 March 2003. Budgeted capital expenditure for 2004 indicates our renewed focus on investing in our transportation network. Our primary transportation capital projects in the three months ended 31 March 2004 were for the construction of a pipeline from the northern region of the Tyumen Oblast to Torzhok and construction of a pipeline from Pestsovoe field to the Yamburg's trunk pipeline. In the three months ended 31 March 2004 capital expenditure on production assets were RR21,470 million, or 43% of total capital expenditure in the three months ended 31 March 2004, decreasing from RR28,130 million, or 59% in the three months ended 31 March 2003. The major portion of these expenditures were for the development of Pestsovoye, Vyngayakhinskoye, and Yen-Yakhinskoe fields and Aneryakhinskoe area of Yamburgskoye field.

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

(RR' millions)	**Three months ended 31 March 2004**	**2003**	**Budget for the year ending 31 December 2004**[1] [4]
Production	21,470	28,130	71,600
Transportation	23,942	17,264	111,600
Refining	1,116	1,613	2,380
Distribution	1,080	522	- [2]
Other [3]	2,812	534	6,760
Total	50,420	48,063	192,340

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

[2]For 2004 included within other segments.

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

[4]Includes VAT

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

Debt obligations

Our net debt balance (defined as the sum of short-term borrowings, current portion of long-term borrowings, short-term promissory notes payable, long-term borrowings, long-term promissory notes payable and restructured tax liabilities, net of cash and cash equivalents and balances of cash and cash equivalents restricted as to withdrawal under the terms of certain borrowings and other contractual obligations) decreased by RR27,506 million, or 6%, from RR425,910 million as of 31 December 2003 to RR398,404 million as of 31 March 2004. This was primarily due to a decrease in the current portion of long-term borrowings and short-term promissory notes payable.