LUKOIL Management Discussion and Analysis

Six months ended June 30, 2001 compared to six months ended June 30, 2002

Results of operations

The table below details certain unaudited 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.

	Six months ended June 30, 2001		Six months ended June 30, 2002	
Revenues				
Sales (including excise and export tariffs)	6,818	99.0%	6,641	99.5%
Equity share in income of affiliates	66	1.0%	35	0.5%
Total revenues	**6,884**	**100.0%**	**6,676**	**100.0%**
Costs and other deductions				
Operating expenses	(2,145)	-31.2%	(2,151)	-32.2%
Selling, general and administrative expenses	(934)	-13.6%	(1,216)	-18.2%
Depreciation, depletion and amortization	(447)	-6.5%	(478)	-7.2%
Taxes other than income taxes	(492)	-7.1%	(808)	-12.1%
Excise and export tariffs	(808)	-11.7%	(785)	-11.8%
Exploration expense	(44)	-0.6%	(50)	-0.7%
Loss on disposal and impairment of assets	(12)	-0.2%	(26)	-0.4%
Income from operating activities	**2,002**	**29.1%**	**1,162**	**17.4%**
Interest expense	(129)	-1.9%	(126)	-1.9%
Interest and dividend income	82	1.2%	68	1.0%
Currency translation loss	(17)	-0.2%	(16)	-0.2%
Other non-operating income	12	0.1%	70	1.0%
Minority interest	(51)	-0.7%	(31)	-0.4%
Income before income taxes	**1,899**	**27.6%**	**1,127**	**16.9%**
Current income taxes	(487)	-7.1%	(356)	-5.3%
Deferred income tax benefit	21	0.3%	69	1.0%
Net income	**1,433**	**20.8%**	**840**	**12.6%**
Basic earnings per share of common stock	1.77		1.04	
Diluted earnings per share of common stock	1.75		1.04	

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Sales

The following set out our sales volumes and realized prices for the six months ended June 30, 2001 and 2002.

Sales breakdown	Six months ended June 30, 2001		2002	
	(millions of US dollars)			
Crude oil	2,395	35.1%	2,218	33.4%
Refined products	3,911	57.4%	3,897	58.7%
Other	512	7.5%	526	7.9%
Total sales	**6,818**	**100.0%**	**6,641**	**100.0%**

Sales volumes	Six months ended June 30, 2001		2002	
Crude oil	(thousands of barrels)			
International sales	84,808	30.8%	100,744	34.0%
Domestic sales	52,153	19.0%	37,293	12.6%
Refined products	(thousands of tonnes)			
International sales	9,666	25.7%	12,264	30.3%
Domestic sales	9,197	24.5%	9,326	23.1%

	2001 (thousands barrels)	2001 (thousands tonnes)	2002 (thousands barrels)	2002 (thousands tonnes)
Crude oil produced	255,729	34,888	258,191	35,224
Gas produced		2,357		2,113
Crude oil produced by affiliates	27,172	3,707	30,874	4,212
Crude oil purchased	26,124	3,564	27,898	3,806
Refined products produced on Group's refineries		14,494		13,986
Refined products produced on associated refinery (Nizhegorodnefteorgsintez)		2,136		4,610
Refined products purchased		2,122		2,923

Our sales decreased by $177 million, or 3%, from the first half of 2001 to the first half of 2002. Our revenues from sales of crude oil decreased by $177 million, or 7%, and our sales of refined products decreased by $14 million, or less then 1%. The main reason of the sales decrease was the reduction of export and domestic prices on crude oil and refined products, which reached the prior year average indexes only by the end of the second quarter. Other sales increased by $14 million, or 3 %.

The proportion of our sales volumes represented by refined products was 53% compared to 50% in the 2001 period. This is the result of the company's strategy to increase the share of the refined products in the total volume of sales.

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

International crude oil
Revenues from our crude oil sales outside Russia were nearly unchanged (increase of $6 million). A decrease in the average realized prices from $23.31 per barrel in 2001 to $19.68 per barrel in 2002, or 16%, which resulted from the decrease in the price of Urals blend, was offset by the increase in sales volumes by 15.9 million barrels, or 19%.

Domestic crude oil
Our revenues from the sale of crude oil on the domestic market decreased by $183 million, or 44%, as a result of decreases in prices and volumes. Average realized price decreased by $1.71 per barrel, or 21%, to $6.30 per barrel in the first half of 2002. Volumes of domestic crude oil sales decreased by 15 million barrels, or 28%. This change primarily resulted from an increase in refining volumes, including processing at “Nizhegorodnefteorgsintez”, and by an increase in export volumes.

International refined products
Our revenues from sales of refined products outside Russia increased by $262 million, or 11%. This was a result of an increase in volumes sold of 2.6 million tonnes, or 27%, primarily due to an increase in export volumes. An increase in volume of sales more than offset a decrease in the average realized prices on refined products by $33 per tonne, or 13%.

Domestic refined products
Our revenues from sales of refined products in the domestic market decreased by $276 million, or 19%. This was principally due to a decrease of the average realized price on refined products within Russia of $32 per tonne, or 20%. The prices reached their lowest point of the period at the end of the first quarter and then increased to the prior year average indexes by the end of the second quarter. Domestic refined products sales volumes slightly increased compared to the 2001 period (0.1 million tonnes).

Equity share in income of affiliates

Our equity share in income of affiliates accounted for using the equity method was $35 million. This was $31 million, or 47%, less than in the previous period. In general, this change was caused by a decrease in oil prices and an increase in expenses of affiliates.

Operating expenses

Operating expenses primarily include the costs of purchased crude oil and petroleum products and direct operating costs and labour costs associated with our exploration and production and refining, marketing and distribution activities. Operating expenses increased by $6 million, or less than 1%, in comparison with the prior period.

Our extraction expenses decreased by $3 million, or less than 1%. At the same time average extraction costs per barrel decreased from $3.02 per barrel during first half 2001 to $2.98 per barrel during first half 2002. Average extraction costs per barrel during the second quarter 2001 were $3.15 per barrel and during the second quarter 2002 were $2.95 per barrel. The decrease in the average extraction costs per barrel resulted from our cost reduction policy, which in the first half of 2002 included shutting-in unproductive wells and increasing oil flows by using artificial stimulation and other technologies.

Our extraction expenses include expenditures on current and capital repair of the extraction equipment, labour costs, expenses of artificial stimulation of reservoirs, fuel and electricity costs and other costs.

Our refining expenses on our refineries decreased by $36 million, or 15%, from first half 2001 to first half 2002. This was primarily caused by the closure of the Petrotel SA refinery in July 2001.

Our processing costs on the affiliated refinery (Nizhegorodnefteorgsintez) increased by $61 million, or 109%, in comparison with the first half 2001. An increase of processing costs was caused by an increased of volumes processed by 2.5 million tonnes, or 116%. During the first half 2002 processing volumes on Nizhegorodnefteorgsintez increased to 4.6 million tonnes.

Other operating expenditures, including costs of purchased crude oil and petroleum products, decreased by $16 million, or 2%, in comparison with the prior period. Costs of purchased crude oil and petroleum products decreased in accordance with a decrease of prices, described above. The decrease in prices was partially offset by an increase in refined products purchased of 0.8 million tonnes.

Selling, general and administrative expenses

Our selling, general and administrative expenses increased by $282 million, or 30%, in comparison to the first half 2001. The above-mentioned expenses include costs related to selling and marketing our products, general business expenses, payroll costs (excluding extraction entities' and refineries' production staff cost), insurance costs, costs of maintenance of social infrastructure and other expenses.

An increase in expenses was principally caused by an increase of all transport tariffs of about 30%, the increase in sales volumes described above and a general increase in expenses due to the real appreciation of the Russian ruble against the dollar.

Depreciation, depletion and amortization

Depreciation, depletion and amortization expenses include depletion of assets fundamental to production, depreciation of other productive and non-productive assets, amortization of goodwill (for year 2001 only) and intangible assets and provision for abandonment and site restoration costs. Our depreciation, depletion and amortization expenses increased by $31 million, or 7%, in comparison to the prior period. This increase was caused by a 17% increase in costs of the depreciable assets in comparison with the end of the second quarter of 2001.

Taxes other than income taxes

Taxes other than income taxes include extraction tax, road user's tax, property tax and social taxes. Beginning January 1, 2002 some taxes, including royalty tax, mineral replacement tax and excise on crude oil sales, were canceled and replaced a unified extraction tax. This unified extraction tax led to an increase of these expenses by $316 million, or 64%, in comparison to the same period in 2001. This increase was partially offset by a decrease of expenses on excise and export duties by $23 million (see below).

Excises and export tariffs

Our excise and export duties include duties on refined products sales, crude oil and refined products export duties. Excises and export duties decreased by $23 million, or 3%, compared to the prior period. Decrease in total amount of excises and export tariffs expenses resulted mainly from cancellation of excise on crude oil sales and establishing of the unified extraction tax.

Exploration expenses

Exploration expenses changed insignificantly in comparison with the prior period. The increase was $6 million, or 14%.

Three months ended June 30, 2001 compared to three months ended June 30, 2002

Company's results of operations

The following schedule summarizes certain unaudited income and expense items of our consolidated statements of income for the periods indicated below. All items are presented in millions of US dollars, except for earnings per share data and the items expressed as a percentage of revenue.

	Three months ended June 30,			
	2001		**2002**	
Revenue				
Sales (including excise and export tariffs)	3,483	99.0%	3,794	99.6%
Equity share in income of affiliates	35	1.0%	15	0.4%
Total revenues	**3,518**	**100.0%**	**3,809**	**100.0%**
Costs and other deductions				
Operating expenses	(1,078)	-30.6%	(1,098)	-28.8%
Selling, general and administrative expenses	(475)	-13.5%	(641)	-16.8%
Depreciation, depletion and amortization	(239)	-6.8%	(241)	-6.3%
Taxes other than income taxes	(217)	-6.2%	(431)	-11.3%
Excise and export tariffs	(362)	-10.3%	(573)	-15.1%
Exploration expense	(25)	-0.7%	(30)	-0.8%
Loss on disposal and impairment of assets	(11)	-0.3%	(4)	-0.1%
Income from operating activities	**1,111**	**31.6%**	**791**	**20.8%**
Interest expense	(67)	-1.9%	(59)	-1.5%
Interest and dividend income	29	0.8%	36	0.9%
Currency translation gain	27	0.7%	18	0.5%
Other non-operating income (expense)	(72)	-2.0%	49	1.3%
Minority interest	(29)	-0.8%	(25)	-0.7%
Income before income taxes	**999**	**28.4%**	**810**	**21.3%**
Current income taxes	(247)	-7.0%	(248)	-6.5%
Deferred income tax benefit	1	0.0%	35	0.9%
Net income	**753**	**21.4%**	**597**	**15.7%**
Basic earnings per share of common stock	0.82		0.73	
Diluted earnings per share of common stock	0.81		0.73	

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Sales breakdown	Three months ended June 30, 2001		2002	
	(millions of US dollars)			
Sales of crude oil	1,301	37.4%	1,170	30.8%
Sales of refined products	2,000	57.4%	2,313	61.0%
Other sales	182	5.2%	311	8.2%
Total sales	**3,483**	**100.0%**	**3,794**	**100.0%**

Revenues. Our sales for the three months ended June 30, 2002 increased by $311 million, or 9%, compared to the three months ended June 30, 2001. Our revenues from sales of crude oil decreased by $131 million, or 10%, and our sales of refined products increased by $313 million, or 16%. The increase in sales of refined products resulted from higher volumes of refined product sales internationally, which increased by 49%. Other sales increased by $129 million, or 71%.

Operating expenses. Our operating expenses for the three months ended June 30, 2002 increased by $20 million, or 2% as compared to the same period in 2001, primarily due to increases in crude oil and refined products purchased. The increase in purchases was partially offset by a decrease in market prices of both crude oil and refined products.

Our average operating costs per barrel extracted decreased to $2.95 per barrel in the three months ended June 30, 2002 from $3.15 in the three months ended June 30, 2001.

Selling, general and administrative. Our selling, general and administrative costs for the three months ended June 30, 2002 increased by $166 million, or 35% compared to the same period in 2001, primarily due to increases in transportation costs and port costs as a result of higher volumes transported and higher tariffs and increases in staff costs.

Taxes other than income taxes. Our taxes other than income taxes for the three months ended June 30, 2002 increased by $214 million, or 99%, due to changes in tax legislation that replaced royalty, mineral replacement tax and excise on crude oil with one unified extraction tax.

Excise and export tariffs. Excise and export tariffs increased by $211 million, or 58%, mainly due to an increase in volume of petroleum products sold and the average excise tax on refined products in Russia and Eastern Europe.

Liquidity and capital resources

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

Cash flows

	For the six months ended June30,	
	2001	**2002**
	($ millions)	
Net cash provided by operating activities..	1,475	863
Net cash used in investing activities..	(1,512)	(1,081)
Net cash provided by financing activities..	280	279

Cash flows provided by operating activities

Our source of cash flow is funds generated from our operations. Net funds generated from our operations for the six months ended June 30, 2002 amounted to $863 million. $840 million of these funds were generated by net income from our operations. Other major items impacting cash flows provided by operating activities were depreciation of $478 million and a decrease of accounts payable which reduced our cash flows by $379 million.

Net funds generated from our operations for the six months ended June 30, 2001 amounted to $1,475 million. $1,433 million of these funds were generated by net income from our operations. Other major items impacting cash flows provided by operating activities were depreciation of $447 million and an increase of taxes payable of $221 million.

Cash flows used in investing activities

During six months ended June 30, 2002 net cash flows used in investing activities amounted to $1,081 million, as compared to $1,512 million during the same period in 2001. This decrease was primarily due to a reduction of our capital expenditures program.

Cash flows provided by financing activities

Net cash flows provided by financing activities did not change significantly and amounted to $279 million and $280 million for the six months ended June 30, 2002 and 2001, respectively.

Working capital and liquidity

Our working capital (current assets less current liabilities) was $2.1 billion at June 30, 2002 and $1.9 billion at December 31, 2001. We believe that, having regard to our liquidity reserves, including credit facilities available, we have sufficient working capital to meet our requirements for at least the next twelve months.

As of June 30, 2002 our short-term borrowings (including the current portion of long-term debt) was $1.4 billion and our long-term debt (excluding the current portion) was $2.2 billion.

Analysis of capital expenditures

Set forth below are our capital expenditures and investments for the first half 2002 and 2001:

	Six months ended June 30,	
	2001	**2002**
	($ millions)	
Exploration and production		
- Russia	658	499
- International	71	81
Total exploration and production	729	580
Refining, marketing and distribution and other		
- Russia	219	233
- International	62	92
Total refining, marketing and distribution and other	281	325
Total cash and non-cash capital expenditures	**1,010**	**905**
Acquisitions and investments in affiliates		
Exploration and production		
- Russia	332	70
- International	-	-
Total exploration and production	332	70
Refining, marketing and distribution and other		
- Russia	9	15
- International	34	30
Total refining, marketing and distribution and other	43	45
Less cash acquired	**(9)**	**-**
Total cash and non-cash capital expenditures	**366**	**115**

Total capital expenditures for first half 2002 decreased by $105 million, or 10%, compared to the same period in 2001. Expenditures of exploration and production entities decreased by $149 million, or 20%, to $580 million primarily due to less intensive drilling program in old oil fields. Capital expenditures in refining, marketing and distribution increased by $44 million, or 16%, to $325 million primarily due to increased investments in refinery and distribution infrastructure.

Capital expenditures for acquisitions (excluding the cash of the acquired companies) totaled $115 million during the first half 2002 compared to $366 million during the first half 2001. In 2002 we purchased minority interests in our subsidiaries from KOMITEK group and purchase of control interest in exploration company Nakhodkaneftegaz. The decrease of $251 million, or 69%, was primarily due to an absence of significant acquisitions during the first half of 2002 compared to the same period in 2001.