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 US GAAP consolidated financial statements and notes and supplemental oil and gas disclosure.

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. Barrels of crude oil are translated into tonnes using a conversion rate of 7.33 and billions of cubic feet into millions of oil equivalent barrels using conversion rate of 0.167.

This report includes forward–looking statements – words such as "believes", "anticipates", "expects", "estimates", "intends", "plans", etc. - that reflect management's current estimates and beliefs, but are not guarantees of future results. Please see "Forward-looking statement" on page 22 for a discussion of some of the factors, that could cause actual results to differ materially.

KEY FINANCIAL AND OPERATIONAL RESULTS

	2002	% change from 2001	2001	% change from 2000	2000
Sales (including excise and export tariffs)	**15,334**	14%	13,426	2%	13,210
Net Income	**1,843**	(13)%	2,109	(36)%	3,312
Net Income excluding special items in 2002 *	**1,985**	(6)%	2,109	(36)%	3,312
Net Income available for common stockholders	**1,843**	(6)%	1,952	(40)%	3,265
Per Share – Basic ($/share)	**2.26**	(16)%	2.68	(45)%	4.83
– Diluted ($/share)	**2.26**	(15)%	2.66	(44)%	4.73
Daily production (including Company's share in Equity affiliates):					
Crude oil (mbbls/day)	**1,545**	4%	1,485	2%	1,456
Natural gas (mmcf/day)	**345**	8%	318	(2)%	326
Refined products (th.tonnes/day)	**107**	14%	94	7%	88
Oil and Gas proved reserves (including Company's share in Equity affiliates):					
Crude oil (million bbls)	**15,258**	4%	14,612	13%	12,895
Natural gas (billion cf)	**24,164**	83%	13,210	264%	3,625
Total oil equivalent (million bbls)	**19,293**	15%	16,818	25%	13,500

mbbls = thousands of barrels
mmcf = millions of cubic feet; bcf = billions of cubic feet
th. tonnes = thousand of tonnes
*See detailed discussion on page 6

Strong revenues Reached $15 billion and increased 14% compared to 2001 primarily as a result of change in sales mix and increased volumes of refined products sales. The Company continued to expand into new markets, both in Russia and internationally and increase our market share in our old traditional regions.

Stable production growth In line with our long term strategy and 2002 plan we increased our total daily oil production by 4% (including our share in affiliates) and produced 564 million barrels. Gas production increased by 8% and will be increasing significantly in coming years.

Second largest reserves in the world We have replaced 216% of our 2002 oil production and almost doubled our proved natural gas reserves. Approximately 60% of our oil reserves replacement was attributable to our successful drilling program and certain strategic acquisitions, with the remainder relating to an improvement of operating efficiencies and higher realized prices in line with our corporate strategy. The increase in our gas reserves related primarily to discoveries and acquisitions. Our total proved hydrocarbon reserves increased 15% and reached 19.3 billion barrels of oil equivalent which makes us the second largest private oil company in the world in terms of reserves.

Net income In 2002 we managed to decrease our operating and selling, general and administrative expenses. However our net income in 2002 is lower compared with 2001 due to a significant increase in taxes other than income taxes caused by changes in tax legislation and an increase in transportation tariffs made by the state transport monopoly. Net income for 2002 also includes special items relating to tax claims made by the taxing authorities in respect of income and other taxes amounting to $103 million. The Company agreed to settle these claims without prejudice. Excluding this tax charge and a pension adjustment net income for 2002 would have amounted to $1,985 million compared to $2,109 million in 2001.

OVERVIEW

We are the largest publicly traded oil company in the world in terms of proven crude oil reserves and in 2002 we were Russia's largest producer of crude oil.

Our operations are divided into two main business segments:

- Exploration and Production, which includes our exploration, development and production operations relating to crude oil and natural gas. These activities are primarily located within Russia, with additional activities in Azerbaijan, Kazakstan, the Middle East, Northern Africa and Colombia; and
- Refining, Marketing and Distribution, which includes marketing and trading of crude oil, natural gas and refined products, and refining and transport operations.

Other businesses include petrochemicals, banking and finance, construction and other activities.

Each of our two 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 22 to our 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.

OPERATING DEVELOPMENTS

Operating developments and events during 2002 and early 2003 included:

On April 16, 2003 our Board of directors approved the Company's development strategy where we set out targets for the next 10 years. According to this development strategy we plan to have 2.2 million barrels of crude oil production per day and 3.4 billion cubic feet of natural gas production per day by 2013. This represents a 42% increase in crude oil production from 2002 level and almost a 10 times increase in gas production compared to 2002.

Restructuring

Since the beginning of 2002, we have been implementing a restructuring plan designed to improve our operations and maximize shareholder value. The plan included undertaking the following measures in the near term: (i) increase exports of crude oil and refined products; (ii) accelerate the development of our most productive fields; (iii) shut-in low-producing wells; (iv) apply enhanced oil recovery technologies; (v) seek competitive bids for oilfield services; (vi) divest non-core businesses, including certain producing assets where we are not the operator, and reduce headcount; (vii) strengthen performance-related pay; and (viii) streamline our administration.
The following has been achieved to date:

- Our oil and refined products international sales in 2002 increased by 15% in terms of volumes while domestic sales decreased 11%, which added $1.5 billion to our revenues;
- 10 new oil fields were put on stream which allowed us to increase production by 4% regardless of the program of shutting low production wells;
- 1,138 low production wells were shut in and as a result of this measure we reduced our cost of oil production down to $2.60 per barrel, compared to $2.74 in 2001 saving $72 million in income before tax;

- We have completed the preparation of our drilling division for sale and are in the process of seeking suitable bids;
- We divested our interest in certain areas in which we were not the operator, most significantly our interest in the production sharing arrangement described below, which will result in our recognition of a substantial gain in our 2003 financial results;
- Other achievements are described in detail in other parts of this report.

Divesture

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 a production sharing agreement ("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 approximately $1.4 billion cash, subject to certain post-closing adjustments. As result of the transaction we expect to record a gain of approximately $1.1 billion in the second quarter of 2003.

Recent acquisitions

In 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. The acquired minority interest represented proved reserves of 423 million barrels of oil and 91 billion cubic feet of natural gas as of December 31, 2002.

In April 2003, the Group acquired 80.8% of the shares in OAO Yaregskaya Nefte-Titan Company ("YaNTK") for $240 million. YaNTK is a company with significant oil and titanium reserves operating in the Komi Republic of the Russian Federation.

As a result of recent acquisitions we increased our proved hydrocarbons reserves by approximately 400 million barrels of oil equivalent or 2% compared to reserves at December 31, 2002.

Major acquisitions in 2002

In February 2002, the Group acquired an additional 16% of OAO Komineft for $40 million, increasing the Group's ownership stake in OAO Komineft to 70%. OAO Komineft is a Russian oil and gas exploration company operating predominantly in the Komi Republic of the Russian Federation.

In June 2002, we acquired 60% of Nakhodkaneftegas for $30 million. As a result of the acquisition we added 5 trillion cubic feet to our proved undeveloped gas reserves located in the Yamal-Nenetsky Autonomic District of Northern Russia.

In July and September 2002 we acquired additional 35% in Nizhegorodnefteorgsintez Refinery, increasing our voting share in the company to 83%. As of December 31, 2002, we held 73% of total share capital of the refinery. Before the acquisition, Nizhegorodnefteorgsintez was recorded as affiliated company using equity method of accounting.

FACTORS AFFECTING OUR RESULTS OF OPERATIONS

In addition to the factors that may affect the petroleum industry generally, our results of operations are also affected by certain factors specific to operating in the Russian Federation.

The price of crude oil and refined products

The price at which we can sell crude oil and refined products is the primary driver of our revenues. International crude oil and refined product prices were relatively high in 2000, whereas they decreased significantly throughout 2001 and then trended up throughout 2002. World crude oil prices increased most of 2000 on demand growth and limited worldwide supply and eased somewhat late in 2000 as major crude oil exporting countries increased output and global demand growth began to slow. Slow demand growth due to the global economic slowdown and concern over worldwide production and storage levels contributed to the decline in crude prices in 2001. World crude oil prices increased in 2002 largely due to political uncertainty in the Middle East and Venezuela.

Substantially all of the crude oil that we sell for export is Urals blend. The following table shows the yearly average crude oil export prices for 2002, 2001 and 2000 and refined product prices based on Northern Europe averages:

	2002	% change from 2001	2001	% change from 2000	2000
	(in US Dollars per barrel, except for percentage data)				
Brent crude oil	**24.98**	2.1%	24.46	(13.8)%	28.39
Urals crude oil (CIF Mediterenean)	**23.68**	3.0%	22.99	(13.3)%	26.53
	(in US Dollars per metric tonne, except for percentage data)				
Fuel oil	**128.89**	16.2%	110.93	(16.9)%	133.50
Diesel Fuel	**208.84**	(4.8)%	219.30	(14.7)%	257.22
High octane gasoline	**243.62**	(1.4)%	247.09	(14.8)%	290.27

Sources: Platts and Kortes

Domestic crude oil prices

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

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

Our average realized prices for domestic crude oil sales were $8.28, $10.83 and $16.25 per barrel in 2002, 2001 and 2000 respectively.

Domestic refined product prices

Domestic prices for refined products are determined to some extent by world market prices, but they are also directly affected by local demand, competition and prices imposed on government-directed sales. The portion of our domestic refined product sales is approximately 23% of total tonnes sold but represents slightly more than 17% of our total sales revenue. Our average realized prices for domestic refined product sales were $146.14, $141.95 and $135.16 per tonne in 2002, 2001 and 2000 respectively.

Access to markets

The Russian Government places restrictions on access to the Transneft crude oil export pipeline network, which limits our ability to export via this method. The principal reasons for this are:

- a need to ensure that sufficient oil remains in Russia to meet domestic requirements, including supplies to various government controlled or strategically important institutions across the Russian Federation; and
- capacity constraints of the crude oil pipeline network.

Access to the crude oil export pipeline network is allocated quarterly, based on recent volumes produced and delivered through the pipeline and proposed export destinations, and allocations are typically in the region of 30% of production. Additional access is obtained to international markets through rail transport. During the current year the Company increased the volume of production sold to international markets by 15%.

Occasionally the Government increases export pipeline allocations under arrangements whereby oil companies provide crude oil or refined products to organisations participating in government construction and improvement projects in return for additional export pipeline access. As a result of our participation in these and other government projects, we have exported through Transneft approximately 36% of our crude oil production during the past two years.

The U.S. dollar-ruble exchange rate and inflation

A substantial part of our revenues are either denominated in U.S. dollars or are correlated to some extent with U.S. 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 a real appreciation of the ruble against the U.S. dollar (i.e., by an inflation rate that is higher than the rate at which the ruble is devaluing against the U.S. dollar) because this will generally cause our costs to increase in real terms relative to our revenues. The following table gives data on inflation in Russia, the nominal devaluation and the level of real appreciation.

	2002	2001	2000
Ruble inflation (CPI)	15.1%	18.8%	20.2%
Nominal devaluation (RUR v. U.S.$)	5.5%	7.0%	4.3%
Real appreciation (RUR v. U.S.$)	9.1%	11.0%	15.2%

Tax burden

Given the relative size of our activities in Russia, our tax profile is largely determined by the taxes payable in Russia (based on Russian accounting records – not U.S. GAAP). For 2002, 2001 and 2000 the tax charge on the Russian part of our operations was more than 95% of our total tax charge.

In addition to profits tax, we are subject to a number of other taxes in Russia, many of which are based on revenue or volumetric measures. Taxes to which we are subject include:

• extraction tax;
• excise and export tariffs;
• property tax;
• social taxes;
• sales tax and VAT;
• other local and regional taxes

Our tax strategy is to structure our affairs to limit our overall tax burden, consistent with our understanding of the legal requirements in effect at the time. This historically resulted in significant tax savings, however, due to changes in tax legislation such savings were limited during 2002 and are expected to be limited in future periods. Our effective income tax rates for 2002, 2001 and 2000, respectively, were 29%, 24% and 19%, while the statutory income tax rates in Russia were 24%, 35% and 30% in 2002, 2001 and 2000, respectively. The effective rates of total taxes and tariffs (total taxes, including income taxes, taxes other than on income and excise and export tariffs, divided by income before taxes and tariffs) for 2002, 2001 and 2000, respectively, were 72%, 60% and 45%.

Effective January 1, 2002, new taxation legislation was adopted by the Russian government. This tax legislation included a number of changes, the most significant of which were:

- a decrease in the maximum income tax rate to 24% from 35%;
- the removal of upper limits on the deductibility of expenses considered to be in the normal course of business;
- the removal of investment tax credits;
- the ability to offset exploration expenditure against income tax instead of against mineral replacement taxes; and
- a change in the basis of calculating mineral based taxes to take account of average world market prices rather than the weighted average of domestic and international selling prices.

These changes resulted in an increase of our effective tax rate and our total tax burden during 2002.

Also, during 2002, we agreed to settle certain claims made by the taxing authorities in respect of income and other taxes amounting to $103 million. We agreed to this settlement without prejudice.

Our tax planning and management strategies have been based on our understanding of tax legislation existing at the time of implementation. We are subject to tax authority audits on an ongoing basis, as is normal in the Russian environment, and, at times, the authorities have attempted to impose significant additional taxes on us. We believe that we have adequately met and provided for tax liabilities based on our interpretation of existing tax legislation. However, the relevant authorities may have differing interpretations and the effects could be significant.

RESULTS OF OPERATIONS

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.

	2002		2001		2000	
Revenues						
Sales (including excise and export tariffs)	15,334	99.3%	13,426	99.0%	13,210	98.3%
Equity share in income of affiliates	115	0.7%	136	1.0%	230	1.7%
Total revenues	**15,449**	**100.0%**	**13,562**	**100.0%**	**13,440**	**100.0%**
Costs and other deductions						
Operating expenses	(2,403)	(15.6)%	(2,584)	(19.1)%	(1,628)	(12.1)%
Costs of purchased crude oil and petroleum products	(2,693)	(17.4)%	(2,087)	(15.4)%	(2,597)	(19.3)%
Transportation expenses	(1,414)	(9.2)%	(919)	(6.8)%	(735)	(5.5)%
Selling, general and administrative expenses	(1,313)	(8.5)%	(1,375)	(10.1)%	(1,221)	(9.1)%
Depreciation, depletion and amortization	(824)	(5.3)%	(886)	(6.5)%	(838)	(6.2)%
Taxes other than income taxes	(1,972)	(12.8)%	(1,010)	(7.4)%	(1,050)	(7.8)%
Excise and export tariffs	(1,996)	(12.9)%	(1,456)	(10.7)%	(932)	(6.9)%
Exploration expense	(89)	(0.6)%	(144)	(1.1)%	(130)	(1.0)%
Loss on disposal and impairment of assets	(83)	(0.5)%	(153)	(1.1)%	(247)	(1.8)%
Income from operating activities	**2,662**	**17.2%**	**2,948**	**21.7%**	**4,062**	**30.2%**
Interest expense	(222)	(1.4)%	(257)	(1.9)%	(198)	(1.5)%
Interest and dividend income	160	1.0%	146	1.1%	209	1.6%
Currency translation loss	40	0.3%	(33)	(0.2)%	1	0.0%
Other non-operating income	11	0.1%	31	0.2%	71	0.5%
Minority interest	(69)	(0.5)%	(52)	(0.4)%	(61)	(0.5)%
Income before income taxes	**2,582**	**16.7%**	**2,783**	**20.5%**	**4,084**	**30.4%**
Current income taxes	(834)	(5.4)%	(861)	(6.3)%	(790)	(5.9%)
Deferred income tax benefit	95	0.6%	187	1.4%	18	0.1%
Total income tax expense	**(739)**	**(4.8)%**	**(674)**	**(4.9)%**	**(772)**	**(5.8)%**
Net income	**1,843**	**11.9%**	**2,109**	**15.6%**	**3,312**	**24.6%**
Basic earnings per share of common stock	2.26		2.68		4.83	
Diluted earnings per share of common stock	2.26		2.66		4.73	
Add back special items:						
Charges for settlement of tax claims	103	0.7%	-	-	-	-
Pension adjustment	39	0.3%	-	-	-	-
Net income excluding special items	**1,985**	**12.9%**	**2,109**	**15.6%**	**3,312**	**24.6%**
Basic EPS, excluding special items	2.43		2.68		4.83	
Diluted EPS, excluding special items	2.43		2.66		4.73	

Special items Our effective income tax rate in 2002 increased as a result of settlement of claims with tax authorities in respect to income tax and other taxes relief received in 2001. The Company agreed to settle these claims without prejudice and accrued a provision of $103 million in the third quarter. Substantial part of this amount was paid to the budget in December 2002. Management is not expecting any other claims from tax authorities related to tax relief received in prior periods.

Due to an improvement of the information gathering process, availability of additional data and the increased stability of the Russian economy, we have significantly revised our actuarial assumptions reducing our pension obligation. During 2002 we have recorded a pension expense of $82 million, which we expect to be reduced by approximately $39 million in future years as a result of the reduced benefit obligation.

Year ended December 31, 2002 compared to year ended December 31, 2001

Sales

This table represents major factors that led to the increase in our sales:

Total sales in 2001 (millions of US dollars)	**13,426**
Change in a sales mix	691
Change in volumes sold	778
Change in prices of oil and oil products	216
Increase of other sales (including petrochemicals)	223
Total sales in 2002 (millions of US dollars)	**15,334**

Our sales increased by $1,908 million, or 14.2%, from 2001 to 2002, primarily as a result of change in sales mix and increased volumes. Our revenues from sales of crude oil decreased by $138 million, or 2.8%, and our sales of refined products increased by $1,823 million, or 25.0%. The total volume of crude oil and refined products sold reached 80.7 million tonnes, that is 4.8% more than for the same period of 2001.

The proportion of our sales volumes represented by refined products was 57.0% compared to 50.6% in the 2001. This is the result of the Company's strategy to increase the share of exports in the total volume of sales, which was realized mainly through an increase of refined products exports. The proportion of our international sales volumes, including both crude oil and refined products, reached 66.0% in 2002 compared to 60.0% in 2001.

The following sets out our sales volumes and realized prices for the years ended December 31, 2002 and 2001:

Sales breakdown	**2002**		**2001**	
	(millions of US dollars)			
Crude oil				
International sales	4,336	28.3%	3,951	29.4%
Domestic sales	469	3.1%	992	7.4%
	4,805	**31.4%**	**4,943**	**36.8%**
Refined products				
International sales	6,225	40.6%	4,690	34.9%
Domestic sales	2,883	18.8%	2,595	19.3%
	9,108	**59.4%**	**7,285**	**54.2%**
Petrochemicals				
International sales	392	2.6%	334	2.5%
Domestic sales	134	0.9%	159	1.2%
	526	**3.4%**	**493**	**3.7%**
Other	**895**	**5.8%**	**705**	**5.3%**
Total sales	**15,334**	**100.0%**	**13,426**	**100.0%**

Sales volumes	**2002**		**2001**	
	(thousands of barrels)			
Crude oil				
International sales	197,548		187,024	
Domestic sales	56,618		91,582	
Crude oil	(thousands of tonnes)			
International sales	26,951	33.4%	25,515	33.1%
Domestic sales	7,724	9.6%	12,494	16.2%
	34,675	**43.0%**	**38,009**	**49.4%**
Refined products	(thousands of tonnes)			
International sales	26,284	32.6%	20,725	26.9%
Domestic sales	19,727	24.4%	18,281	23.7%
	46,011	**57.0%**	**39,006**	**50.6%**
Total sales of crude oil and refined products volumes	**80,686**	**100.0%**	**77,015**	**100.0%**

Realized average sales prices

	2002		2001	
	($/barrel)	($/tonne)	($/barrel)	($/tonne)
Average realized price international				
- crude oil	21.95	160.88	21.13	154.85
- refined products		236.85		226.30
Average realized price within Russia				
- crude oil	8.28	60.72	10.83	79.40
- refined products		146.14		141.95

The increase in our sales was principally due to the following:

International crude oil
Revenues from our crude oil sales outside Russia increased by $385 million, or 9.7% as a result of two factors: a) an increase in the average realized prices from $21.13 per barrel in 2001 to $21.95 per barrel in 2002, or 3.9%, which resulted from the increase in the price of Urals blend; b) an increase in sales volumes of 10.5 million barrels, or 5.6%.

Domestic crude oil
Our revenues from crude oil sales on the domestic market decreased by $523 million, or 52.7%, as a result of decreases in prices and volumes. The average realized price decreased by $2.55 per barrel, or 23.5%, to $8.28 per barrel in 2002. Volumes of domestic crude oil sales decreased by 35.0 million barrels, or 38.2%. This change primarily resulted from an increase in refining volumes, including processing at Nizhegorodnefteorgsintez, and from an increase in export volumes.

International refined products
Our revenues from sales of refined products outside Russia increased by $1,535 million, or 32.7%. This was a result of an increase in volumes sold of 5.6 million tonnes, or 26.8%. The average realized prices on refined products increased slightly by $10.55 per tonne, or 4.7%.

Domestic refined products
Our revenues from sales of refined products on the domestic market increased by $288 million, or 11.1%. Volumes of domestic refined products sales increased by 1.4 million tonnes, or 7.9%. The average realized price on refined products sold within Russia increased by $4.19 per tonne, or 2.9%.

Petrochemicals
Sales of Petrochemicals increased by $33 million, or 6.7%, basically due to a reallocation of sales from the domestic to international market with a corresponding increase in average price and processing at the newly acquired LUKOR petrochemical refinery.

Other sales
Other sales increased by $190 million or 27.0% as a result of increased activity of providing services to third parties such as transportation, construction and consumer goods.

Equity share in income of affiliates

Our equity share in income of affiliates accounted for using the equity method was $115 million. This was $21 million, or 15.4%, less than in the previous period. In general, this change was caused by obtaining control over certain affiliate companies in the second half of 2001, while before that these companies were accounted for using the equity method.

Operating expenses	**2002**	**2001**
	(millions of US dollars)	
Extraction expenses	1,355	1,411
Refining expenses	417	426
Processing costs on the affiliated refinery	131	109
Other operating expenses	500	638
Total operating expenses	**2,403**	**2,584**
Costs of purchased crude oil and petroleum products	**2,693**	**2,087**

Operating expenses, consisting primarily of direct operating and labor costs associated with our exploration and production and refining, marketing and distribution activities, have decreased by $181 million, or 7%, primarily as a result of our corporate cost saving program. Costs of purchased crude oil and petroleum products have increased $606 million, or 29%, in comparison with the same period of 2001 primarily as a result of the increase in volumes of crude oil and petroleum products purchased for resale. The following table summarizes our production and purchases data:

	2002		**2001**	
	(thousands barrels)	(thousands tonnes)	(thousands barrels)	(thousands tonnes)
Crude oil produced by consolidated subsidiaries	522,446	71,275	514,540	70,196
Crude oil produced by affiliates	62,853	8,575	58,935	8,040
Crude oil purchased	60,736	8,286	52,250	7,128
Gas produced	19,873		17,535	
Refined products produced at Group's refineries		33,652		29,366
Refined products produced at affiliated refinery (Nizhegorodnefteorgsintez)		5,567		4,823
Refined products purchased		7,399		7,059

Our extraction expenses decreased by $56 million, or 4.0%. At the same time average extraction costs per barrel decreased from $2.74 per barrel in 2001 to $2.60 per barrel in 2002. The decrease in the average extraction costs per barrel resulted from our cost reduction policy, primarily from shutting-in low-producing wells and from increasing oil flows as a result of using artificial stimulation and other technologies.

The volume of oil extracted by our subsidiaries in 2002 was 71.3 million tonnes (522 million barrels), while in 2001 it was 70.2 million tonnes (515 million barrels). Average daily production in 2002 reached 1,431 thousand barrels per day, which is 1.4% more than in the same period of 2001 (average daily production for that period was 1,411 mbbls per day).

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. Other operating expenses of our oil production companies are excluded from extraction expenses. These other operating expenses are related to sale of other services and goods (such as electricity, heat, etc.) and are included in other operating costs.

Refining expenses at our refineries decreased by $9 million, or 2.1%, from 2001 to 2002. This was primarily caused by the closure of the Petrotel SA refinery in July 2001. The decrease in our refining expenses due to the closure of Petrotel SA was partially offset by an increase in refining expenses of Nizhegorodnefteorgsintez refinery. Operating expenses of Nizhegorodnefteorgsintez were included in our refining expenses starting from July 2002, when it became a consolidated subsidiary.

Our processing costs at the affiliated refinery (Nizhegorodnefteorgsintez) increased by $22 million, or 20%, in comparison with 2001. The increase in processing costs was caused by an increase of volumes processed by 0.7 million tonnes, or 15%. During 2002 total processed volumes at Nizhegorodnefteorgsintez increased to 10.3 million tonnes, or by 113% in comparison with 2001. Nizhegorodnefteorgsintez became a consolidated subsidiary in July 2002.

Other operating expenses include operating expenses of petrochemical companies as well as costs of other services provided and goods sold (such as electricity, heat, etc.) by our production companies and operating expenses of other non-core businesses. Reduction of other expenses in the amount of $138 million was caused by a decrease in other operating activities and divestments of certain non-core businesses.

Costs of purchased crude oil and petroleum products increased by $606 million, or 29%, in comparison with the prior period primarily due to a significant increase in volumes purchased (crude oil by 8.5 million barrels, refined products by 0.34 million tonnes) and a slight increase in prices.

Transportation expenses

Our transportation expenses increased by $495 million, or 53.9%, in comparison with 2001. The increase in transportation expenses was principally caused by an increase of all transport tariffs, the increase in sales volumes described above and a change in product mix – increase in volume of refined products sold as a percentage of total volume sold.

Selling, general and administrative expenses

Our other selling, general and administrative expenses decreased by $62 million, or 4.5%, in comparison with 2001. 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 decrease was attributable to a reduction in 2002 of $141 million in costs relating to achieving certain tax efficiencies, which are no longer available to the Company. This was offset by an increase of $79 million resulting primarily from an increase in selling expenses related to the growth in the international wholesale and retail business and increases in salaries and performance related pay.

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 2001 only) and intangible assets and provision for abandonment and site restoration costs. Our depreciation, depletion and amortization expenses decreased by $62 million, or 7.0%, in comparison to the prior period. This decrease resulted from our discontinuance of amortization of goodwill during 2002 and also due to a decrease in applied depletion rates resulting from revisions of the Company's proved reserves and revisions of future abandonment and site restoration costs of our productive oil and gas assets.

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 with a unified extraction tax. This unified extraction tax led to an increase of these expenses by $737 million (including the effect of excise tax on sale of crude oil, discussed below), or 100%, in comparison to the same period in 2001. Other taxes increased by $52 million.

	2002		2001	
	Russian	**International**	**Russian**	**International**
		(millions of US dollars)		
Extraction tax	1,472	-	-	-
MRT	-	-	215	-
Royalty	-	-	347	-
Social security taxes and contributions	191	7	197	4
Road taxes	126	-	100	-
Property taxes	89	12	72	11
Other taxes	48	27	35	29
	1,926	**46**	**966**	**44**
Total		**1,972**		**1,010**

Excise and export tariffs

Our excise and export tariffs include duties on the sale of refined products and export duties on the export of crude oil and refined products. Excise and export tariffs increased by $540 million, or 37%, compared to the prior period (or, excluding the effect of excise tax on sale of crude oil, $713 million, or 55.6%). The increase in the total amount of excise and export tariffs expense resulted mainly from an increase in excise tax rates and volumes of petroleum products and the elimination of certain excise concessions previously available to the Company. 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.

	2002		2001	
	Russian	International	Russian	International
	(millions of US dollars)			
Excise tax and sales taxes on refined products	387	811	176	276
Excise tax on sale of crude oil	-	-	173	-
Export duties	796	2	831	-
	1,183	**813**	**1,180**	**276**
Total		**1,996**		**1,456**

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 expense. During 2002, the amount charged to exploration expense decreased in comparison with the prior period by $55 million, primarily due to higher level of successful drilling.

Loss on disposal and impairment of assets

Loss on disposal and impairment of assets in 2002 was $83 million compared to $153 million in 2001. The change of $70 million, or 45.8%, was due to impairment of goodwill relating to Petrotel and other investments recorded in 2001.

Interest expense

Interest expense decreased by $35 million, or 13.6%, compared to 2001 primarily due to a decrease in interest rates. The weighted-average interest rate on short-term borrowings from third parties was 6.0% per annum and 6.7% per annum as of December 31, 2002 and 2001, respectively. The weighted-average interest rate on long-term loans and borrowings from third parties was 5.58%, and 6.32% per annum as of December 31, 2002 and 2001, respectively.

Interest and dividend income

Interest and dividend income increased primarily due to an increase in cash balances and investments held.

Currency translation gain (loss)

During 2002, we recorded a currency translation gain of $40 million compared to a currency translation loss of $33 million in 2001. During 2002 we were in a net liability position for our Russian rouble denominated monetary assets which resulted in a gain of $40 million.

Income taxes

Our total income tax expense in 2002 increased by $65 million or 9.6% compare to 2001 while our income before income tax decreased by $201 million. A reconciliation of our statutory income tax rate to our effective tax rate (total income taxes divided by income before income taxes) is provided in note 14 to the consolidated financial statements.

Our effective tax rate in 2002 was 28.6%. This rate was higher than the 24% maximum statutory rate for the Russian Federation primarily because the Company was no longer able to use certain tax incentives and concessions that were previously available, but no longer allowed in 2002 by changed tax legislation. Also, some costs incurred during the year were not tax deductible or were only deductible to a certain limit, thus increasing the effective tax rate.

Our effective tax rate in 2001 was 24.2% in 2001. This rate was less than the 35% statutory maximum rate for Russian Federation primarily because of concessional tax rates we were able to utilize and the use of investment tax credits in certain subsidiaries in several tax jurisdictions both within Russia and internationally.

Year ended December 31, 2001 compared to year ended December 31, 2000

Sales

The following sets out our sales breakdown, sales volumes and realised prices for the years ended December 31, 2001 and 2000:

Sales breakdown	**2001**		**2000**	
	(millions of US dollars)			
Crude oil				
International sales	3,951	29.4%	4,380	33.2%
Domestic sales	992	7.4%	1,471	11.1%
	4,943	**36.8%**	**5,851**	**44.3%**
Refined products				
International sales	4,690	34.9%	4,076	30.9%
Domestic sales	2,595	19.3%	2,287	17.3%
	7,285	**54.2%**	**6,363**	**48.2%**
Petrochemicals				
International sales	334	2.5%	97	0.7%
Domestic sales	159	1.2%	224	1.7%
	493	**3.7%**	**321**	**2.4%**
Other	**705**	**5.3%**	**675**	**5.1%**
Total sales	**13,426**	**100.0%**	**13,210**	**100.0%**

Our sales increased by $216 million, or 2%, from 2000 to 2001. Our revenues from the sales of crude oil decreased by $908 million, or 16%. This was offset by an increase in our revenues from the sale of refined products of $922 million, or 15%, predominantly due to our acquisition of Getty in December 2000. Other sales increased by $202 million, or 20%, as a result of an increase of sales of petrochemical products.

Sales volumes	**2001**		**2000**	
	(thousands of barrels)			
Crude oil				
International sales	187,024		173,715	
Domestic sales	91,582		90,501	
Crude oil	(thousands of tonnes)			
International sales	25,515	33.1%	23,699	33.1%
Domestic sales	12,494	16.2%	12,347	17.3%
	38,009	**49.4%**	**36,046**	**50.4%**
Refined products	(thousands of tonnes)			
International sales	20,725	26.9%	18,544	25.9%
Domestic sales	18,281	23.7%	16,921	23.7%
	39,006	**50.6%**	**35,465**	**49.6%**
Total sales of crude oil and refined products volumes	**77,015**	**100.0%**	**71,511**	**100.0%**

Realized average sales prices	**2001** ($/barrel)	**2001** ($/tonne)	**2000** ($/barrel)	**2000** ($/tonne)
Average realized price international				
- crude oil	21.13	154.85	25.21	184.82
- refined products		226.30		219.80
Average realized price within Russia				
- crude oil	10.83	79.40	16.25	119.14
- refined products		141.95		135.16

	2001 (thousands barrels)	**2001** (thousands tonnes)	**2000** (thousands barrels)	**2000** (thousands tonnes)
Crude oil produced by company's subsidiaries	514,540		510,102	
Crude oil purchased	52,250		73,381	
Refined products produced by company's subsidiaries		34,189		32,156
Refined products purchased		7,059		4,261

The proportion of our volumes represented by refined products increased slightly in 2001 from 50% in 2000 to 51% in 2001, reflecting our strategy of increasing the proportion of our crude oil production that is refined. The impact of this strategy is understated, however, because we sold a portion of our crude oil production to domestic customers for refining in Russia and then repurchased and resold the refined products they produced. If we had had sufficient refining capacity of our own, these crude oil sales to domestic customers may have been reduced, and, as a result, the proportion, of our sales volumes represented by refined products may have been higher.

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

International crude oil
Our revenues from the sale of crude oil outside Russia decreased by $429 million, or 10%. This was a result of a decrease in our average realised prices for crude oil of $4.08 per barrel, or 16%, reflecting the decrease in the price of Urals blend, partially offset by an increase in volumes sold of 13.3 million barrels, or 8%.

Domestic crude oil
Our revenues from the sale of crude oil on the domestic market decreased by $479 million, or 33%. This was a result of a decrease in our average realised price for crude oil sales in the domestic market of $5.42 per barrel, or 33%, partially offset by an increase in volumes sold in the domestic market of 1.1 million barrels, or 1%. The decrease in our realised price was due to the oversupply of oil that existed in the Russian market in the second half of the year.

International refined products
Our revenues from sales of refined products outside Russia increased by $614 million, or 15%. This was a result of a net increase in volumes sold of 2.2 million tonnes, or 12%. An increase of 2.8 million tonnes, attributable to refined product sales of Getty, was partially offset by a reduction in sales in other international markets due to the closure of Petrotel in July 2001.

Our average realised prices for refined products sold outside Russia increased by $6.5 per tonne, or 3%, principally due to the Getty acquisition. The types of products sold through Getty's distribution network (principally gasoline, diesel and heating oil) had an average selling price that was approximately 60% higher than our average realised selling price in other international markets. Excluding Getty, there was a general reduction in the average selling price in other markets of $18.41 per tonne, or 8%.

Domestic refined products
Our revenues from sales of refined products on the domestic market increased by $308 million, or 13%. This was due to an increase in volumes sold of 1.4 million tonnes, or 8%. Additionally there was an increase in our average realised price for refined product sales in the domestic market of $6.79 per tonne, or 5%, primarily as a result of an increase in excise taxes on gasoline, diesel and motor oil, which was included in our sales revenues.

Equity share in income of affiliates
Our equity share in income of affiliates, which in 2001 principally included our 72% interest in LUKOIL AIK, our 38% interest in LUKOIL-Neftegazstroi and our 50% interest in Turgai Petroleum, decreased by $94 million, or 41%, from 2000 to 2001. This decrease was a result of the following:

- reduced profitability of LUKOIL AIK of $16 million due to reduced margins resulting from lower realisations on crude oil sales and inflationary effects on operating costs;
- the impact of changes in our shareholding in LUKOIL-Perm of $53 million, as a result of which LUKOIL-Perm was fully consolidated in the second half of 2000 and all of 2001; and
- the impact of changes in our shareholding in RITEK of $8 million, as a result of which RITEK was fully consolidated in the second half of 2000 and all of 2001.

Operating expenses
Our operating expenses increased by $446 million, or 11%, from 2000 to 2001. As a proportion of revenues, operating expenses increased from 2000 to 2001 by 3%.

The increase in our operating expenses was primarily due to changes in our structure. During 2000, we consolidated LUKOIL-Perm and RITEK for only half of the year, included Getty only from December 2000 and did not consolidate KomiArcticOil. During 2001, all of these businesses were consolidated for the full financial year. Other increases related to employment expenditures, artificial stimulation costs and costs related to energy and extraction materials.

In our Exploration and Production segment, average operating costs per barrel extracted increased to $2.74 per barrel in 2001, from $2.52 per barrel in 2000. This was primarily due to increased activity related to well repairs, artificial stimulation and other repair programmes as well as increased production costs, primarily electricity and labour costs, to extract oil within our main western Siberian and European Russia production subsidiaries. Other costs increased in line with inflation.

In our Refining, Marketing and Distribution segment, the major operating expense was the cost of purchasing crude oil and refined products. Our cost of purchasing crude oil and refined products decreased by $510 million, or 20%. This was due to a general price decrease in market prices for crude oil and refined products and changes in the volumes purchased between the years.

Our average purchase price for crude oil and refined products decreased by $36 per tonne, or 19%. This price decrease was consistent with the decreases outlined in our analysis of revenue movements.

The volumes of crude oil we purchased decreased by 21 million barrels, or 29%, notwithstanding an increase in our sales volumes of crude oil of 14 million barrels. The main reasons for the reduction in our need to make crude oil purchases were as follows:

- an increase in our production of 5 million barrels. This relates to increases in production at our main production subsidiaries and the acquisition of AGD and Bitech;
- a decrease in the required feedstock for our international refineries of 10 million barrels. This decrease was principally a result of reduced production at our Petrotel refinery due to its closure; and
- a decrease in oil utilised in our own operations and a reduction of inventory balances totaling 21 million barrels; offset by
- an increase in feedstock provided to third party refineries under tolling arrangements of 22 million barrels.

The volumes of refined products we purchased increased by 3 million tonnes, or 75%. The major component of this increase in purchases of refined products was an increase of 2.8 million tonnes to meet the requirements of our Getty distribution network in the United States.

Selling, general and administrative expenses
Our selling, general and administrative expenses increased by $338 million, or 17%, to $2.3 billion in 2001 due to a number of factors.

These include:

- an increase of $184 million in transport tariffs and port costs as a result of increases in both volumes transported and tariff rates together with changes in customer and supplier terms;
- an increase of $147 million in sales commissions, advertising and charitable donations;
- increased staff and insurance costs; and
- our acquisition of Getty, contributing an additional $25 million in costs.

Offsetting these factors was a reduction in 2001 of $315 million in costs relating to achieving certain tax efficiencies. In addition, selling, general and administrative expenses in 2000 were reduced by the reversal of a provision recorded in 1999.

Depreciation, depletion and amortisation
Our depreciation, depletion and amortisation expenses increased by $48 million in 2001, or 6%, compared to 2000, primarily due to an increase in the provision for abandonment and site restoration costs of $35 million during 2001. This increased provision is a result of changes in the estimated costs of the future abandonment and restoration of our productive oil and gas assets.

Taxes other than income taxes
Our taxes other than income taxes include royalty tax, mineral replacement tax, road user's tax, property tax and social taxes. The majority of our taxes other than income taxes are based on either revenue, sales volumes or the value of our assets. The expenditures decreased by $40 million, or 4%, in 2001 compared to 2000, primarily due to a reduction in the rate of road user's tax from 2.5% to 1%.

Excise and export tariffs
Excise and export tariffs increased by $524 million, or 56%, from 2000 to 2001, and represented 10.7% of our revenues in 2001 compared to 6.9% in 2000. The main reason for this increase was a change in the basis of calculating crude oil export tariffs from a flat monetary amount per tonne in 2000 to a rate based on international crude oil prices for Urals blend in 2001.

Exploration expense

During 2001 the amount charged to exploration expense increased slightly in comparison with the prior period by $14 million, or 10%, primarily due to a higher level of exploration activity in our prospective regions.

Loss on disposal and impairment of assets

Our loss on disposal and impairment of assets decreased by $94 million in 2001, to $153 million, from $247 million in 2000. Included in the 2001 amount was $28 million attributable to the write-off of goodwill relating to Petrotel. The remaining portion of the 2001 loss was a result of disposals of non-core assets in our production subsidiaries of $84 million and an impairment provision raised against investments.

Interest expense

The increase in interest expense from $198 million in 2000 to $257 million in 2001 was primarily due to the increase in short-term and long-term borrowings. The average annual interest rate (calculated as interest expense to average balance of borrowings) was 6.4% in 2001 and 8.2% in 2000.

Interest and dividend income

Our interest and dividend income decreased by $63 million, or 30%, from 2000 to 2001, primarily due to changes in cash balances and investments held.

Income taxes

Our effective income tax rate, defined as our income taxes divided by our income before income taxes, was 24% in 2001 and 19% in 2000. Fluctuations in these rates from year to year were principally due to differing levels of concessional tax rates we were able to utilise and the use of investment tax credits in Russia.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows

	2002	2001	2000
	(millions of US dollars)		
Net cash provided by operating activities	2,396	2,673	2,768
Net cash used in investing activities	(2,390)	(3,061)	(1,912)
Net cash provided by financing activities	96	471	(228)
Current ratio	1.35	1.48	1.65
Total net debt	2,941	2,258	1,175
Total Debt to Equity	30%	28%	22%
Long term debt to Long term debt and equity	11%	14%	12%
Total Net Debt to cash flow from operations	1.23	0.84	0.42

Sources of Capital

Our primary source of cash flow is funds generated from our operations. In 2002 cash generated by operating activities was $2,396 million, a decrease of $277 million from $2,673 million recorded in 2001 and of $372 million from the $2,768 million in 2000. Lower cash from operating activities in 2002 was primarily due to higher inventory balances, lower net income and the timing of settlements of the Company's payables and receivables.

In 2002 investing activities included $2,240 million of capital expenditures and acquisition costs and $302 million of investment purchases partially offset by asset and investment sale proceeds of $152 million. Net cash used in investing activities amounted to $2,390 million in 2002, a decrease of $671 million from the $3,061 million in 2001 and an increase of $478 million from the $1,912 million in 2000. Lower capital spending in 2002 compared with 2001 was due to a reduction of our capital expenditures program in line with the Company's strategic plan.

In 2002 cash provided from financing activities included $879 million from the issuance of long-term debt and $316 million of proceeds from sales of treasury stock. In addition, short-term borrowings increased by $203 million. Cash utilized by financing activities in 2002 included $579 million of debt repayments, $423 million of dividends paid on common shares and $326 million used for purchases of treasury stock. In 2002 net cash provided by financing activities decreased by $375 million from the $471 million in 2001. This was primarily the result of the lower borrowings and increased debt repayments in line with the Company's strategic plan to finance operations and capital expenditures from the net cash generated by operations.

The Company made payments of $423 million, $244 million and $118 million for dividends for common stock and preferred stock in 2002, 2001 and 2000, respectively.

As of December 31, 2002 our outstanding long-term debt amounted to $2,698 million, including amounts due within one year, compared to $2,426 as of December 31, 2001. The annual maturities of our total long-term debt are $1,032 million in 2003, $473 million in 2004, $503 million in 2005, $152 million in 2006, $408 million in 2007 and $130 million thereafter. As of December 31, 2002, the Company also had obligations under short-term borrowings, excluding current portion of long-term debt, and customer deposits in banking subsidiaries of $740 million and $755 million, respectively, compared with $553 million and $449 million as of December 31, 2001.

As of December 31, 2002 the Company had available unutilized credit facilities with a number of banks in the amount of $200 million. Interest rates on these facilities vary and are based on LIBOR.

The Company has a credit rating of BB- (RUAA) by Standard and Poor's which is one grade below the Russian country credit rating of BB (RUAAA). Our bond issues are also rated BB-.

Taking into account expected sufficient cash flow generation from our operations to cover our capital expenditures and approximately $1.4 billion proceeds from the sale of our interest in Azeri Chirag project received in April 2003, we plan to reduce our total debt, excluding customer deposits in our banking subsidiary, by approximately $400 million by the end of 2003. We also believe that the Company has sufficient borrowing capacity to meet unanticipated cash requirements, and during the periods of low commodity prices and narrow margins for refined products, it has the flexibility to increase borrowings and/or modify capital spending plans to continue paying the common stock dividend and to maintain the Company's high-quality debt ratings.

Analysis of capital expenditures

	2002	2001	2000
	(millions of US dollars)		
Exploration and production			
- Russia	1,078	1,543	648
- International	333	246	297
Total exploration and production	1,411	1,789	945
Refining, marketing and distribution and other			
- Russia	683	645	738
- International	110	183	184
Total refining, marketing and distribution and other	793	828	922
Total cash and non-cash capital expenditures	**2,204**	**2,617**	**1,867**
Acquisitions of subsidiaries			
Exploration and production			
- Russia	67	467	45
- International	-	-	-
Total exploration and production	67	467	45
Refining, marketing and distribution and other			
- Russia	53	35	-
- International	57	59	118
Total refining, marketing and distribution and other	110	94	118
Less cash acquired	**(4)**	**(62)**	**(65)**
Total	**173**	**499**	**98**

According to our strategy the 40% increase of crude oil production up to 2013 will be achieved from new provinces which we started developing during last three years. The table below shows our historical capital expenditures included into exploration and production numbers above on new promising oil regions.

Exploration and production (Russia)	2002	2001	2000
	(millions of US dollars)		
Timan-Pechora	338	373	93
Caspian region	46	94	76

2003 Capital Expenditures Program

The Company estimates 2003 capital expenditures will be $2,583 million, which is about 17% higher than capital expenditures in 2002. About $2,036 million, or 79% of the total, is budgeted for exploration and production activities, with $627 million of that outside of Russia. Exploration and production expenditures will target the most promising exploratory prospects in Caspian region and major development projects in Timan-Pechora region. Refining, marketing and distribution capital spending is estimated to be $465 million, with $84 million of that outside of Russia. Refining, marketing and distribution expenditures in Russia will be allocated to upgrading our refineries and selling facilities. International refining, marketing and distribution capital spending will target refineries in Bulgaria and Ukrain.

The Company believes that, based on its current expectation for commodity prices for 2003, its capital expenditures program of $2,583 million will be funded by operating activities and, to the extent required, available lines of credit. In the event of significantly lower cash flow the Company is able to defer certain of its capital spending program without penalty.

GUARANTEES, OFF-BALANCE-SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS, AND OTHER CONTINGENCIES

Financial Guarantees

Millions of dollars	Total	2003	2004	2005	2006	2007	After
		Commitment Expiration by Period					
Guarantees of equity affiliate's debt	629	-	13	25	25	31	535
Guarantees of third party's debt	38	13	-	25	-	-	-

As of December 31, 2002 the Company provided guarantees of $629 million for loans of equity investees and $38 million for third parties. There are no amounts being carried as liabilities for the Company's obligations under these guarantees. Guarantees issued in regard to equity investees relate to borrowings for capital projects or general corporate purposes. These guarantees were undertaken to enhance the credit standing of the affiliated operations and to achieve lower interest rates. Under the terms of guarantees, the Company would be required to perform should an affiliate be in default of its loan term, generally for the full amount disclosed. There are no provisions for recourse to third parties, and no assets are held as collateral for the obligations of affiliates. One of the guarantees is secured by the shares of an affiliated company held by the Group, the carrying amount of which was approximately $1 million as of December 31, 2002. No collateral secures other guarantees. See Note 19, "Letters of credit and financial guarantees."

Capital Commitments and contractual obligations.

The Company and it's subsidiaries have significant capital commitments in respect to oil and gas fields development in Russia. These commitments are regulated by law and described in the individual license agreements. Also we have long term lease obligations for retail outlets in US.

The following table displays our total on and off balance sheet contractual obligations:

Contractual obligations:

Millions of dollars	Total	2003	2004	2005	2006	2007	After
		Payments Due by Period					
On balance sheet:							
Short term debt	740	740	-	-	-	-	-
Long-term bank loans and borrowings	1,511	422	400	477	133	40	39
Long-term non-bank loans and borrowings	192	50	62	15	8	5	52
1% Convertible US dollar bonds	455	455	-	-	-	-	-
3.5% Convertible US dollar bonds	351	-	-	-	-	351	-
Variable interest unsecured ruble bonds	94	94	-	-	-	-	-
Capital lease obligations	95	11	11	11	11	12	39
TOTAL	**3,438**	**1,772**	**473**	**503**	**152**	**408**	**130**
Off balance sheet							
Operating lease obligations	850	74	73	72	73	62	496
Capital commitment in Neftohim Burgas refinery (Bulgaria)	112	38	43	31	-	-	-
Capital commitment in Petrotel refinery (Romania)	107	43	10	11	10	33	-
Capital commitment in PSA	138	77	12	1	2	1	45
Capital commitment under oil and gas license agreements in Russia	3,037	788	492	492	492	491	282
TOTAL	**4,244**	**1,020**	**630**	**607**	**577**	**587**	**823**

Litigation On November 27, 2001, Archangel Diamond Corporation ("ADC"), a Canadian diamond development company, filed a lawsuit in the district court of Denver, Colorado, against AGD, a Group company, and the Company (together the "Defendants") claiming compensation for damage allegedly caused by the Defendants relating to Almazny Bereg, a joint venture between AGD and ADC. ADC claims, among other things, that the Defendants interfered with the transfer of a diamond exploration license which was subject to an agreement between ADC and AGD. The total damages claimed by ADC are $4.8 billion, including compensatory damages of $1.2 billion and punitive damages of $3.6 billion. On October 15, 2002, the District Court of Denver, Colorado dismissed ADC's action against the Defendants based on lack of jurisdiction. On November 22, 2002, the Denver District Court denied ADC's request for reconsideration of the Court's October 15th order dismissing the case. ADC has subsequently filed an appeal with the Court of Appeals in the State of Colorado. The Company does not believe that the ultimate resolution of this matter will have a material adverse effect on its financial condition.

The Group is involved in various other claims and legal proceedings arising in the normal course of business. While these claims may seek substantial damages against the Group and are subject to uncertainty inherent in any litigation, management does not believe that the ultimate resolution of such matters will have a material adverse impact on the Group's operating results or financial condition.

Environmental The Company maintains provision for dismantlement, abandonment and restoration of it's oil and gas properties at the end of their productive lives. Many of these costs are related to environmental issues. Expenses are recorded on units of production basis and accrued liability recorded as part of "Accumulated depreciation, depletion and amortisation". Please, refer to Note 2 of our consolidated financial statements for information related to the Company's 2003 implementation of Financial Accounting Standards Board (FASB) Standard No. 143, "Accounting for Assets Retirement Obligations". The following table displays the annual changes to the company's environmental reserves.

	2002	2001	2000
	(millions of US dollars)		
Balance at January 1	368	247	172
Accrual of provision	45	125	92
Expenditures	(12)	(4)	(17)
Balance at December 31	401	368	247

Other matters During July 2001, the Group temporarily shut down operations of the Petrotel SA refinery due to the economic conditions in Romania. The refinery remains closed as of the date of these consolidated financial statements. Management has recently completed and approved the results of a feasibility study and investment program to upgrade the Petrotel SA refinery and resume operations during 2004. However, if management ultimately decides to sell or abandon the refinery, the Group may be exposed to losses on the carrying value of property, plant and equipment of up to approximately $60 million. Additionally, a decision to abandon the refinery may result in claims against the Group's future investment commitments.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

Interest rate risk. We are exposed to changes in interest rates, primarily associated with our variable rate short-term and long-term borrowings. We do not utilize any interest rate swaps or other derivatives to hedge against the risk of changes in interest rates on our variable rate debt. Utilizing the actual interest rates in effect and the balance of our variable rate debt as of December 31, 2002 and assuming a 10% change in interest rates and no change in the balance of debt outstanding, the potential effect on annual interest expense would not be material to our results of operations.

Foreign currency risk. The countries in which our principal operations are located have been subject to hyperinflation for a substantial period and during the last 10 years the local currency has been subject to large devaluations. As a result we are subject to the risk that the local currency may suffer future devaluation that may subject us to losses, depending on our net monetary asset position. We currently do not use any formal hedging arrangements to minimize the effect of these potential losses. Additionally, because we have operations in a number of other countries we are required to conduct business in a variety of foreign currencies and, as a result, we are subject to foreign exchange rate risk on cash flows related to sales, expenses, financing and investment transactions. The impacts of fluctuations in foreign currency exchange rates on our geographically diverse operations are varied. We currently do not utilize any foreign currency exchange contracts to hedge against the risk of adverse foreign currency movements. We recognized net foreign currency translation gains (losses) of $40 million, $(33) million and $1 million for the years ended December 31, 2002, 2001 and 2000, respectively

Commodity instruments. We make limited use of commodity instruments in our operations. The use of such instruments relates to limited marketing and trading of petroleum products outside of our physical crude oil and products businesses. This includes the use of futures contracts together with purchase and sale contracts that qualify as derivative instruments. The Company maintains a system of controls over these marketing and trading activities that includes policies covering the authorization, reporting and monitoring of derivative activity. We do not believe our derivative activities pose material credit or market risks to our operations, financial condition or liquidity. We recognized a net loss of $5 million during 2002 associated with such activities. The volume of petroleum products under contracts that were physically settled during 2002 related to this activity was 593,000 tonnes. The fair value of derivative contracts outstanding and recorded on the consolidated balance sheet as of December 31, 2002 was a net payable of $6 million. The derivative activity during 2001 and 2000 was negligible.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to select appropriate accounting policies and to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. See Note 2, "Summary of significant accounting policies," for descriptions of the Company's major accounting policies. Certain of these accounting policies involve judgments and uncertainties to such an extent that there is a reasonable likelihood that materially different amounts would have been reported under different conditions, or if different assumptions had been used.

Successful Efforts Accounting for Oil and Gas Activities

Accounting for oil and gas activities is subject to special accounting rules that are unique to the oil and gas industry. Property acquisitions, successful exploratory wells, all development costs and support equipment and facilities are capitalized. Artificial stimulation and well work-over costs are included in operating expenses as incurred.

Property Acquisition Costs

For individually significant undeveloped properties, management periodically performs impairment test based on exploration and drilling efforts to date. For undeveloped properties acquisition costs that individually are relatively small, management exercises judgment and determines a periodic property impairment charge that is reported in exploration expense.

Exploratory Costs

For exploratory wells, drilling costs are temporarily capitalized, or "suspended," on the balance sheet, pending a judgmental determination of whether potentially economic oil and gas reserves have been discovered by the drilling effort. If a judgment is made that the well did not encounter potentially economic oil and gas quantities, the well costs are expensed as a dry hole and are reported in exploration expense. Exploratory wells that are judged to have discovered potentially economic quantities of oil and gas and that are in areas where a major capital expenditure would be required before production could begin, remain capitalized on the balance sheet as long as additional exploratory appraisal work is under way or firmly planned. Unlike license acquisition costs, there is no periodic impairment assessment of suspended exploratory well costs. Management continuously monitors the results of the additional appraisal drilling and seismic work and expenses the suspended well costs as dry holes when it judges that the potential field does not warrant further exploratory efforts in the near term.

Other exploratory expenditures, including geological and geophysical costs are expensed as incurred.

Proved Oil and Gas Reserves

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas liquids including condensate and natural gas that geological and engineering data demonstrate with reasonable certainty can be recovered in future years from known reservoirs under existing economic and operating conditions. Reserves are considered proved if they can be produced economically as demonstrated by either actual production or conclusive formation tests. Reserves which must be produced through the application of enhanced recovery techniques are included in the proved category only after successful testing by a pilot project or operation of an installed program in the same reservoir that provides support for the engineering analysis on which the project was based. Proved developed reserves are expected to be produced through existing wells and with existing facilities and operating methods.

The estimates are made using all available geological and reservoir data as well as historical production data. Estimates are reviewed and revised as appropriate. Revisions occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Company's plans.

Impairment Of Long-Lived Assets

Long-lived assets used in operations are assessed for impairment whenever changes in facts and circumstances indicate a possible significant deterioration in the future cash flows expected to be generated by an asset group. If, upon review, the sum of the undiscounted pretax cash flows is less than the carrying value of the asset group, the carrying value is written down to estimated fair value. Individual assets are grouped for impairment purposes based on a judgmental assessment of the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. Because there usually is a lack of quoted market prices for long-lived assets, the fair value usually is based on the present values of expected future cash flows using discount rates commensurate with the risks involved in the asset group. The expected future cash flows used for impairment reviews and related fair value calculations are based on judgmental assessments of future production volumes, prices and costs, considering all available information at the date of review.

Site Restoration and Abandonment Costs

Under various laws, contracts, permits and regulations, the Company has legal obligations to remove tangible equipment and restore the land or seabed at the end of operations at production sites. The largest site restoration and abandonment obligations facing the Company relate to wells and oil and gas production facilities and pipelines. The estimated undiscounted site restoration and abandonment costs, net of salvage values, are accrued, using primarily the unit-of-production method, over the productive life of the asset. Estimating the future site restoration and abandonment costs necessary for this accounting calculation is difficult. Most of these obligations are many years in the future and the contracts and regulations often have vague descriptions of what removal practices and criteria will have to be met when the removal event actually occurs. Asset removal technologies and costs are constantly changing, as well as political, environmental, safety and public relations considerations.

Legal, Environmental Remediation and Other Contingent Matters

The Company is required to both determine whether a loss is probable based on judgment and interpretation of laws and regulations and determine that the loss can be reasonably estimated. When the loss is determined it is charged to net income. The Company’s management must continually monitor known and potential contingent matters and make appropriate provisions by charges to net income when warranted by circumstance.

Defined Benefit Pension Plan

Determination of the projected benefit obligations for the Company's defined benefit pension plan is important to the recorded amounts for such obligations on the balance sheet and to the amount of benefit expense in the income statement. This also impacts the required Company contributions into the plans. The actuarial determination of projected benefit obligations and Company contribution requirements involves judgment about uncertain future events, including estimated retirement dates, salary levels at retirement, mortality rates, lump-sum election rates and rates of return on plan assets. Due to the specialized nature of these calculations, the Company engages outside actuarial firms to assist in the determination of these projected benefit obligations. Ultimately, the Company will be required to fund all promised benefits under pension benefit plans not funded by plan assets or investment returns, but the judgmental assumptions used in the actuarial calculations significantly affect periodic financial statements and funding patterns over time. Benefit expense is particularly sensitive to the discount rate and return on plan assets assumptions. A 1 percent decrease in the discount rate would increase annual benefit expense by $3.5 million, while a 1 percent decrease in the return on plan assets assumption would increase annual benefit expense by $0.3 million.

New Accounting Pronouncements

There are a number of new FASB Statements of Financial Accounting Standards (SFAS) and Interpretations that the Company implemented either in December 2002 or January 2003, as required: SFAS No. 143, "Accounting for Asset Retirement Obligations;" SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections;" SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities;" SFAS No. 148, "Accounting for Stock-Based Compensation--Transition and Disclosure;" Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others;" and Interpretation No. 46, "Consolidation of Variable Interest Entities." In addition, in 2003, the FASB is expected to issue SFAS No. 149, "Accounting for Certain Financial Instruments with Characteristics of Liabilities and Equity." For additional information about these, see Note 2, “Summary of significant accounting policies,”

FORWARD-LOOKING STATEMENTS

Certain statements in this document are not historical facts and are "forward-looking." We may from time to time make written or oral forward-looking statements in reports to shareholders and in other communications. Examples of such forward-looking statements include, but are not limited to:

- *statements of our plans, objectives or goals, including those related to products or services;*
- *statements of future economic performance; and*
- *statements of assumptions underlying such statements.*

Forward looking statements that may be made by us from time to time (but that are not included in this document) may also include projections or expectations of revenues, income (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios. Words such as "believes," "anticipates," "expects," "estimates," "intends" and "plans" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. You should be aware that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements.

These factors include:

- *inflation, interest rate and exchange rate fluctuations;*
- *the price of oil;*
- *the effects of, and changes in, Russian government policy;*
- *the effects of competition in the geographic and business areas in which we conduct operations;*
- *the effects of changes in laws, regulations, taxation or accounting standards or practices;*
- *our ability to increase market share for our products and control expenses;*
- *acquisitions or divestitures;*
- *technological changes; and*
- *our success at managing the risks of the aforementioned factors.*

This list of important factors is not exhaustive. When relying on forward-looking statements, you should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as of the date on which they are made, and, subject to any continuing obligations under the Listing Rules of the U.K. Listing Authority, we do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.