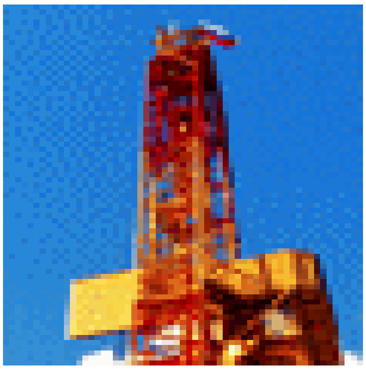
United Heavy Machinery (OAO OMZ)

Annual Report

2001



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UHM Vision

UHM is a diversified industrial company that designs, manufactures and sells a wide range of heavy machinery. Created through consolidation of a number of Russian engineering and manufacturing plants and historically being a dominant player on the Russian domestic market for knowledge intensive industrial products, UHM strives to even further expand its domestic business on the back of continuing economic recovery in the Russian Federation focusing on improving efficiency, introducing new technologies and international standards for quality and customer support on quickly growing domestic market.

In addition to keeping focus on its domestic market, UHM's new goal is to become the world's major player in carefully selected sectors of global engineering industry. Capitalizing on extensive, relatively low cost and professionally solid pool of UHM Russia based engineering talent, and benefiting from UHM's proprietary low cost manufacturing facilities, the Company seeks to establish itself as highly competitive international engineering company in selected sectors of knowledge intensive machinery and equipment industry. UHM enhances its market leadership and shareholders value by acquiring like-minded businesses that strengthen our existing competitive positions and offer new markets.

While staying as loyal corporate citizen of the Russian Federation where UHM will continue to maintain its core market and production base, UHM intends to become the new global player in the engineering sector capitalizing on intellectual potential of its people and delivering consistent tangible benefits to its customers and shareholders. By adhering to the world's best corporate governance standards and socially responsible business practices, UHM strives to become the "model" public company for Russian emerging capital markets further enhancing UHM shareholders value as well as fair rewards and true job satisfaction for its employees.

Comparative Financial Highlights

All values are in thousands of US Dollars except for ratios and per share figures, years ending Dec 31 each.

	2001	2000
Net Sales	**313,116**	241,024
Cost of sales	**249,889**	221,042
Gross Margin	**63,227**	19,982
EBITDA	**32,743**	25,682
EBIT	**10,638**	5,011
Net Earnings	**6,010**	339
Earnings per share	**0.17**	0.01
Free Float Adjusted EPS	**0.19**	0.01
Capital Expenditures	**30,417**	9,933
Long Term Investments	**9,217**	12,728
Number of Employees	**42,940**	34,341
Sales / Assets Ratio	**59%**	48%

Source: US GAAP Financials as audited by Ernst & Young

"Comparative Financial Highlights" represents results from continuing operations, results for newly acquired companies are added when consolidated and no backwards restatements (to allow year-to-year comparability) were included in this table.

EBIT and EBITDA shown before minority interest and have been calculated by management.

Earnings per share represent basic and diluted net income per share.

Free float adjusted EPS are Earnings Per Share adjusted for the number of treasury shares (excluded from the calculation). For detailed information on free float and treasury shares see Section "Capital Structure".

For the purpose of the table above Long Term Investments include acquisitions.

Capital Expenditures and Long Term Investments values include only cash based transactions, are calculated based on related US GAAP accounts and exclude capital expenditures and acquisition values booked through stock-for-stock acquisitions. Please refer to Capital Expenditures and UHM Acquisitions subsections of the "Management Discussion and Analysis of Operations" of this report for more details.

Letter to Shareholders

Year 2001 and the first six months of 2002 turned out to be the most exciting and challenging years in a brief history of UHM (OAO OMZ), the MICEX (Russia's leading stock exchange) quoted public company. UHM has been established in 1996 and a year later turned into a diversified industrial group after acquisitions of OAO Uralmash and OAO Izhorskiye Zavody, two of UHM largest engineering and manufacturing properties in the Russian Federation to date. With not yet 5 years of operating history as the consolidated group, and only in the fourth year after the devastating Russian crisis of 1998, UHM is emerging as the quickly growing international engineering company with strong positions at home and some very recent successes in expanding abroad. UHM is one of the most successful and still very sensitive industrial turnaround stories in the Russian Federation, and as such UHM is emphasizing the long term nature of its business and strong commitment to the world's best standards of disclosure and corporate governance.

Focusing on Long Term Growth

UHM is in business of manufacturing and selling knowledge intensive equipment and machinery that often is produced based on individual and heavily customized orders in a series of one or few items and takes many months to complete and ship.

Long term planning, long manufacturing cycles and long revenue recognition periods are the every day reality of UHM business that on the one hand provides for continuity and predictability of the company's operations, and on the other hand create constant challenges to adjust to ever changing market environment and customer preferences. Identifying long term trends in the knowledge intensive machinery and equipment industry, developing and leveraging UHM competitive advantages and following elaborate risk management system in its operations are the core priorities of the UHM management on the way to an overall goal of delivering strong and consistent long term returns to the Company's shareholders.

UHM business model is a carefully planned, solidly staked and properly risk managed series of bets on a few essential long term trends. First, UHM believes and eagerly contributes to economic recovery of the Russian Federation and its industrial base. This commitment to domestic market has already paid back in such sectors as drilling equipment and shipbuilding where UHM's focused business development and acquisition strategies helped to deliver the dominant market share in related sectors of engineering industry that enjoyed better-than-peers growth in 2001 and first six months of 2002 fuelled by strong oil price and massive capital expenditure investment in Russian energy sector.

Second, UHM is focused on deriving long term benefits from carefully selected and historically well developed niches of global machinery market where some of UHM technologies and products stay and will continue to be very competitive. Thus, most of UHM export sales in 2001 (approximately 27%) had been generated from such very important niche export sales that include nuclear power plant equipment sales predominantly to Asian markets, and metallurgical and mining equipment sales to CIS (Commonwealth of Independent States) countries.

Thirdly, UHM believes that knowledge based machinery industry is becoming increasingly global where the focus and value is shifting to new technologies, abilities to access and service the markets and intrinsic capabilities of engineering companies to react quickly and efficiently to continuing changes in market environment. Developing new markets for UHM products and engineering resources, and growing internationally through carefully planned and efficiently executed acquisitions strategy is another essential priority of UHM management committed to a long term trend of increasing globalization and flexibility of engineering industry.

Clear focus of UHM management on those long term strategies is our principal way of turning UHM in a true global company and delivering better-than-the-peers above average returns to UHM shareholders for the next 3 to 10 years.

Acquisitions: Core Competence

Fundamental and largely positive changes in the Russian economy and massive volatility of the global engineering sectors have created exceptional opportunities for UHM to grow both organically and through acquisitions in 2001 and first half of 2002.

UHM grabbed this opportunity and developed a science of investing profitably in acquisitions into the core competence of the Company. As you would learn further from the text of this annual report, in 2001 UHM consolidated two new substantial manufacturing companies (Krasnoe Sormovo and Burovaya Tekhnika) and in 2002 it has acquired 7 more engineering and machinery ventures including three international acquisitions in Ukraine, Romania and the United States of America.

Supporting organic growth with those acquisitions had been critical in achieving UHM goal to gain the size and weight necessary to allow UHM successfully competing internationally, creating efficiently new markets for its products and obtaining radically better access to capital markets and multiple other financing options.

Capital Markets and Corporate Governance

As UHM had been investing heavily in assets modernization, other capital expenditures and acquisitions, it had become reasonably dependent on the capital and bank debt markets for existing and future financing of its activities. In the year 2001 the net cash provided by financing activities slightly exceeded US$ 50 million and thus provided the mission critical function to fuel aggressive growth of UHM.

Making international and domestic investors to understand and appreciate UHM efforts in building a new generation global diversified engineering company is the top priority of UHM management, which is committed to building and maintaining further trust with the investment community.

This is why UHM had pioneered, introduced and is staying compliant with the best international practice for corporate governance and disclosure voluntarily championing such initiatives as independent board of directors, corporate governance code and so forth. UHM’s 2002 Annual Shareholders Meeting has already approved revisions of company’s charter aimed to accommodate best standards or corporate governance as recommended by Russian Securities and Exchange Commission.

With all our successes so far in building a competitive industrial company, UHM management is still at a fairly early stage of a long term exercise of transforming UHM into a truly global competitive player in the international engineering industry. We are committed to deliver strong long terms returns to our shareholders and comply with the best disclosure and corporate governance standards and expect support from our stakeholders on the way to a joint goal of making UHM a new and better company.

Kakha A. Bendoukidze,

President & CEO,

United Heavy Machinery (OAO OMZ)

UHM: Management Discussion and Analysis of Operations

UHM is involved in engineering, production as well as sales and services of knowledge intensive equipment and machinery along six major lines (business segments): oil and gas rig equipment (OILEQ), equipment for nuclear power plants (NPPEQ), metallurgical equipment (METEQ), mining equipment (MINEQ), shipbuilding (SHIP), and specialty steels (STEEL). Based on 2001 US GAAP financial report, the year 2001 was the most successful year in the brief history of UHM confirming company's ability to deliver both consistent organic growth and efficient expansion through acquisitions. Riding on the back of continuous Russian economic recovery, UHM achieved 29.9% increase in 2001 sales over 2000, and reported net earnings of USD 6.01 M or USD 0.17 per share of common stock, its all time record high earnings and sales. UHM has firmly moved to profitability under US GAAP and its gross margin more than tripled over the year 2000 exceeding USD 63M. Additionally, UHM collected approximately USD 41M in advances recognized as sales according to Russian Accounting Standards but not included in 2001 sales under US GAAP and instead booked as deferred revenues. Approximately 73% of UHM sales are in the Russian Federation and 27% are export sales, with the share of export sales increasing by 7 percentage points over the year 2000, and UHM total sales growing by 29.9% on y-t-y basis in 2001 thus bucking the general downturn trend in the global engineering sector.

UHM ability to grow sales and improve profitability on 2001 had a lot to do with company's diversified business portfolio. Three out of six UHM business segments (METEQ, MINEQ and STEEL) experienced decline in sales in 2001, partially reflecting some unfavorable market conditions but mostly being affected by changes in UHM's own business strategy. The company is focusing on high value added products and services exiting from low margin businesses, including outright disposals (which was a principal cause for decline in sales in STEEL business segment), and concentrating its business development efforts on higher margin sectors. This value management strategy has already translated into robust growth in sales in OILEQ and NPPEQ segments and also is a principal justification behind UHM expansion into shipbuilding industry.

New Business Processes

UHM aggressive expansion through acquisitions and company's commitment to identifying new markets for its products and services led UHM to embarking on a profound corporate restructuring plan ("Plan") that started in 2001 and would continue through the middle of 2003. The purpose of the Plan is to unleash cost savings and synergies from UHM completed acquisitions, and modify production and business processes around expanded and better integrated corporate structure of UHM through re-organization of various UHM subsidiaries and asset pools into six business segments with their own profitability targets and dedicated management teams. Value creation and profitability are the core optimization targets of the Plan, thus not all of UHM business segments would be vertically integrated units, as UHM might increasingly focus on selected high value / higher barriers-to-enter sub-sectors exiting or avoiding expanding into lower value sections of the value chain.

Key operations and financial data for six UHM business segments are:

All data is in USD Millions except for percentages

Character	OILEQ	NPPEQ	METEQ	MINEQ	SHIP	STEEL
2001 Sales	55.8	58.4	47.1	37.7	15.7	62.7
% change to 2000	+ 95.2 %	+ 90.1 %	- 18.7 %	- 17.9 %	New	- 18.8 %
% of UHM 2001 Sales	18%	19%	15%	12%	5%	20%
% of UHM 2000 Sales	12%	13%	24%	19%	0%	32%

Notes: (i) % of revenues / earnings do not add up to 100% due to "Other Revenue / Income" not attributed to any of the business segments; (ii) all data is based on US GAAP financials.

As this data on business segments demonstrates, UHM runs a fairly diversified business model in terms of products and services range, with some business segments being counter cyclical, and have enormous growth potential should it manage to build on its strong domestic market position and expand even further on international markets.

Capital Expenditures

Formed through consolidation into UHM of the two industrial giants, Uralmash and Izhorskie Zavody, UHM inherited a vast and deeply depreciated industrial asset base, that needed both modernization and much focused technological upgrade aimed at strategically most important manufacturing and other production processes. In the year 2001 UHM doubled its investments over the previous year and has invested over USD 47 M in its asset base, including capital expenditures, repair & maintenance, investments in information technology and R&D (under current accounting policy R&D investments are not capitalized and expensed at the same year as made – see detailed discussion of Technology and R&D policies in the namesake section of this report).

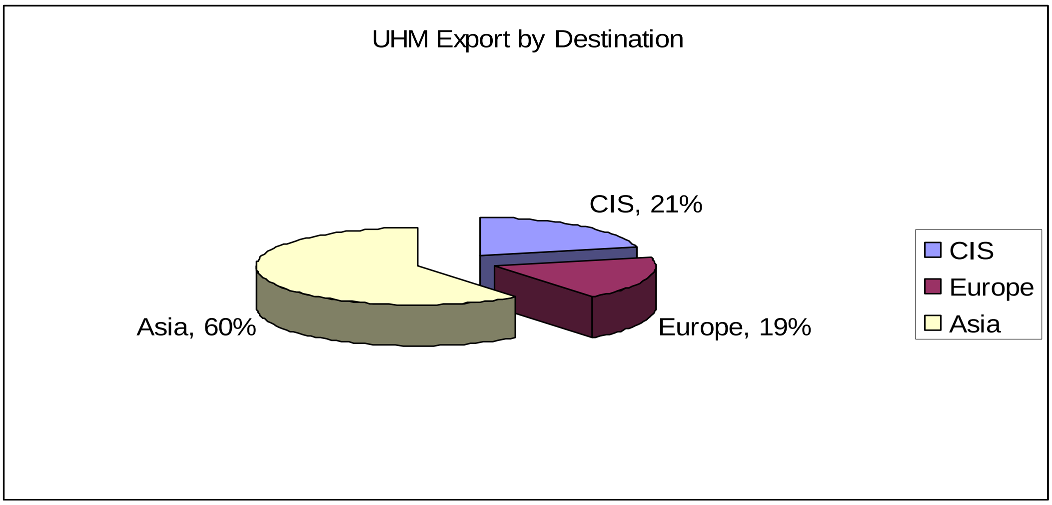
In the year 2001 UHM first time in its short history added more to PP&E account on its books due to investments in new plant and equipment than wrote off from the same account because of depreciation and disposals. Investing over USD 30M in new plant and equipment in 2001 or almost 10% of its same year revenue and almost 17% of company's fixed assets, UHM has significantly modernized its asset base and created an excellent starting point for dramatic costs reduction due to technology change and efficiency increase going forward.

Export Sales

The year 2001 had been very convincing in terms of proving UHM abilities to increase export sales – based on the 2001 US GAAP financials, UHM total exports were $ 84 M or 27% of total sales, representing 74% growth over the year 2000.

Almost 2/3 of export revenues had been generated by two major contracts for supplying equipment for nuclear power plants, including those located in China and India. Oil and gas rig equipment is mainly exported in CIS countries while dry-cargo ships manufactured in UHM SHIP business segment are exported to Western European customers.

UHM Export by Region, Year Ending December 31, 2001

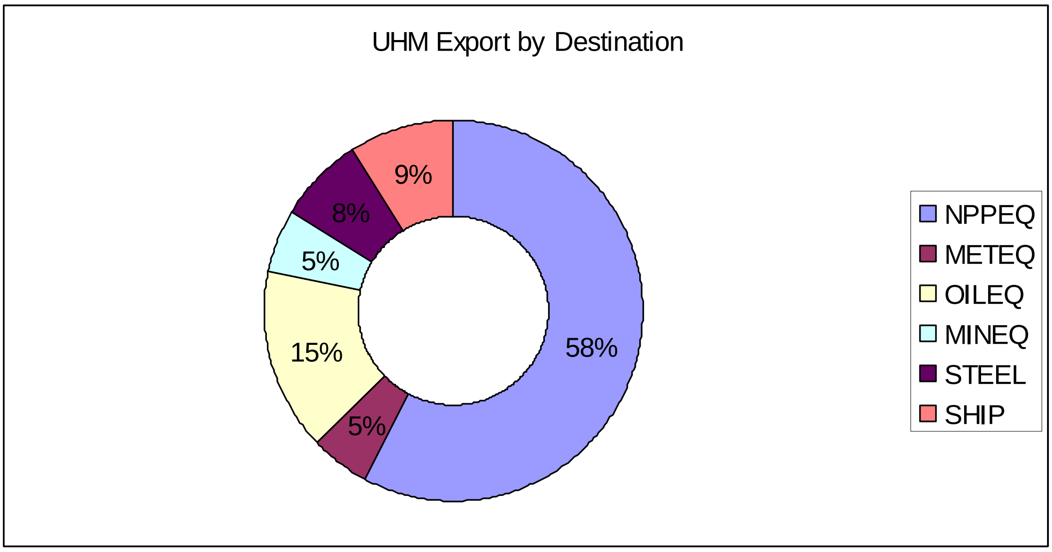


Source: UHM, excludes sales to Americas that are in 0.1% range

While UHM experienced substantial changes in revenues, profitability and sales breakdown in the past, as the company was going through expansion and consolidation of its various assets, NPPEQ is now expected to stay as UHM's leading business segment in terms of export sales, at least for the years 2002-2003.

This is largely attributed to the fact that as of December 31, 2001 UHM had significant existing long term contracts for the future production of nuclear power station equipment to be exported to China (Liang Yung Gang). In addition to that in the spring of 2002 the Company has signed a long term contract for nuclear power equipment to be provided to a project in India (the nuclear power station at Kudankulam).

UHM Export by Business Segment, Year Ending December 31, 2001



Source: UHM, see business segment codes definitions at the top of page 7

In addition to traditional long term export destinations for UHM products and services, UHM's 2002 international sales statistics is likely to present a much more diversified product and destination structure, largely thanks to international acquisitions completed by UHM in 2001 and first of half of 2002 in the US, Romania and Ukraine. This is the last UHM annual report where we would be presenting the export breakdown data, as of the year 2002 annual report UHM would shift to International Sales by Business Segment presentation to reflect the fact that UHM now has design and manufacturing facilities in four countries and some of its international (outside traditional Russian market) sales may not be export sales but domestic sales by foreign subsidiary of UHM.

UHM Acquisitions

The year 2001 and the year 2002 to date made for the most intensive period for UHM acquisition activities. In the year 2001 UHM increased its ownership interest over 50% and consolidated two major subsidiaries – Krasnoe Sormovo[1] and Burovaya Technika. The key data about those acquisitions is presented below:

<u>Acquisition cost and goodwill values are in USD thousands</u>

Name	Consolidation Date *	Business Segment and Rationale	UHM Acquisition Cost**	Resulting Goodwill Values	UHM ownership interest ***
Krasnoe Sormovo	Dec 19, 2000	SHIP; UHM's first investment in shipbuilding sector as a part of ongoing diversification strategy	7,742	(42,795)	60.74%
Burovaya Technika	Apr 17, 2001	OILEQ; vertical integration of UHM's fast growing OILEQ business segment through purchase of Russia's leading R&D and manufacturing company for oil drilling equipment	1,255	(6,747)	55.09%

* the date when UHM acquired over 50% ownership interest in the subsidiary
** acquisition cost aggregate is based on cash purchase, fair value of stock-for-stock purchase, cash purchase from related parties or any other forms of purchase as disclosed in UHM financial statements, no NPV adjustments are made (some of acquisition cost has been incurred in prior years), only purchases of stock in the subsidiary up until Consolidation Date have been included in the aggregate
*** as of December 31, 2001

UHM management believes that both acquisitions not only made perfect commercial reason by broadening the scope of UHM engineering and manufacturing capabilities, but had also been executed at perfect price allowing UHM acquiring strategic assets at deep discount which is partially illustrated by substantial negative goodwill values booked by UHM as a result of those acquisitions.

[1] Krasnoe Sormovo has been consolidated on December 19, 2000

In 2002 UHM continued to buy out minority shareholders from already consolidated subsidiaries as well as make long term equity investments in carefully selected engineering and heavy machinery manufacturing companies both in Russia and internationally, including Romania, Ukraine and the United States. Detailed information on those acquisitions and the applicable accounting / consolidation policies would appear in UHM 2002 annual report and was (is) disclosed on as-you-go basis once major investments were (are) made by UHM.

Integration and Costs Management

As UHM has been growing aggressively through acquisitions in the recent years, the company's primary focus is now shifting from extensive growth to releasing the benefits from consolidation of its various industrial assets by optimizing production processes, modernizing its asset base and increasing overall efficiency and profitability of the company.

As already discussed earlier, UHM is in process of implementing a comprehensive Corporate Restructuring Plan ("Plan") aimed to streamline UHM's organization structure, effectively integrate acquired companies and businesses and release synergies and cost savings potential built into UHM's acquisition strategy.

UHM is already a centrally managed company with all of its business development, large sales, financial management, debt & capital markets and some other essential functions consolidated in UHM Moscow based headquarters. Re-organizing UHM business around six business segments and transitioning to business and financial targets as well as cost control set around those segments is the Company's Plan top priority and should result in substantial cost savings following implementation of the Plan by mid 2003.

Once UHM's operations are structured, budgeted for and monitored around six core business segments and independent long term strategies for each business segment are developed, UHM management intends to implement a state-of-the-art Management Information System (MIS) across the company. While MIS can be fully implemented by 2006 the earliest, some of MIS essential modules including inventory management systems can be integrated at some business segments almost immediately following implementation of the Plan in 2003, delivering first material cost savings from optimizing UHM business processes starting from 2004.

In the meantime, UHM is focused on less precise but nevertheless efficient and materially significant methods of monitoring and reducing the costs across the Company. First, UHM consistently and rather successfully disposes of non-core businesses and assets. In 2001 alone UHM made US$ 2.8 M worth of such disposals, the number material enough to help to swing UHM cash flow from investment activities into positive territory.

Secondly, UHM actively invests in modernizing its asset base, improving productivity and reducing the employees in particularly labor intensive and less productive parts of the organization. UHM works closely and fairly successfully with local governments and trading unions on the programs supporting UHM layoff plans, including employee re-training initiatives.

Thirdly, UHM runs a very aggressive business integration practice removing duplicate functions and business processes in acquired companies or elsewhere within UHM immediately upon completing the acquisitions, as a rule installing centralized general management, financing, procurement, sales and business development functions to newly acquired UHM subsidiaries. UHM is actively leveraging the multi-location nature of its operations, placing certain group wide functions in relatively low cost cities such as centralizing advertising and PR group in St Petersburg, web production and business intelligence group in Ekaterinburg.

Capital Structure

UHM shareholders capital consists of 35,350,000 common shares and 2,750,000 cumulative non-voting preferred shares with the par value of 0.1 Rubles each. Preferred shares are entitled to the annual dividend of 12% of the par value. The Company's charter provides for additional 30,000,000 authorized common shares for future issuances. As of May 8, 2002, the Company had 4,568 shareholders.

54% of the total shares outstanding are in the free float which excludes about 11% of treasury shares and 35% of management owned shares.

Foreign institutional investors control 42% of the Company while management owns about 35%. Another 11% are held with the Company as Treasury Stock. Russian institutional and individual investors control 9% and 3% respectively.

As of May 2002 the following nominees were represented in the company register:

Nominee	Common shares owned	Preferred shares owned	Total shares owned
Promtorgbank*	45.26%	-	45.26%
ING Bank**	22.21%	0.93%	23.14%
Citibank	9.92%	0.59%	10.51%
Credit Suisse First Boston	6.63%	0.44%	7.07%

* Promtorgbank is the custodian for management owned shares and for treasury shares. According to Russian laws, treasury shares can not be held on the company books for more than a year, this is why UHM treasury shares are held by UHM 100% owned subsidiary OMZAR that is using Promtorgbank as the custodian.

** As of January 2001 UHM has established and maintains the Level I American Depositary Receipts (ADR) program registered with the US Securities and Exchange Commission under exemption 12g3-2(b) through The Bank of New York (BONY), ING Bank acts as BONY custodian in the UHM register. This program has been created in addition and eventually to consolidate the 144A / Regulation S facilities originally established back in 1998. The number of ADRs outstanding during the year 2001 is varying from 7 to 8 million shares (underlying stock), which represents 20-22% of the Company's total number of shares.

Corporate Structure

UHM (Open Type Joint Stock Company Obyedinneny Mashinostroitelny Zavody – Uralmash-Izhora or OAO OMZ) is a fast growing international holding registered and operating in accordance with the laws of the Russian Federation. UHM has 24 main subsidiaries divided in 3 groups: production, engineering & sales and investment & support infrastructure. Some of the subsidiaries listed below had not been yet consolidated for accounting purposes as the majority ownership in them have either been bought after December 31, 2001 or the level of ownership interest does not allow consolidation other than on equity method.

Production Subsidiaries

Subsidiary	Location	Principal Activities	UHM Ownership Interest
OAO Ural Heavy Machine-Building Plant ("Uralmash")	**Ekaterinburg**	**Production of drilling, mining and metallurgical equipment**	**69.16%**
OAO "Izhorskiye Zavody"	**St Petersburg Region**	**Production of mining equipment, equipment for nuclear power plants and specialty steels**	**75.48%**
OAO "Krasnoe Sormovo" Plant	**Nizhny Novgorod**	**Shipbuilding**	**60.74%**
OAO Welded and Machine Building Structure Plan "ZSMK"	**Ekaterinburg Region**	**Production of metallurgical and drilling equipment**	**73.62%**
OAO NPO "Burovaya Tekhnika"	**Moscow**	**Production of drilling equipment and components, R&D services for oil production companies**	**55.09%**
OAO "Pavlovsky Mashzavod"	Perm Region	Production of oil field equipment	24.98%
Upet S.A. (Romania)	Tyrgoviste, Romania	Production of mobile and offshore rigs, multipurpose metal valves	65.99%
OAO "Shipbuilding Company "Almaz"	St Petersburg Region	Shipbuilding and repair	30.18%
OAO "Zavod Nizhegorodsky Teplokhod"	Nizhny Novgorod	Production of port facilities, floating cranes and maintenance ships	45.79%
"3rd International" Shipbuilding Plant	Astrakhan	Production of oil field equipment, Shipbuilding and repair	19.30%

Subsidiaries shown in "bold" have been consolidated in UHM for accounting purposes prior to or in the 2001 financial year. The ownership percentage is as of July 1, 2002.

Engineering and Sales Subsidiaries

Subsidiary	Location	Principal Activities	UHM Ownership Interest
OAO "Central Design Office "Korall"	Sevastopol, Ukraine	Design and R&D for shipbuilding industry including drilling platforms	30.44%
OAO "Central Design Office "Lazurit"	Nizhny Novgorod	Design and R&D for shipbuilding industry, including complex underwater constructions	32.73%
OAO "Volzhsky Planning Institute "Proektverf"	Nizhny Novgorod	Design and R&D for shipbuilding yards and shipbuilding companies	54.39%
Friede Goldman Ltd.	Houston, TX, USA	Design and R&D for offshore drilling units, including submersibles, semi-submersibles and drillships	100%
OOO "United Heavy Machinery"	**Moscow**	**Sales and marketing headquarters**	**100%**
ZAO "Komplekt-Atom-Izhora"	**St Petersburg Region**	**Sales and marketing for nuclear power plants equipment, master contractor services**	**100%**

Subsidiaries shown in "bold" have been consolidated in UHM for accounting purposes prior to or in the 2001 financial year. The ownership percentage is as of July 1, 2002.

Investment and Support Infrastructure Subsidiaries

Subsidiary	Location	Principal Activities	UHM Ownership Interest
United Heavy Machinery B.V.	**Amsterdam, Netherlands**	**Investment services**	**100%**
OOO "OMZAR"	**Yerevan, Armenia**	**Investment services**	**100%**
OOO "United Accounting Company"	**Moscow**	**Accounting services**	**100%**
OOO OMZ "Structural Development"	**Ekaterinburg**	**Management of non-core businesses**	**90%**
OOO "OMZ-Center"	**Moscow**	**Real estate development**	**89.3%**
OOO "Leasing of Machinery and Equipment"	**Moscow**	**Lease of Machinery and Equipment**	**100%**
OAO "Leasing-Centre-Invest"	**Gorno-Altaysk**	**Lease of Machinery and Equipment**	**100%**
OOO "Soft System Service"	**St Petersburg**	**Software development**	**100%**

Subsidiaries shown in "bold" have been consolidated in UHM for accounting purposes prior to or in the 2001 financial year. The ownership percentage is as of July 1, 2002.

Management

UHM is governed by Annual Shareholders Meeting that elects the Board of Directors.

UHM Board of Directors is made of three representatives of the management team and four independent directors.

UHM Board of Directors

Kakha Bendoukidze, President and Chief Executive Officer

Based in Moscow, Mr. Bendoukidze graduated Tbilisi University and holds the Ph.D., Biology / Genetics from the Moscow Lomonosov University. Mr. Bendoukidze has been an entrepreneur since 1990, was actively and successfully participating in Russian privatization in 1992-1996 and has been an architect of the consolidation initiative in Russian engineering sector that resulted in creation of the UHM in 1996. Mr. Bendoukidze had been UHM's large shareholder, CEO and Board Member since UHM formation.

Rodric Braithwaite, Independent Director

Based in London, Rodric Braithwaite was formerly a member of the British Foreign Service. He served twice in Moscow: in the 1960s, and as Ambassador from 1988 to 1992. His current positions include the Chairmanship of the Moscow School of Political Studies.

Horst Wiesinger, Independent Director

Based in Linz, Austria, Dr. Wiesinger holds the Doctorate from the Leoben University and has extensive engineering industry background. Currently a Managing Director of Horst Wiesinger Consulting GmbH, in 1995-1999 Dr. Wiesinger served as President of Voest-Alpine Industrieanlagenbau, and was Deputy Chairman of VA Technologie AG in 1999-2001.

Alan Kazbekov, Chief Operating Officer

Based in Moscow and long time business partner of Mr. Bendukidze, Mr. Kazbekov is the graduate of the Moscow Institute for Railways Engineering and was actively involved in creation and evolution of the UHM since its formation. Mr. Kazbekov served as Chief Executive Officer of the Moscow based investment company Bioprocess prior to joining UHM Board of Directors in 1997 and becoming company's COO in the year 2000.

Michael Kosolapov, Chief Financial Officer

Based in Moscow, Mr. Kosolapov is the graduate of the Moscow Lomonosov University, Economics, and prior to joining UHM in 1999 as CFO and as Board Member in 2001 Mr. Kosolapov served as Chief Operating Officer of another Russian public company, OAO Vostoksibugol.

Seppo Remes, Independent Director

Based in Moscow, Mr. Remes has graduated Oulu University (Finland) and holds the Decree of Licenciate from Turku School of Economics and Business Administration (Finland). Currently Mr. Remes serves as the President of Vostok Energo Investments Ltd. and is a member of restructuring committee established to advise the Board of Directors of RAO Unified Energy System. Prior to joining UHM Board of Directors in 2002, Mr. Remes served as Chairman of the Finnish Entrepreneurs Association in Moscow and he was 9 years corporate vice president, Russian Affairs and head of Neste/Fortum office in Moscow. Mr.Seppo Remes has been the Chairman of the Board of European Business Club (EBC) in the RF for the period of five years.

Marc Winer, Independent Director

Based in London, Mr. Winer is the graduate of Indiana State University (USA) and UHM Board Member since 1997. Prior to joining UHM Board, Mr. Winer held senior executive positions in McDonalds and Coca Cola corporations, and served for eight years as General Manager of OAO Moscow-McDonalds, a subsidiary of McDonalds Corp.

Technology and R&D

UHM is committed to maintain and further expand its competitive edge in selected engineering and machine building technologies that make for the core expertise of the company.

As a part of ongoing consolidation of its various manufacturing and production subsidiaries, UHM has introduced in the late 2000 a centralized Research and Development Lab that currently employs about 3800 qualified and highly educated engineers and equipped with the state-of-the-art design and engineering technologies including licensed Unigraphics and Auto-CAD software packages.

Following 39% (in dollar terms) increase in investment in its R&D Lab in year 2001 over year 2000 and over 30% increase in investments in information technology in the same period (together UHM investments in R&D and IT exceeded USD 5M in the year 2001), UHM currently operates at best international R&D and product development standards and managed to more than halve new products design and development time, streamline the process and optimize the cost for developing engineering documentation and achieved substantial improvements in quality and competitiveness of its newly developed products / machines.

Most of UHM’s R&D resources are currently allocated to the company’s most actively growing business units, with oil drilling (OILEQ), shipping (SHIP), mining (MINEQ) and metallurgical equipment (METEQ) business units being the four largest consumers of UHM R&D budget and resources in the year 2001. In addition to R&D for those units, UHM intends to make further expansion of R&D budget to bring in new technologies for transportation and storage of nuclear waste, the sector where UHM already has certain experience and intends to develop it further into its core expertise.

Environment & Social Responsibility

As most of UHM operations are in heavy industries characterized with relatively high pollution levels and requiring substantial efforts to minimize negative impact on the environment, UHM has adopted a long term comprehensive environment policy focused on developing and implementing massive modernization programs and introducing socially responsible business practices across all of the UHM's six business units.

Shutting down the most polluting manufacturing assets and transitioning to more environment friendly production technologies is UHM's most immediate priority. In 2001 alone UHM phased out a number of such heavily polluting assets including all of the remaining martin steel furnaces in St Petersburg Region (at Izhorsky Works) and the city of Ekaterinburg (at Uralmash). Those heavily focused and very efficient policies to phase out most damaging environment wise technologies and equipment helped UHM to reduce dramatically various waste and pollution, removing out of annual production cycle 32500 tons of carboxide gas, 400 tons of dust and 108 tons of nitroxides.

Upgrading existing and investing in new waste recycling and refining facilities is another important component of UHM environment policy. UHM has a comprehensive monitoring and modernization program for recycling and refining equipment installed at its manufacturing facilities nationwide and works closely with local governments to ensure its environment policies and pollution levels are in line with sanitary and other norms established by local governments and other regulators.

UHM is an important employer in many of the cities where its manufacturing facilities are based and substantial contributor to local tax budgets. While UHM is committed to constant improvements in its efficiency and profitability, the company is working in close contact with local governments, trade unions, environment organizations and NGOs to ensure that such UHM policies as increase of productivity (leading to substantial employee layoffs) and expansion of manufacturing capacity are balanced out with comprehensive environmental policies and support of local governments' sponsored employee retraining initiatives.

Report of Independent Auditors

The Board of Directors
OAO United Heavy Machinery (Uralmash-Izhora Group)

We have audited the accompanying consolidated balance sheets of OAO United Heavy Machinery (Uralmash-Izhora Group) and subsidiaries (collectively referred to as the "Company") as of December 31, 2001 and 2000 and the related consolidated statements of income, changes in shareholders' deficiency, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of OAO United Heavy Machinery (Uralmash-Izhora Group) and subsidiaries as of December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ ERNST & YOUNG (CIS) LIMITED
Moscow, Russia

June 14, 2002,
except for Note 2, as to which the date is
August 23, 2002

Consolidated Balance Sheets

(In thousands of US dollars)

	December 31, 2001	December 31, 2000
Assets		
Current assets:		
Cash and cash equivalents	**$ 15,267**	$ 9,324
Short-term investments *(Note 5)*	**22,374**	53,366
Trade accounts receivable, net *(Note 6)*	**50,563**	36,012
Due from related parties *(Note 7)*	**12,554**	13,361
Inventories, net *(Note 8)*	**184,214**	133,922
Taxes receivable *(Note 3)*	**21,474**	19,504
Prepaid expenses and advances to suppliers	**22,737**	29,843
Deferred taxes *(Note 12)*	**3,393**	–
Other current assets	**4,569**	6,481
Total current assets	**337,145**	301,813
Plant and equipment, net *(Note 9)*	**178,001**	176,947
Long-term investments, net *(Note 10)*	**11,516**	8,488
Due from related parties, long-term *(Note 7)*	**7,301**	18,458
Total assets	**$ 533,963**	$ 505,706
Liabilities and Shareholders' Deficiency		
Current liabilities:		
Trade accounts payable and accruals	**$ 35,174**	$ 44,484
Advances received and deferred revenues *(Note 11)*	**183,084**	180,827
Taxes payable *(Note 13)*	**47,290**	79,050
Payroll and related obligations	**5,717**	4,291
Due to related parties *(Note 7)*	**7,497**	13,149
Deferred taxes *(Note 12)*	**343**	2,938
Short-term borrowings *(Note 14)*	**31,983**	11,918
Current portion of long-term accounts payable and long-term debt *(Notes 16 and 17)*	**4,526**	4,586
Other payables	**8,235**	5,217
Total current liabilities	**323,849**	346,460
Non-convertible bonds *(Note 15)*	**24,856**	–
Long-term debt *(Note 17)*	**2,458**	1,407
Trade accounts payable, long-term *(Note 16)*	**2,498**	3,555
Taxes payable, long-term *(Note 13)*	**49,732**	24,968
Deferred taxes, non-current *(Note 12)*	**431**	395
Total liabilities	**403,824**	376,785
Minority interest *(Notes 3 and 18)*	**201,700**	207,066
Shareholders' deficiency *(Note 19)*:		
Common stock (0.1 ruble par value per share), 65,350,000 shares authorized and 35,350,000 shares issued as of December 31, 2001 and 2000; 31,375,282 and 35,350,000 shares outstanding as of December 31, 2001 and 2000, respectively	**582**	582
Cumulative preferred stock (0.1 ruble par value per share), 2,750,000 shares authorized, issued and outstanding as of December 31, 2001 and 2000	**48**	48
Additional paid-in capital	**75,644**	73,844
Treasury stock, 3,974,718 shares of common stock as of December 31, 2001 (nil as of December 31, 2000)	**(13)**	–
Accumulated deficit	**(146,609)**	(152,619)
Accumulated other comprehensive loss	**(1,213)**	–
Total shareholders' deficiency	**(71,561)**	(78,145)
Total liabilities and shareholders' deficiency	**$ 533,963**	$ 505,706

See Report of Independent Auditors and accompanying notes.

Consolidated Statements of Income

(In thousands of US dollars, except for per share data)

	Year ended December 31, 2001	2000
Sales	**$ 313,116**	$ 241,024
Cost of sales	**249,889**	221,042
Gross margin	**63,227**	19,982
Selling, general and administrative expenses	**64,101**	45,906
(Release from) provision for doubtful accounts receivable	**(3,097)**	3,234
(Release from) provision for obsolete inventory	**(975)**	11
Provision for obsolete equipment under construction	**2,284**	2,615
Income (loss) from operations	**914**	(31,784)
Other income (expense)		
Interest income	**3,084**	1,428
Interest expense	**(8,308)**	(1,339)
Investment income *(Note 3)*	**5,236**	–
Investment loss *(Note 3)*	**(4,447)**	(1,834)
Gain on sale of non-core business units *(Note 20)*	**4,539**	14,656
Gain on release from tax penalties *(Note 21)*	**4,313**	14,952
Provision for tax penalties *(Note 22)*	**(11,235)**	(7,999)
Other non-operating gains	**2,887**	2,677
Foreign exchange gain *(Note 3)*	**8,431**	14,343
Income before income taxes and minority interest	**5,414**	5,100
Income tax expense *(Note 12)*	**(1,374)**	(3,527)
Income before minority interest	**4,040**	1,573
Minority interest in net losses (income) of subsidiaries	**1,970**	(1,234)
Net income	**$ 6,010**	$ 339
Other comprehensive loss, net of income tax		
Unrealized holding losses from available for sale securities *(Note 5)*	**(1,213)**	–
Comprehensive income	**$ 4,797**	**$** 339
Basic and diluted net income per share	**$ 0.17**	$ 0.01
Basic and diluted comprehensive income per share	**$ 0.14**	$ 0.01
Average shares of common stock outstanding	**35,184,387**	35,350,000

See Report of Independent Auditors and accompanying notes.

OAO United Heavy Machinery (Uralmash-Izhora Group)

Consolidated Statements of Changes in Shareholders' Deficiency

(In thousands of US dollars, except for share data)

	Common stock		Cumulative preferred stock		Additional paid-in-capital			Treasury common stock				
	Shares	Amount	Shares	Amount	Common and preferred stock	Treasury Stock	Total	Shares	Amount	Accumulated deficit	Accumulated other comprehensive loss	Total
Balances as of January 1, 2000	35,350,000	$ 582	2,750,000	$ 48	$73,844	$ –	$ 73,844	–	$ –	$ (152,958)	$ –	$ (78,484)
Net income	–	–	–	–	–	–	–	–	–	339	–	339
Balances as of December 31, 2000	35,350,000	$ 582	2,750,000	$ 48	$73,844	$ –	$ 73,844	–	$ –	$ (152,619)	$ –	$ (78,145)
Purchase of treasury stock from related parties	–	–	–	–	–	–	–	(4,424,718)	(14)	–	–	(14)
Treasury stock issued to management	–	–	–	–	–	1,800	1,800	450,000	1	–	–	1,801
Unrealized holding losses from available for sale securities	–	–	–	–	–	–	–	–	–	–	(1,213)	(1,213)
Net income	–	–	–	–	–	–	–	–	–	6,010	–	6,010
Balances as of December 31, 2001	**35,350,000**	**$ 582**	**2,750,000**	**$ 48**	**$73,844**	**$ 1,800**	**$ 75,644**	**(3,974,718)**	**$ (13)**	**$ (146,609)**	**$ (1,213)**	**$ (71,561)**

See Report of Independent Auditors and accompanying notes.

OAO United Heavy Machinery (Uralmash-Izhora Group)

Consolidated Statements of Cash Flows

(In thousands of US dollars)

	Year ended December 31, 2001	2000
Net income	**$ 6,010**	$ 339
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation of plant and equipment	**22,105**	20,602
Foreign exchange gain	**(8,431)**	(14,343)
Deferred tax (benefit) expense	**(5,952)**	1,390
(Release from) provision for doubtful accounts receivable	**(3,097)**	3,234
(Release from) provision for obsolete inventory	**(975)**	11
Provision for obsolete equipment under construction	**2,284**	2,615
Investment income	**–**	(1,131)
Investment loss	**4,447**	1,834
Minority interest	**(1,970)**	1,234
Gain on sale of non-core business units	**(4,539)**	(14,656)
Gain on release from tax penalties	**(4,313)**	(14,952)
Provision for tax penalties	**11,235**	7,999
Management compensation in non-cash form	**1,800**	–
Loss (gain) on sale of short-term investments and other assets	**966**	(4,713)
Net change before change in working capital	**19,570**	(10,537)
Changes in assets and liabilities, net of effects from purchase of Burovaya Tekhnika in 2001 and Krasnoe Sormovo in 2000:		
Trade accounts receivable	**(14,226)**	(9,561)
Inventories	**(47,260)**	(37,189)
Taxes receivable	**(2,466)**	(3,387)
Prepaid expenses and advances to suppliers	**5,293**	(11,222)
Other current assets	**1,487**	(2,823)
Trade accounts payable and accruals	**16**	8,310
Deferred revenues	**3,937**	60,964
Payroll and related obligations	**1,193**	10,599
Taxes payable	**(10,201)**	10,685
Amounts due to and from related parties	**(4,845)**	13,242
Other payables	**3,109**	(1,261)
Net cash (used in) provided by operating activities	**$ (44,393)**	$ 27,820

OAO United Heavy Machinery (Uralmash-Izhora Group)

Consolidated Statements of Cash Flows (continued)

(In thousands of US dollars)

	Year ended December 31, 2001	2000
Cash Flows from Investing Activities		
Acquisition of Burovaya Tekhnika *(Note 4)*	**$ 799**	$ –
Acquisition of (additional interest in) Krasnoe Sormovo *(Note 4)*	**(2,178)**	(1,211)
Acquisition of additional interest in Izhorskiye Zavody *(Note 4)*	**(1,318)**	–
Net purchases of short-term investments	**26,146**	(16,314)
Purchases of plant and equipment	**(30,417)**	(9,933)
Proceeds from sale of non-core business units	**2,818**	19,930
Proceeds from sale of other assets	**1,742**	1,123
Purchase of long-term investments	**(6,520)**	(11,517)
Proceeds from long-term investments	–	1,043
Repayments of (loans) issued to related parties, net	**9,041**	(19,818)
Net cash provided by (used in) investing activities	**113**	(36,697)
Cash Flows from Financing Activities		
Net proceeds from loans and borrowings	**22,623**	17,917
Proceeds from issuance of non-convertible bonds	**36,036**	–
Repurchases of non-convertible bonds	**(7,898)**	–
Purchase of treasury stock	**(14)**	–
Sale of treasury stock	**1**	–
Dividends paid by subsidiaries	**(160)**	(2)
Net cash provided by financing activities	**50,588**	17,915
Effect of exchange rate changes on cash and cash equivalents	**(365)**	(148)
Net increase in cash and cash equivalents	**5,943**	8,890
Cash and cash equivalents at beginning of year	**9,324**	434
Cash and cash equivalents at end of year	**$ 15,267**	$ 9,324

Supplementary cash flow information:		
Interest paid	**$ 2,573**	$ 14
Income taxes paid	**5,212**	1,698
Supplementary disclosure of non-cash activities:		
Treasury stock issued to management	**$ 1,800**	$ –
Proceeds from sale of non-core business units received in the form of the Company's non-convertible bonds	**3,282**	–

See Report of Independent Auditors and accompanying notes.

1. Description of Business

Open Joint Stock Company ("OAO") OAO United Heavy Machinery (Uralmash-Izhora Group) (the "Holding"), formerly OAO Uralmash-Zavody, is incorporated in Ekaterinburg, in the Sverdlovsk Region of the Russian Federation, and is a holding company with significant investments in five entities: OAO Ural Heavy Machine-Building Plant ("Uralmash"), a manufacturer of heavy machinery, including mills and mill equipment, on-shore and off-shore drilling equipment, quarry shovels, hot and cold rolling equipment and continuous casting units; OAO Izhorskiye Zavody ("Izhorskiye Zavody"), a manufacturer of heavy engineering machine-building and metallurgical products, equipment for nuclear power plants and mining equipment; OAO Welded and Machine-Building Structure Plant ("ZSMK"), a manufacturer of electrical line pilings, drilling equipment, and custom metal construction; OAO Krasnoe Sormovo Plant ("Krasnoe Sormovo"), a manufacturer of sea-river tankers and dry-cargo vessels for shipping companies and circulation systems for oil rigs, and OAO NPO Burovaya Tekhnika ("Burovaya Tekhnika"), a manufacturer of drilling equipment. The consolidated financial statements include the accounts of the Holding, Uralmash, Izhorskiye Zavody, ZSMK, Krasnoe Sormovo, Burovaya Tekhnika and certain other minor entities (collectively referred to as "the Company").

The Company organizes its business along six major business lines: drilling equipment (oil and gas rigs), equipment for nuclear power plants, metallurgical equipment, mining equipment, shipbuilding and specialty steels.

The Holding exercises operating and strategic control over its production subsidiaries. The Holding was incorporated in 1996 and in 1997 acquired its ownership shares in Uralmash and ZSMK through stock swaps with the previous shareholders.

Formed in 1933, Uralmash, a Russian legal entity incorporated in Ekaterinburg, was instrumental in the industrialization of the Soviet Union, particularly in the mining and metallurgical industries. During World War II, Uralmash changed its focus to the manufacturing of military tanks and fighter planes, converting back to the production of heavy machinery following the war. In December 1992, Uralmash was registered as an open joint stock company in accordance with the laws of the Russian Federation, allowing the public trade of Uralmash shares. At December 31, 2001, the Holding held 69.16% of the outstanding stock of Uralmash.

Founded in 1722, Izhorskiye Zavody, a Russian legal entity incorporated in St. Petersburg, is one of the oldest plants in Russia. Izhorskiye Zavody was formerly a state owned production association. In 1992, Izhorskiye Zavody was re-organized into an open joint stock company. In 1998, the Holding acquired 46.53% of the Izhorskiye Zavody shares for cash and issuance of shares. Further in 1999, the Holding acquired additional 20.65% of interest in Izhorskiye Zavody for cash. At December 31, 2001, the Holding held 75.48% of the outstanding stock of Izhorskiye Zavody.

1. Description of Business (continued)

ZSMK, a Russian legal entity incorporated in the Sverdlovsk region, was founded in 1980 and was formerly a state owned production association. Subsequently ZSMK was re-organized into open joint stock company. At December 31, 2001, the Holding held 73.62% of the outstanding stock of ZSMK.

Krasnoe Sormovo, a Russian legal entity incorporated in Nizhniy Novgorod, was founded in 1849 and was formerly a state owned production association specializing in the manufacture of military vessels and submarines. In 1994, Krasnoe Sormovo was re-organized into an open joint stock company and switched its facilities to the manufacture of the non-military fleet. In 1998 the Holding acquired 18.68% of the Krasnoe Sormovo shares for cash. Further in 2000 the Holding acquired additional 31.32% of the shares in Krasnoe Sormovo for cash and through the exchange of other assets. In 2001 the share was increased by 10.73% (Note 4).

Burovaya Tekhnika, a Russian legal entity incorporated in Moscow and having subsidiaries in Volgograd, Lubertsy and Perm, was founded in 1953. Besides manufacturing drilling equipment, Burovaya Tekhnika currently carries out research and development for the oil drilling industry and provides drilling services to oil companies. In the course of 1997-2001, the Holding acquired 55.09% of the Burovaya Tekhnika share capital.

The Company is making ongoing efforts to expand its market presence and modernize its facilities through a series of acquisitions with Russian and foreign entities in similar industries and joint ventures with western counterparts (Note 4).

The Company is one the biggest manufacturers of heavy engineering products in Russia. The Company's main customers are Russia's largest oil and gas companies and metallurgical plants. Approximately 27% and 20% of its revenues for the years ended December 31, 2001 and 2000, respectively, came from export sales, mostly sales of nuclear power plant equipment to Asia-based nuclear power stations and sales of mining equipment to customers in the Commonwealth of Independent States. During 2000 and 2001, the Company expanded its customer base in the Asia region (China, Iran, Mongolia).

2. Financial Position

As of December 31, 2001, the Company's consolidated balance sheet reflected an accumulated deficit of $146,609. This accumulated deficit is the result of losses from operations over the last several years, including substantial impairment charges to property plant and equipment in 1999. Although its profitability has improved during 2001, the Company had negative cash flows from operating activities of $44,393 during the year ended December 31, 2001. The nature of the Company's growing business, combined with the long-term nature of its production cycle, requires the Company to continue to invest cash in inventory prior to receiving cash from its customers. While management continues to implement actions to minimize this cash flow cycle, it expects that the trend for negative cash flow from operations will continue in the near future. In addition, management expects to continue to make significant investments into new businesses and existing plant and equipment.

2. Financial Position (continued)

These factors could raise doubt as to the Company's ability to continue its operations as a going concern. The accompanying consolidated balance sheets do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

Management of the Company believes that the Company has sufficient financial resources to maintain current operations. Management also believes that the current market situation in Russia and projected future business development of the Company will allow management to improve the financial position and cash flow from operations of the Company. Specifically, the Company's plans and actions include the following:

- As of December 31, 2001, the Company has significant existing long-term contracts for the future production of nuclear power station equipment to be exported to China and Iran. Subsequent to December 31, 2001 the Company has executed a long-term contract for nuclear power equipment to be provided to a project in India.
- As of December 31, 2001, the Company has significant existing contracts for the production of drilling equipment and long-term contracts for the production of continuous casting units. In addition to these individually significant contracts, subsequent to December 31, 2001, the Company has continued to experience continued growth in demand for its products, resulting in a significant future production portfolio, many of which extend for several years.
- Over the past year the Company has successfully worked with creditors to secure necessary financing for the long-term contracts in process and for other investing needs. Based on the terms of existing contracts as well as its recent experience, management of the Company expects to be able to continue to secure necessary short-term and long-term financing for its operational and investing cash flow requirements.
- During 2001, Management has continued to restructure its operations to increase its efficiency and reduce costs. Management has also, over the past several years, implemented a program to divest of non-core businesses and increase its business in core, higher margin business lines. Management expects these actions to continue to improve its profitability and results of operations.

Management believes that the indicators that raise doubt about the Company's ability to continue as a going concern are substantially mitigated by the above factors, as well as its overall evaluation of its business environment. As a result, the consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern which assumes that the Company will continue operations in the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations.

3. Significant Accounting Policies

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below.

Basis of consolidation and presentation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("US GAAP").
Significant intercompany balances and transactions have been eliminated in the consolidation. The following subsidiaries have been included in the Company's consolidated financial statements as of December 31, 2001:

Name	Principal activities	Country of incorporation	Stake held by the Holding or its subsidiaries
OAO Ural Heavy Machine-Building Plant ("Uralmash")	Production of drilling, mining and metallurgical equipment	Russia	69.16%
OAO Izhorskiye Zavody ("Izhorskiye Zavody")	Production of mining equipment, equipment for nuclear power plants and specialty steels	Russia	75.48%
OAO Welded and Machine-Building Structure Plant ("ZSMK")	Production of metallurgical and drilling equipment	Russia	73.62%
OAO Krasnoe Sormovo Plant"("Krasnoe Sormovo")	Shipbuilding	Russia	60.74%
OAO NPO Burovaya Tekhnika ("Burovaya Tekhnika")	Production of drilling equipment and research and development for oil companies	Russia	55.09%
ZAO Uralmash-Tovary	Production of consumer goods	Russia	100% owned by Uralmash
ZAO UMZ-Engineering	Engineering services and sales of products manufactured by Uralmash	Russia	100%
ZAO UMZ-Trading Company	Sales of products manufactured by Uralmash	Russia	100%
ZAO Uralmash-Service	Engineering services and sales of products manufactured by Uralmash	Russia	100%
OOO Leasing of Machinery and Equipment	Lease of machinery and equipment	Russia	100%
OAO Leasing-center-invest	Lease of machinery and equipment to Uralmash and related parties	Russia	100%
ZAO Trading Company – Izhorskiye Zavody ("ZAO TK Izhorskiye Zavody")	Sales of products manufactured by Izhorskiye Zavody and purchases of supplies for Izhorskiye Zavody	Russia	100%
ZAO KomplektAtomIzhora	Engineering and installation services	Russia	100%
OOO United Heavy Machinery	Engineering, marketing and sales of metallurgical, nuclear power plant and mining equipment, and steels.	Russia	100%
OOO OMZAR	Investing activities	Armenia	100%
United Heavy B.V.	Investing activities	The Netherlands	100%
OOO SoftSystemService	Software development	Russia	100%
OOO OMZ-Structure Development	Managing of non-profile business	Russia	90%
OOO Machinery-Building Plants Support Company	Procurement of raw materials and spare parts to main production units	Russia	100%
OOO Autocomplect	Production of mufflers	Russia	100%
OOO Firm Izoterm	Production of converters	Russia	100%

3. Significant Accounting Policies (continued)

Basis of consolidation and presentation (continued)

For majority-owned subsidiaries that incur losses, it is the Company's policy to recognize 100% of the losses, after first reducing the related minority interests' balances to zero. Further, when a majority-owned subsidiary becomes profitable, the Company will recognize 100% of profits until such time as the excess losses previously recorded have been recovered. Thereafter, the Company will recognize profits in accordance with the underlying ownership percentage.

Although the significant subsidiaries have control over other companies, the investment in those other companies have been carried at the lower of cost or market value, due to their insignificant net assets and earnings. The inclusion of the results and net assets of these companies would be immaterial to the Company.

The Holding and its subsidiaries maintain their accounting records and prepare their financial statements in Russian rubles in accordance with the requirements of Russian accounting and tax legislation. The financial statements used in preparing the accompanying consolidated financial statements differ from the financial statements issued for statutory purposes in Russia in that they reflect certain adjustments, not recorded in the respective accounting books, which are appropriate to present the financial position, results of operations, and cash flows in accordance with US GAAP.

The principal adjustments are related to the reserve for doubtful debts and inventory obsolescence, timing of revenue and expense recognition, deferred income taxes, foreign currency translation, depreciation and valuation of fixed assets, purchase accounting, impairment of assets, and elimination of intercompany balances and transactions.

Foreign Currency Translation

The accompanying financial statements have been prepared in US dollars. Transactions and balances not already measured in US dollars (primarily Russian rubles) have been remeasured into US dollars in accordance with the relevant provisions of US Financial Accounting Standard ("FAS") No. 52, "Foreign Currency Translation", as applied to entities in highly inflationary economies.

Under FAS No. 52, revenues, costs, capital, and non-monetary assets and liabilities are translated at historical exchange rates prevailing on the transaction dates. Monetary assets and liabilities are translated at exchange rates prevailing on the balance sheet date. Exchange or translation gains and losses arising from remeasurement of monetary assets and liabilities that are not denominated in US dollars are credited or charged to non-operating expenses. The foreign exchange gain arising in 2001 of $8,431 (2000 - $14,343) resulted from the fact that the Company was in a net monetary ruble liability position during the course of the year, and the ruble devalued in both years.

3. Significant Accounting Policies (continued)

Foreign Currency Translation (continued)

The Russian ruble is not a convertible currency outside the territory of Russia. Official exchange rates are determined daily by the Central Bank of Russia ("CBR") and are generally considered to be a reasonable approximation of market rates. The translation of ruble-denominated assets and liabilities into US dollars for the purpose of these financial statements does not indicate that the Company could realize or settle in US dollars the reported values of the assets and liabilities. Likewise, it does not indicate that the Company could return or distribute the reported US dollar values of capital and retained earnings to its shareholders.

The official exchange rates as of December 31, 2001 and 2000 for one US dollar were 30.14 rubles and 28.16 rubles, respectively.

Use of Estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents includes cash on hand and deposits held on call with domestic banks with maturity less than three months. Included in cash and cash equivalents as of December 31, 2001 and 2000 are several bank accounts opened with ZAO Promtorgbank ("Promtorgbank"), a related party, in the total amount of $10,576 and $3,813, respectively.

Trade Receivables

Trade receivables are stated net of an allowance for accounts identified as doubtful.

Inventories

Inventories are stated at the lower of cost or net realizable value. Cost is determined using the first-in first-out (FIFO) method. A reserve for obsolete inventory is created for inventory which management believes may not be fully recoverable.

Short-Term Investments

The Company accounts for investments in accordance with FAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". The Company determines the appropriate classification of investments at the time of purchase and re-evaluates such designation as of each balance sheet date.

3. Significant Accounting Policies (continued)

Short-Term Investments (continued)

Short-term investments include certain Russian government securities, bank promissory notes, commercial promissory notes, and bank deposits which were acquired for short-term purposes, and are stated at fair value. Certain Russian government and corporate securities that have an established market are stated at their quoted market value and classified as available for sale. Accordingly, net realized gains and losses are included in investment income or loss, while net unrealized gains and losses are included in other comprehensive income. Changes in the fair value of short-term investments other than marketable securities are recognized as income or expense.

Long-Term Investments

Long-term investments consist of equity securities, which do not have an established market, and are carried at cost. The carrying amount of long-term investments is reduced to recognize a decline other than temporary in the value of the investments, if necessary.

Taxes Receivables

Taxes receivable are represented predominantly by the input Value-Added Tax ("VAT"), which is offsetable against future VAT charged on the Company's sales.

Plant and Equipment

As of the acquisition date (mid-1997), Uralmash plant and equipment was stated at its fair value being depreciated replacement cost, which was determined by independent appraisal as of December 31, 1995 (as adjusted for additions and disposals through the acquisition date). Subsequent to the initial recognition, the Company allocated the amounts of negative goodwill of $395,333 and $21,878 resulting from the acquisitions of shares in Uralmash in 1997 and 1998, respectively, against the values of Uralmash plant and equipment acquired.

Since the acquisition date (September 1, 1999), Izhorskiye Zavody plant and equipment was stated at depreciated replacement cost ($357,260) determined by independent appraisal as of December 31, 1999, reduced by the amount of impairment loss of $310,355 (Notes 4 and 9). An additional impairment loss of $1,015 was recognized during the year ended December 31, 1999.

ZSMK plant and equipment is stated at historical cost. Subsequent to the initial recognition, the Company allocated the negative goodwill of $45,468 and $2,271 resulting from the acquisitions of shares in ZSMK in 1997 and 1998, respectively, against the values of its plant and equipment.

3. Significant Accounting Policies (continued)

Plant and Equipment (continued)

Krasnoe Sormovo plant and equipment is stated at historical cost. Subsequent to the initial recognition, the Company allocated the negative goodwill of $36,372 and $6,423 resulting from the acquisitions of Krasnoe Sormovo shares during 2000 and 2001, respectively, against the values of its plant and equipment (Notes 4).

Plant and equipment of Burovaya Tekhnika is stated at historical cost. Subsequent to the initial recognition, the Company allocated the negative goodwill of $6,747 resulting from the acquisitions of Burovaya Tekhnika shares during 2001 against the values of its plant and equipment.

As of December 31, 2001, there was no information available on the market value of the Company's plant and equipment because of its specialized nature and age, and because such items are rarely sold. As of that date, there was no information available that indicated the carrying value of the Company's plant and equipment was impaired.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, as follows:

Buildings	30 years
Machinery and equipment	15 years
Vehicles	3 years
Furniture and fixtures	3 years

Maintenance costs relating to items of plant and equipment are expensed as incurred.

Negative Goodwill Arising on Acquisitions

When the cost of acquisition is less than the Company's interest in the fair values of identifiable assets assumed and liabilities acquired as at the date of the exchange transaction, the fair values of the non-current assets (specifically, plant and equipment) acquired are reduced proportionally until the excess is eliminated.

3. Significant Accounting Policies (continued)

Impairment of Long-Lived Assets

The Company follows the provisions of FAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", which requires that plant and equipment held and used by the Company and goodwill be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Such events may include economic crises, drastic devaluations of the Russian ruble, significant changes in prices for similar equipment and other conditions. Impairment loss is recognized if the sum of the estimated undiscounted future cash flows expected to result from use of the long-lived assets and their ultimate disposition, at the subsidiary level, is less than the carrying value of such assets. Once impairment loss is expected, it is measured as the amount by which the carrying amount of plant and equipment exceeds the estimated future cash flows discounted at the asset-specific rate of return expected from the companies operating in the Russian market. As of December 31, 2001, there was no information available that indicated that the Company's plant and equipment was impaired below its carrying value.

When the plant and equipment of subsidiaries acquired in a business combination accounted for using the purchase method is being tested for recoverability, the goodwill that arose in that transaction is included as part of the plant and equipment in determining recoverability. In instances where goodwill is identified with plant and equipment that are subject to an impairment loss, the carrying amount of goodwill is eliminated before making any reduction of the carrying amounts of impaired long-lived assets.

Pension Funds

The Company contributes to the Russian Federation state pension fund, social insurance, medical insurance fund, and employment fund on behalf of its employees. The Company's contributions amount to approximately 35.6% and 38.5% during the years ended December 31, 2001 and 2000 of the portion of employees' compensation reported for the statutory purposes as salaries and are expensed as incurred. Total amounts expensed in connection with contributions to the above funds for the years ended December 31, 2001 and 2000 were $19,900 and $16,114, respectively. In 2001, the Company also made contributions to named funds in respect to restructured overdue liabilities (Note 13).

The Company has no other program or obligation for payment of post retirement benefits to its employees.

Minority Interest

Minority interest represents interests of third parties in the net assets of the Company's subsidiaries.

Treasury Stock

Treasury stock is accounted for under the cost method, whereby a gain or loss is determined when the treasury stock is reissued or retired.

3. Significant Accounting Policies (continued)

Revenue Recognition

Sales of Routinely Manufactured Equipment and Standard Services

The Company generates its revenue from the sales of goods to third party customers and the development of certain engineering documentation. For sales of goods produced in a standard manufacturing operation, even if produced to buyers' specification, and standard services, revenue is recognized, net of value added tax ("VAT"), in the period in which the goods are dispatched from the plant or the services are provided, and invoices are raised both for cash and for non-monetary transactions. In cases where a contract covers several homogenous or various routinely manufactured products, sales are recognized under the unit-of-delivery method. Such sales cover the majority of contracts for the manufacturing and supply of drilling equipment, equipment for nuclear power plants, metallurgical equipment, mining equipment, and specialty steels, except for those specifically referred to below.

Payments and goods received in the exchange for future shipments are recorded as deferred revenue. Costs of supplied equipment that do not meet the criteria to be recorded as sales under the unit-of-delivery method are recorded as deferred costs. Taxes on operating revenues were charged to general and administrative expenses at the rates of 1% and 4% over the years ended December 31, 2001 and 2000.

In September 1999, the Security and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition" ("SAB No. 101"), which allows public companies to recognize revenue only if the following four criteria have been met: (1) there is persuasive evidence of an arrangement; (2) delivery has occurred or services have been rendered; (3) the seller's price is fixed or determinable; (4) collectibility is reasonably assured. The Company adopted SAB No. 101 effective January 1, 2000. The adoption of SAB No. 101 did not have a material effect on the Company's financial position or results of operation.

Multiple-Element Revenue Arrangements

If a contract is segregated in a number of discreet stages and if the title to equipment or service passes to the customer upon the completion of a certain stage, revenue is recognized after each stage provided (a) the goods are dispatched from the plant or the services are provided, and (b) invoices are raised. The Company recognizes revenue upon the acceptance of such stages ("elements") following the requirements of the FASB's Emerging Issues Task Force ("EITF") consensus on Issue No. 00-21, "Accounting for Multiple-Element Revenue Arrangements". Fair value allocated to each element of a multiple-element arrangement, which includes various products and/or services, approximates the values stated in the long-term contracts with buyers.

Construction-Type Contracts

Construction-type contracts generally include long-term contracts to manufacture design-build equipment, including continuous casting machines, nuclear power plant equipment, ships, and vessels.

3. Significant Accounting Policies (continued)

Revenue Recognition (continued)

Construction-Type Contracts (continued)

A single contract or a group of contracts that otherwise meet the test for combining under Statement of Position No. 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" ("SOP No. 81-1"), may include several elements or phases, each of which the contractor negotiated separately with the same customer and agreed to perform without regard to the performance of others. The Company recognizes revenue upon the completion of each element or phase only if it meets all of the criteria of SOP No. 81-1, including, but not limited to, the following: (i) the terms and scope of the contract or project clearly call for separable phases or elements; (ii) the separable phases or elements of the project are often bid or negotiated separately; (iii) the Company has a significant history of providing similar services to other customers, and the similarity of such services and prices to other customers are verifiable; (iv) the excess of the sum of the prices of the separate elements over the price of the total project is clearly attributable to cost savings incident to the combined performance of the contract obligation.

Sales of continuous casting machines, ships and vessels are accounted for under the completed contract method or unit-of-delivery method, if several homogenous units are covered by the same agreement.

Sales under the construction-type contracts for nuclear power plant equipment are accounted for under the percentage-of-completion method on a pro rata basis of cost of equipment supplied to customer to total estimated contract costs. If the estimates of total contract costs can be made in ranges most likely to occur, those amounts should be used. If the Company cannot determine "most likely" amounts, it uses the lowest probable level of profit in the range until it can estimate more precise results. Billings made by the Company in excess of revenues recognized under the percentage-of-completion method are deferred and recorded in trade accounts receivable and deferred revenues.

Expense Recognition

Expenses are recognized in the period in which they are incurred. Expenses related to future periods are recognized as deferred expenses.

Compensated Absences

The costs related to compensated absences cannot be reasonably estimated and are expensed as incurred.

Advertising Costs

Advertising costs are expensed as incurred. These costs totaled $518 and $494 for the years ended December 31, 2001 and 2000, respectively.

3. Significant Accounting Policies (continued)

Research and Development Costs

Research and development costs are expensed as incurred. These costs totaled $1,189 and $853 for the years ended December 31, 2001 and 2000, respectively.

Investment Income

Investment income represents gains realized by the Company on transactions with government and corporate securities, bank notes and commercial promissory notes that are routinely acquired for short or medium-term purposes and generate income in the form of interest, coupons or excess of sales prices over the original purchase prices. In addition, included in investment income are net gains resulting from the repurchase of the Company's own promissory notes at a discount.

Capital Investment Tax Deductions

Russian tax legislation allows for certain additional tax deductions related to new capital investments. These deductions are accounted for as a reduction of current taxable income in the year in which the deduction arises.

Non-Monetary Transactions

As with most companies operating in Russia, a significant portion of the Company's business is conducted via non-monetary transactions related primarily to the Company's purchases of inventory and property and equipment in exchange for its products. Typically, these transactions are accounted for at the normal, open-market selling prices of the items transferred, which may include bills of exchange issued by banks and the companies. The Company has recently undertaken significant efforts to reduce, or minimize, the volume of such transactions.

Concentration of Credit Risk

Financial instruments which potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term and long-term investments, trade accounts receivable and other receivables. The Company limits its credit risk arising from its accounts receivable through the use of non-monetary transactions as a settlement of such accounts. Although the Company normally does not require collateral, it usually obtains advances from customers before launching significant or long-term contracts. E.g., for a $42,000 contract with OAO Magnitogorsk Iron Works to supply continuous casting units, the Company obtained the guarantee of the customer's bank as well as a collateral in the form of the customer's promissory notes. Under one of the long-term contracts for construction of two reactors at the Liang Yung Gang nuclear power station, the Company obtained a $24,000 advance payment (Note 11).

The Company deposits available cash with several non-state owned Russian banks, including Promtorgbank, a related party. The Company also maintains short-term bank deposits and keeps short-term Russian bank promissory notes. Management regularly monitors the financial status of the banks where deposits are maintained.

3. Significant Accounting Policies (continued)

Concentration of Credit Risk (continued)

The Company also has corporate promissory notes, classified as short-term investments, issued mostly by regular customers having a good credit history, or related parties, for which the collectibility is reasonably assured.

The Company's production revenue for the year ended December 31, 2001 was split as follows: specialty steels – 20% (2000 - 32%), metallurgical equipment – 15% (2000 - 24%), mining equipment – 12% (2000 - 19%), drilling equipment – 18% (2000 - 12%), nuclear power plant equipment – 19% (2000 - 13%), shipbuilding - 5% (2000 – 0%) and other 11% (2000 – 0%).

Fair Value of Financial Instruments

The fair value of financial instruments, consisting of cash, short-term investments, accounts receivable and payable, non-convertible bonds, and debt instruments approximates their carrying values.

Related Party Transactions

The Holding and its subsidiaries, as part of their normal business, entered into a number of transactions with related parties, which form part of the unconsolidated group controlled by the same individual and corporate investors and directors. Such transactions related mainly to the short-term financing of operating activities in the form of transfer of promissory notes and the trading of marketable securities and promissory notes as well as the acquisitions of equity stakes in other entities. In addition, certain entities acted as agents to receive cash on behalf of the subsidiaries (Note 7). The related party transactions during the years ended December 31, 2001 and 2000 might not have been carried at arm's length, and the promissory notes issued to or received from other related parties might be illiquid outside the unconsolidated group of entities under common control, and are solely used as a settlement instrument among such group. Amounts due to and from related parties are carried at cost.

Comprehensive Income

Effective January 1, 1998, the Company adopted FAS No. 130, "Reporting Comprehensive Income". FAS No. 130 establishes comprehensive standards for the reporting and presentation of income and its components in a set of general-purpose financial statements.

Segment Information

In June 1997, the Financial Accounting Standards Board ("FASB") issued FAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". FAS No. 131 changes the way publicly traded companies report selected segment information in annual financial statements. As the Company is not considered a public company, it has chosen not to adopt the new statement in 2001.

3. Significant Accounting Policies (continued)

Current Accounting Pronouncements

In June 1998, the FASB issued FAS No. 133, “Accounting for Derivative Instruments and Hedging Activities”, which was amended in June 1999. This statement provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. The Company adopted the new statement effective January 1, 2001. The adoption of FAS No. 133 did not have a significant effect on the Company’s financial position.

In 1999 and 2000, the FASB issued FAS No. 135, “Deferral of the Effective Date of Certain Accounting Requirements for Pension Plans and Local Governmental Units”, FAS No. 136, “Transfers of Assets Involving a Non-for-Profit Organization That Raises or Holds Contributions for Others”, and FAS No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities”. The adoption of these standards did not have any impact on the Company's consolidated financial statements.

In June 2001, the FASB issued FAS No. 141, “Business Combinations”, and FAS No. 142, “Goodwill and Other Intangible Assets”. FAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. It also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. FAS No. 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. FAS No. 142 requires that these assets be reviewed for impairment at least annually. Intangible assets with finite lives will continue to be amortized over their estimated useful lives. Additionally, FAS No. 142 requires that goodwill included in the carrying value of equity method investments no longer be amortized. The Company will apply FAS No. 142 effective January 1, 2002. Application of the non-amortization and impairment provisions of FAS No. 142 is not anticipated to be significant.

In August 2001, the FASB issued FAS No. 143, "Accounting for Asset Retirement Obligations". This statement deals with the costs of closing facilities and removing assets. FAS No. 143 requires entities to record the fair value of a legal liability for an asset retirement obligation in the period it is incurred. This cost is initially capitalized and amortized over the remaining life of the asset. Once the obligation is ultimately settled, any difference between the final cost and the recorded liability is recognized as a gain or loss on disposition. FAS No. 143 is effective for years beginning after June 15, 2002. The Company does not believe that the adoption of FAS No. 143 will have a significant impact on its future consolidated financial statements.

3. Significant Accounting Policies (continued)

Current Accounting Pronouncements (continued)

In August 2001, the FASB issued FAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes FAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions", for the disposal of a segment of a business (as previously defined in that opinion). This statement also amends Accounting Research Bulletin No. 41, "Consolidated Financial Statements", to eliminate the exception to consolidation for a subsidiary for which control is likely to be temporary. The provisions of the statement will be effective for financial statements issued for fiscal years beginning after December 15, 2001. The Company is currently evaluating the impact the pronouncement will have on future consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the 2000 comparatives, for them to conform to the 2001 presentation.

4. Business Combinations

Acquisition of additional interest in Izhorskiye Zavody

Throughout the first half of 2001, the Company acquired an additional 6.52% interest in Izhorskiye Zavody for cash of $1,318, bringing its overall interest in Izhorskiye Zavody to 75.48%. As of the dates of the purchase of additional shares of Izhorskiye Zavody, the consideration paid approximated the Company's share in the fair value of the net assets acquired.

Acquisition of Krasnoe Sormovo

In 1998, the Holding acquired 18.68% of Krasnoe Sormovo for cash of $2,052. Through the period from May 22, 2000 to June 23, 2000 the Holding acquired an additional 14.14% of shares: 4% of shares were exchanged for Pnevmostroymachina shares, with the fair value of $425, and remaining 10% of shares were purchased for $9 from OOO "Novye Vozmozhnosti", a related party. The total value of the consideration paid for 32.82% of shares amounts to $2,486.

Since June 23, 2000, the investment in Krasnoe Sormovo had been accounted for under the equity method. To determine the results of the acquisition, net assets of Krasnoe Sormovo were valued at their fair values in accordance with the APB Opinion No. 18. The carrying values were assumed to approximate their fair values. The total value of the acquired share in the net assets of Krasnoe Sormovo amounted to $28,314. The acquisition resulted in negative goodwill of $25,828, which was allocated against the value of acquired plant and equipment.

4. Business Combinations (continued)

Acquisition of Krasnoe Sormovo (continued)

In December 2000, the Holding acquired additional 17.001% of Krasnoe Sormovo for cash of $3,078. December 19, 2000 is considered to be the effective date of the acquisition of Krasnoe Sormovo for accounting purposes since from that date the Holding's share in Krasnoe Sormovo had exceeded 50%. Accordingly, Krasnoe Sormovo has been treated as a subsidiary since December 19, 2000 and the results of operations have been included in the consolidated statement of income since that date.

To determine the results of the acquisition accounted for as a purchase, net assets of Krasnoe Sormovo were recorded at their fair values. The fair value of property and equipment at December 19, 2000 was presumed to approximate their carrying values. The total value of the acquired share of the net assets of Krasnoe Sormovo amounted to $13,622. The acquisition resulted in negative goodwill of $10,544, which was allocated against the value of plant and equipment acquired.

The fair value of assets acquired and liabilities assumed were as follows as of the acquisition date:

		December 19, 2000
Cash	$	1,867
Trade receivables		1,452
Inventories		16,606
Taxes receivable		661
Other current assets		21,317
Long-term investments		260
Plant and equipment, net		47,567
Trade payables		(1,884)
Payroll and related obligations		(553)
Deferred revenues		(6,165)
Taxes payable		(261)
Other payables		(740)
Net assets as of the acquisition date	**$**	**80,127**
Minority interest @ 49.999% as of December 19, 2000		(40,063)
Share in net assets previously owned by the Holding, 33%		26,442
Net assets acquired	**$**	**13,622**
Consideration paid by the Holding		3,078
Negative goodwill	**$**	**(10,544)**

Impact of the acquisition on the consolidated statement of cash flows for the year ended December 31, 2001:

Cash paid by the Holding	$	3,078
Less cash of Krasnoe Sormovo		(1,867)
Cash flows on acquisition, net of cash acquired	**$**	**(1,211)**

4. Business Combinations (continued)

Acquisition of Krasnoe Sormovo (continued)

At various dates throughout 2001, the Holding acquired an additional 10.73% interest in Krasnoe Sormovo for cash of $2,178. The acquisition of such additional interest in Krasnoe Sormovo resulted in negative goodwill of $6,423, which was allocated against the value of plant and equipment acquired.

Acquisition of Burovaya Tekhnika

In 2000, the Holding acquired 45.10% of shares in Burovaya Tekhnika for consideration of $1,161. Through December 31, 2000, the investment in Burovaya Tekhnika had been accounted for under the cost method. The non-application of equity method for Burovaya Technika did not have a material impact on the Company's financial position or results of its operations in 2000.

In 2001, the Holding continued to acquire additional shares of Burovaya Tekhnika. By April 17, 2001, the Holding acquired an additional 9.99% for cash of $94 from ZAO Neftyanoi Investitsionnyi Dom, a related party, increasing its equity share to 55.09%. April 17, 2001 is considered the effective date of the acquisition of Burovaya Tekhnika for accounting purposes since from that date the Holding's share in Burovaya Tekhnika had exceeded 50%. Accordingly, Burovaya Tekhnika has been treated as a subsidiary since April 17, 2001 and the results of operations have been included in the consolidated statement of income for the period from April 17, 2001 through December 31, 2001.

To determine the results of the acquisition accounted for as a purchase, net assets of Burovaya Tekhnika were recorded at their fair values. The fair value of property and equipment at April 17, 2001 was presumed to approximate their carrying values. As of the date of acquisition, Burovaya Tekhnika had current assets of $4,191 (including cash of $893), non-current assets of $12,465 and current liabilities of $2,131. The total value of the acquired share of the net assets of Burovaya Tekhnika amounted to $8,002. The acquisition resulted in negative goodwill of $6,747, which was allocated against the value of plant and equipment acquired. Net cash inflows on the acquisition amounted to $799, which is recorded in the consolidated statement of cash flows.

5. Short-Term Investments

Short-term investments consisted of the following:

	2001	2000
Corporate promissory notes	**$ 2,338**	$ 23,446
Available for sale securities	**15,083**	–
Bank promissory notes	**2,953**	10,257
Bank deposits	**2,000**	17,644
Trading securities	**–**	2,019
Total short-term investments	**$ 22,374**	$ 53,366

5. Short-Term Investments (continued)

As of December 31, 2001 and 2000, corporate promissory notes represented obligations of various Russian legal entities, primarily the Company's trade debtors, in the form of promissory notes that did not have an established market. They are reported net of allowance for accounts identified as doubtful.

Available for sale securities consisted of the following as of December 31, 2001:

	Historical Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Gazprom promissory notes	$ 16,296	$ –	$ (1,213)	$ 15,083

Since the purchase of the ruble-denominated Gazprom promissory notes in 2001, Company has designated them as available for sale marketable securities. Accordingly, the decrease in market value of Gazprom promissory notes of $1,213 was reported as unrealized holding losses in other comprehensive income in the year ended December 31, 2001.

Bank promissory notes as of December 31, 2001 and 2000 represented mainly interest-free promissory notes issued by Alfa-Bank of $1,659 and $8,523, respectively. As of December 31, 2001 included in bank promissory notes were three Sberbank US dollar-denominated promissory notes, $1,068 at par value in total, that were pledged as a collateral for the $1,000 long-term loan received from Sberbank (Note 18). The Sberbank notes bear interest at a rate of 5.65% per annum, payable semiannually. Bank promissory notes as of December 31, 2001 and 2000 also included notes issued by Promtorgbank of $156.

Bank deposits as of December 31, 2001 represented a US dollar-denominated deposit account with Promtorgbank, a related party (Note 7), bearing interest at a rate of 6% per annum and maturing on April 25, 2002. In 2001, the Company recorded interest income of $120 on its deposit with Promtorgbank.

Bank deposits as of December 31, 2000 consisted mainly of deposits with Sberbank, a Russian government owned bank, of $16,523 with various maturity dates throughout 2001. Such bank deposits bore interest from 4.6% to 7.7% on US dollar-denominated deposits and from 10% to 13% on ruble-denominated deposits.

Trading securities as of December 31, 2000 consisted mainly of Russian Federal loan bonds (“OFZ”), which were frequently traded by the Company and were stated at their quoted market value.

6. Trade Accounts Receivable

Trade accounts receivable consisted of the following:

		2001		2000
Trade accounts receivable	**$**	**58,917**	$	48,759
Allowance for doubtful accounts		**(8,354)**		(12,747)
	$	**50,563**	$	36,012

As of December 31, 2000, $433 of accounts receivable were restricted for the use by the St. Petersburg tax authorities.

7. Related Party Transactions

During 2001 and 2000, the Company had significant transactions or balances with the following of its shareholders or the companies under their control or control of management (Note 3):

- Promtorgbank, incorporated in Russia
- OAO Industrial Group NIPEK-Bioprocess, incorporated in Russia
- ZAO Neftyanoi Investitsionnyi Dom, incorporated in Russia
- ZAO Almaz Marketing, incorporated in Russia
- OAO SF Almaz, incorporated in Russia
- OOO Novye Vozmozhnosti, incorporated in Russia
- OOO NitsTyazhMash, incorporated in Russia
- OOO Machinery Engineering, incorporated in Russia
- OAO Nizhegorodskiy Teplohod Plant, incorporated in Russia
- OOO Resource, incorporated in Russia
- Speed Arrow Limited, incorporated in Cyprus
- Allbrand Services Limited, incorporated in Cyprus
- Ventor Limited, incorporated in Turks and Caicos Isles

During 2000, the Company purchased 10% of Krasnoe Sormovo shares for $9 from Novye Vozmozhnosti and 4.1% from Neftyanoi Investitsionnyi Dom for $984. It is likely that the values assigned in these transactions were different from the market prices of shares acquired.

7. Related Party Transactions (continued)

During 2001, the Company used OOO NitsTyazhMash and OOO Machinery Engineering, the registered taxpayers in the Russian Federation with certain tax holidays applicable to both entities, to generate income from securities trading and sales of certain assets. In 2001, such investments and sales income amounted to $5,236 and $1,234, respectively.

In 2001, the Company used Ventor Limited and Allbrand Services Limited to find a potential buyer for the sale of OOO Tube Works and consummate the sale transaction. The transaction fee paid to these related parties amounted to $36.

Below is the summary of all related party balances as of December 31, 2001 and 2000, which arose from the transactions described in Notes 3, 4 and 7.

Amounts due from related parties consisted of the following:

	2001	2000
Promtorgbank	**$ 8,781**	$ 13,361
Speed Arrow Limited	**2,688**	–
OOO Resource	**868**	–
Other	**217**	–
Total due from related parties	**$ 12,554**	$ 13,361

As of December 31, 2000, a receivable from Promtorgbank consisted of $5,920 of short-term loans issued thereto maturing throughout 2001, and $7,441 of Promtorgbank promissory notes. As of December 31, 2001, a receivable from Promtorgbank consisted of $8,303 of Promtorgbank own promissory notes, $462 of the Promtorgbank's liabilities for third-party promissory notes, and $16 of other receivables. In 2001, the Company recorded $675 and $170 of interest income on the Promtorgbank promissory notes and loans, respectively.

As of December 31, 2001, the amount due from Speed Arrow Ltd. of $2,688 represented a loan granted by United Heavy B.V. Although the loan agreement does not stipulate its maturity date, management believes it is current as more than 50% of the loan had been repaid prior to June 14, 2002.

OOO Resource is under the operating control of management of Izhorskiye Zavody. In 2001, OOO Resource acted as a collection agent on behalf of Izhorskiye Zavody, and as of December 31, 2001, the amount due from OOO Resource comprised $868 of promissory notes issued by the Company's debtors. In 2002, the Company discontinued using OOO Resource as collection agent.

7. Related Party Transactions (continued)

Amounts due from related parties, long-term, consisted of the following:

	2001	2000
Promtorgbank – trust fund, including interest	**$ 7,301**	$ 12,030
Promtorgbank – long-term loans	**–**	6,428
Total due from related parties – long-term	**$ 7,301**	$ 18,458

Trust fund represents cash deposited by the Holding in Promtorgbank for a period of 5 years starting April 5, 2000. Trust fund bears interest at a rate of 10% per annum, which is payable by Promtorgbank upon the repayment of the principal amount. As of December 31, 2000, the principal and accrued interest amounted to $10,899 and $1,131, respectively. As of December 31, 2001, a portion of the principal had been repaid and the remaining principal and accrued interest amounted to $5,756 and $1,545, respectively. In 2001, the interest income on the trust funds amounted to $999.

Included in long-term receivables from Promtorgbank as of December 31, 2000 was a long-term loan issued by the Holding of $6,428 with the maturity date on August 3, 2003. The loan was fully repaid in advance during February-April 2001.

Other related party long-term assets as of December 31, 2001 represented Promtorgbank's common stock held by Izhorskiye Zavody that was purchased for $2,116.

Amounts due to related parties consisted mainly of loans with Promtorgbank and promissory notes issued by the Company and held by the following related parties:

	2001	2000
Promtorgbank	**$ 5,517**	$ 12,064
ZAO Neftyanoi Investitsionnyi Dom	**1,765**	40
OAO Industrial Group NIPEK-Bioprocess	**–**	592
ZAO Almaz Marketing	**–**	453
Other	**215**	–
Total due to related parties	**$ 7,497**	$ 13,149

The amount due to Promtorgbank as of December 31, 2001 included loans of $4,158; $182 of interest accrued; $685 of Izhorskiye Zavody liabilities for bank charges, and $492 of the Uralmash promissory notes. The $1,158 short-term loan is denominated in rubles, bears interest at an annual rate of 12%, and matures on July 16, 2002. The long-term $3,000 loan obtained with Promtorgbank is denominated in US dollars, bears interest at an annual rate of 5% and matures on January 8, 2003. The loan was fully repaid in advance on May 14, 2002. Included in the amount due to Promtorgbank as of December 31, 2000 were $11,342 of short-term borrowings and the Company's promissory notes of $722. In 2001, the Company accrued $462 of interest on loans received from Promtorgbank.

7. Related Party Transactions (continued)

Liabilities to ZAO Neftyanoi Investitsionnyi Dom at December 31, 2001 related to the Company's purchase of its share in OAO IMZ Ural (Note 10) through ZAO Neftyanoi Investitsionnyi Dom.

In 2001, the Company issued loans to, and borrowed funds from, OOO Machinery Engineering. The interest expense and interest income on these loans amounted to $783 and $166, respectively. As of December 31, 2001, all loans had been fully repaid.

8. Inventories

Inventories consisted of the following:

	2001	2000
Materials and spare parts	**$ 49,400**	$ 49,289
Work-in-process	**98,421**	83,935
Finished goods	**63,269**	28,549
Total inventories, at cost	**211,090**	161,773
Reserve for obsolete inventories	**(26,876)**	(27,851)
	$ 184,214	$ 133,922

As of December 31, 2000, $484 of raw materials was restricted for use by the St. Petersburg tax authorities. As of December 31, 2001, $33,725 of inventories was pledged under several loan agreements (Note 14).

Included in finished goods inventories as of December 31, 2001 were deferred costs of $16,528 related to the contracts accounted for under the completed-contract or units-of-delivery methods, predominantly drilling rigs and metallurgical equipment.

9. Plant and Equipment

Plant and equipment consist of the following:

	Buildings	Machinery and Equipment	Vehicles	Furniture and Fixtures	Equipment under Construction	Total
Net book value as of January 1, 2000	$107,876	$ 59,372	$ 808	$ 972	$ 9,792	$ 178,820
Additions	2,454	7,673	439	2,452	3,108	16,126
Disposals	(2,621)	(3,159)	(24)	(35)	(163)	(6,002)
Depreciation charge for the year	(7,894)	(11,635)	(426)	(716)	–	(20,671)
Plant and equipment of Krasnoe Sormovo acquired on December 19, 2000	6,269	4,723	255	5	37	11,289
Reserve for obsolete equipment under construction	–	–	–	–	(2,615)	(2,615)
Net book value as of December 31, 2000	$106,084	$ 56,974	$1,052	$ 2,678	$ 10,159	$ 176,947
Negative goodwill offset against plant and equipment of Krasnoe Srormovo (Note 4)	(3,560)	(2,683)	(145)	(3)	(32)	(6,423)
Plant and equipment of Burovaya Tekhnika acquired on April 17, 2001	3,849	1,735	88	37	9	5,718
Additions	5,027	14,890	533	2,000	7,967	30,417
Disposals	(832)	(3,198)	(32)	(207)	–	(4,269)
Depreciation charge for the year	(8,940)	(11,285)	(565)	(1,315)	–	(22,105)
Reserve for obsolete equipment under construction	–	–	–	–	(2,284)	(2,284)
Net book value as of December 31, 2001	**$101,628**	**$ 56,433**	**$ 931**	**$ 3,190**	**$ 15,819**	**$ 178,001**

$10,994 and $5,126 of Uralmash machinery and equipment were pledged for the loans with Promtorgbank as of December 31, 2001 and 2000, respectively. $871 of Izhorskie Zavody machinery and equipment were pledged for the loans with North-West Branch of Konversbank as of December 31, 2001 (Note 17).

10. Long-Term Investments

Long-term investments consisted of the following:

	December 31,			
	2001		2000	
	% of ownership	Amount	% of ownership	Amount
UPET S.A.	**–**	**$ 3,397**	–	$ –
Promtorgbank	**2.79%**	**2,116**	–	–
OAO IMZ Ural	**19.00%**	**1,889**	–	–
ZAO Transkat	**15.00%**	**480**	15.00%	3,004
Nizhegorodsky Teplokhod Plant	**18.39%**	**639**	–	–
OOO AMT Stealth	**–**	**319**	–	–
OAO Volgograd Plant of Burovaya Tekhnika	**2.00%**	**238**	3.20%	235
Burovaya Tekhnika	**–**	**–**	45.10%	1,161
Other	**–**	**2,438**	–	4,088
		$ 11,516	–	$ 8,488

By April 17, 2001, the Company completed its acquisition of additional 314,026 shares of common and 1,134,708 shares of preferred stock of Burovaya Tekhnika. During the period from January 1, 2001 through April 17, 2001, before the Company's stake in Burovaya Tekhnika reached 55.09%, its investment therein was accounted using the equity method. Subsequent to April 17, 2001, Burovaya Tekhnika has been accounted for under the full-consolidation method.

Before December 31, 2001, the Company transferred $3,397 to its purchase agents to acquire a 75.19% equity interest in the Romanian metallurgical plant UPET. According to the terms of the transaction, the acquisition was subject to the approval by the Romanian Stock Exchange Commission. Such approval was not obtained before December 31, 2001. As of that date, the investment in UPET was recorded at cost.

In 2001, the Company acquired 67,085 shares of Promtorgbank's common stock from Promtorgbank, a related party, representing 2.79% of ownership interest therein. As of December 31, 2001, such shares were valued at cost.

In 2001, the Company purchased an 18.39% stake in Nizhegorodsky Teplokhod Plant for cash of $639. Nizhegorodsky Teplokhod Plant specializes in vessel hull construction and manufacturing of press forgings, and other processing equipment. Subsequent to December 31, 2001, the Company increased its share in therein to 55.67% (Note 24).

10. Long-Term Investments (continued)

In 2001, the Company recorded a permanent reduction in value of its long-term investments in ZAO Transkat, OOO Blackline and some other companies. The loss of $4,447 was recognized in its consolidated statement of income. During 2001, Izhorskiye Zavody transferred to Promtorgbank certain of its long-term investments, predominantly in ZAO Transkat of $480, into the trust fund for total amount of $495.

As of December 31, 2001 and 2000, the Company owned a 19% ownership share in OAO IMZ Ural, a manufacturer of motorcycles. The investments were valued at cost.

No information was available on the fair values of the Company's investments in Promtorgbank, OAO IMZ Ural, and other entities as of December 31, 2001 and 2000. The non-application of equity method for Burovaya Technika in 2000 and certain minor equity investments included in the "Other" line does not have a material impact on the Company's financial position or results of its operations.

11. Advances Received and Deferred Revenues

Advances received from customers consisted of the following:

	December 31,	
	2001	**2000**
OAO Surgutneftegaz	**$ 24,322**	$ 35,393
ZAO Atomstroyexport	**18,214**	24,310
OAO Sibneft	**8,125**	2,519
ZAO Ukos-Service	**7,198**	–
OOO Gazresourse	**4,713**	–
NTC Energonasos ZKBM	**4,160**	3,082
OAO Rosneft	**2,964**	–
OOO Oil Service Leasing Company	**2,957**	–
OAO Severstal	**2,375**	–
Itochu Corporation	**1,950**	–
OOO Vars	**1,599**	–
KCC Shipping Ltd., Malta	**1,125**	–
OOO Lukoilpermnefteorgsintez	**1,099**	–
ZAO Uralmontorem	**1,082**	–
ZAO Eltekhstandard	**910**	–
GP Admiralteyskie Verfi	**882**	–
Russian Federation Ministry of Finance	**792**	–
ZAO Severgazkomplekt	**752**	–
Nizhniy-Tagil Iron Works (NTMK)	**725**	5,080
ZAO Nadezhdinskoe	**717**	–
Newsproject	**–**	4,777
OAO Slavneft	**–**	3,541
Other	**20,796**	67,186
	$ 107,457	$ 145,888

11. Advances Received and Deferred Revenues (continued)

Deferred revenue consisted of the following:

	December 31,	
	2001	**2000**

Kremikovitsi (government financing)	**$ 34,939**	$ 34,939
OAO Sibneft	**16,776**	**–**
Atomstroyexport	**13,824**	–
OAO Magnitogorsk Iron Works	**3,783**	–
Nefteservice Leasing Company	**2,139**	–
ZIO Mashzavod Podolsk	**1,730**	–
OAO Surgutneftegaz	**860**	–
OAO Rosneft	**790**	–
Gazresource	**786**	–
	$ 75,627	$ 34,939

In 1994, Uralmash and Kremikovitsi (Bulgaria) signed an agreement for deliveries of metallurgical equipment for the total amount of $52,000. 70% of the deliveries are effected as a redemption of a debt of the Russian Federation to the Republic of Bulgaria. Therefore, the Ministry of Finance of the Russian Federation is responsible for 70% of the revenues. In 1997, the financing ceased due to disagreements between the parties. Through December 31, 2001 and 2000, the Ministry of Finance had paid $34,939. The remaining balance to be paid was $1,464. An inventory reserve amounting to $2,513 was created.

The Company has conducted regular negotiations with the representatives of the governments of Russia and Bulgaria. The parties agreed to reconsider the terms of the agreement. No ultimate resolution of the issue has been achieved as of December 31, 2001. The amount paid to date by the Ministry of Finance of the Russian Federation has been treated as deferred revenue until the products are physically delivered and accepted by the customer, i.e. the revenue earning process is complete.

In 2000, the Company signed two agreements to supply seven drilling rigs to OAO Sibneft. Under these agreements the Company defers revenues and related costs until it fully supplies assembled drilling rigs under the unit-of-delivery method. None of the drilling rigs had been fully shipped by December 31, 2001. The existing agreements provide for the entire shipment to be effected in 2002.

In 1999, the Company entered into several long-term agreements related to the construction of Liang Yung Gang nuclear power plant in China for the total amount of $111,828, including ZAO Atomstroyexport and other parties. The Company accounted for these long-term contracts using percentage-of-completion method, and deferred revenue of $13,824 ($11,780 of which relates to Liang Yung Gang construction project) as of December 31, 2001.

12. Income Taxes

On August 5, 2000, the Profits tax law was amended to allow local authorities to increase the statutory tax rate by up to 5%. On November 29, 2000, the authorities of Moscow enacted an increase in the statutory tax rate from 30% to 35% effective January 1, 2001. Similar acts were passed by the other cities where the Company's subsidiaries are located. Effective January 1, 2002, the Russian Federation profit tax rate was reduced to 24%. This change was enacted in August 2001 and taken into account when computing tax effects of temporary differences as of December 31, 2001.

The income tax provision (benefit) consisted of the following for the years ended:

	December 31, 2001	December 31, 2000
Current tax expense	**$ 7,326**	$ 2,137
Deferred tax (benefit) expense	**(5,952)**	1,390
	$ 1,374	$ 3,527

The reconciliation between the income tax expense computed by applying the Russian enacted statutory tax rates (35% and 30% in 2001 and 2000, respectively, except for Izhorskiye Zavody, for which 29% was applied in 2001) to the income before income taxes presented in the accompanying consolidated financial statements to the income tax expense reported in the consolidated financial statements is as follows:

	2001	2000
Income tax expense computed on income before income taxes at statutory tax rates	**$ 1,895**	$ 1,530
Tax effect of permanent differences:		
Effect of foreign exchange differences	**(2,951)**	(4,303)
Non-deductible expenses	**2,452**	1,275
Non-deductible provisions	**5,319**	5,244
Disallowed loss from equity investments	**–**	550
Other non-taxable income	**(2,973)**	–
Capital investment and other deductions	**(7,841)**	–
Effect of exchange rate differences in expenses translation	**5,997**	5,359
Non-taxable gain from sale of non-core business units	**(1,589)**	(4,397)
Non-taxable gain from the release of tax penalties	**(1,510)**	(4,485)
Other permanent differences	**(483)**	3,009
Effect of changes in tax rate	**4,882**	(4,139)
Temporary differences not recognized as measured by the change in the valuation allowance during the year	**(1,824)**	3,884
Income tax expense reported in the accompanying financial statements	**$ 1,374**	$ 3,527

12. Income Taxes (continued)

As of the acquisition date (December 19, 2000), deferred tax assets of Krasnoe Sormovo amounted to $0, net of valuation allowance of $541. As of the acquisition date (April 17, 2001), deferred tax assets of Burovaya Tekhnika amounted to $0, net of valuation allowance of $239.

The deferred tax balances were calculated by applying the statutory tax rates (24% and 35% as of December 31, 2001 and 2000, respectively) in effect at the balance sheet dates to the temporary differences between the tax basis of assets and liabilities and the amounts reported in the accompanying financial statements are comprised of the following:

	December 31, 2001	December 31, 2000
Deferred tax assets - current:		
Revenue deferrals under long-term contracts	**$ 5,469**	$ –
Deductible inventory provisions	**4,986**	–
Total deferred tax assets - current	**10,455**	–
Deferred tax liabilities - current:		
Revenue taxed on cash basis	**(2,438)**	(2,938)
Other	**(18)**	–
Total deferred tax liabilities - current	**(2,456)**	(2,938)
Valuation allowance for deferred tax assets	**(4,949)**	–
Net deferred tax assets - current	**$ 3,393**	$ –
Net deferred tax liabilities - current	**$ (343)**	$ (2,938)
Deferred tax assets - non-current:		
Plant and equipment	**372**	299
Available loss carry-forwards	**184**	1,715
Other	**2,528**	7,843
Total deferred tax assets	**3,084**	9,857
Valuation allowance for deferred tax assets	**(3,084)**	(9,857)
	$ –	$ –
Deferred tax liabilities – non-current:		
Difference in depreciation	**(36)**	–
Interest accruals on trust fund	**(395)**	(395)
	$ (431)	$ (395)

For financial reporting purposes, a valuation allowance has been recognized to reflect management's estimate of the deferred tax assets that are not likely to be realized.

Net statutory operating loss incurred by Izhorskiye Zavody in 1998 can be carried forward five years and expires December 2003.

13. Taxes Payable

Taxes payable consisted of the following:

	December 31, 2001	December 31, 2000
Tax penalties	**$ 26,575**	$ 31,652
VAT	**27,376**	28,644
Unified social tax penalties	**15,572**	13,375
Unified social tax	**11,066**	13,437
Road-users' tax	**8,317**	7,596
Personal income tax	**2,045**	3,085
Income tax	**2,978**	1,624
Assets tax	**1,860**	2,404
Other taxes	**1,233**	2,201
	97,022	104,018
Less long-term portion	**49,732**	24,968
Taxes payable, current portion	**$ 47,290**	$ 79,050

On March 10, 2000, Izhorskiye Zavody signed a restructuring agreement with the state budget to repay its overdue taxes of $4,074 during the period of 2000-2006, and tax penalties of $3,515 during the period of 2006-2010. These restructured tax obligations bear interest at one tenth of the CBR refinancing rate (which was approximately 55% per annum as of the restructuring date). Through December 31, 2001 and 2000, Izhorskiye Zavody paid $801 and $417 of overdue taxes, respectively.

On September 18, 2000, Uralmash signed a restructuring agreement with the state and local budgets to repay its overdue taxes of $14,460 during the period of 2001-2010, and tax penalties of $9,064 during the period of 2001-2010. These restructured tax obligations bear interest at one tenth of the refinancing rate (which was approximately 28% per annum as of the restructuring date). Through December 31, 2001 and 2000 Uralmash paid $4,473 and $538 of overdue taxes, respectively.

Pursuant to the statutory legislation on restructuring, the above tax penalties might be fully or partially forgiven by the government if Izhorskiye Zavody and Uralmash make their payments under the restructuring agreements ahead of the schedule above, as follows: 50% of the penalties will be forgiven if the subsidiaries repay 50% of the principal due within two years; and the entire amount of penalties due will be forgiven if the subsidiaries repay 100% of the principal due within four years.

On December 27, 2001, Izhorskiye Zavody signed another restructuring agreement with the state social non-budget funds to repay its overdue social taxes and related penalties during the period of 2002-2006.

13. Taxes Payable (continued)

Subsequent to December 31, 2001, the decision of the North-West Federal Arbitration Court of June 14, 2002 ruled that the Company be released from the part of accrued pension fund penalties equal to $6,718 (Note 21). Therefore, the long-term restructured social taxes and related penalty liabilities were reduced by $6,718 and the remaining tax and penalty liability was $6,078 and $15,572 at December 31, 2001. These restructured social obligations are interest-free. The total outstanding amount of social taxes should be paid quarterly in equal installments during the five-year period. 15% of fines and penalties should be paid quarterly in equal installments during the five-year period, and upon the completion of these payments the remaining 85% of fines and penalties, equal to $13,600, due in 2006, might be forgiven.

Aggregate maturities of taxes payable as of December 31, 2001 were as follows:

2003	**$**	**4,844**
2004		**4,844**
2005		**4,844**
2006		**19,236**
2007		**4,497**
2008		**4,509**
Thereafter		**6,958**
	$	**49,732**

14. Short-Term Borrowings

Short-term borrowings consist of the following:

	December 31,			
		2001		**2000**
Alfa-Bank	**$**	**11,773**	$	6,000
Probusinessbank		**–**		5,327
Konversbank		**5,942**		–
Sberbank		**5,318**		–
Bank Petrovsky		**3,437**		–
Vneshtorgbank		**2,322**		–
Avtobank		**1,700**		–
Gazprombank		**1,019**		–
Other		**472**		591
	$	**31,983**	$	11,918

As of December 31, 2001 and 2000, the Company had outstanding loans with Alfa-Bank in the amount of $11,773 and $6,000, respectively.

14. Short-Term Borrowings (continued)

In 2001, ZAO TK Izhorskiye Zavody received a $9,451 loan from Alfa-Bank. The loan was denominated in US dollars and bore interest at a rate of 14%. The loan was secured by the guarantee of Izhorskiye Zavody and ZAO Atomstroyexport (one of major customers) and was fully repaid in March 2002. Per agreement with ZAO Atomstroyexport, part of advances for future deliveries is effected through the arrangement of loans to the Company, guaranteed by ZAO Atomstroyexport. The Company repays the loan at the time the payment is received for equipment delivered. Interest expense incurred in relation to such transactions was included in purchase price offered to ZAO Atomstroyexport.

In 2001, Uralmash received a $2,322 loan from Alfa-Bank. The loan was denominated in rubles and bore interest at a rate of 18.5% per annum. The loan was secured by the Company's plant and equipment with net book value of $5,844 as of December 31, 2001.

In 2000, ZAO TK Izhorskiye Zavody received a $6,000 loan from Alfa-Bank. The loan was denominated in US dollars and bore interest at a rate of 14-16% per annum. It was fully repaid in 2001.

In June-July 2001, ZAO KomplektAtomIzhora received two loan tranches of $3,955 and $1,987 from the North-West branch of ZAO Konversbank. The loans were denominated in US dollars and bore interest at a rate of 14.75% per annum. The loans were secured by inventory and plant and equipment with book values of $6,236 and $871, respectively, as of December 31, 2001.

On December 25, 2001, Uralmash received a $3,318 loan from the Ural branch of Sberbank. The loan was denominated in rubles and bore interest at a rate of 20% per annum. The loan was secured by plant and equipment with a net book value of $5,150 and finished goods in amount of $3,090.

On November 2, 2001, Izhorskiye Zavody obtained a $2,000 loan from Sberbank. The loan was denominated in rubles and bore interest at a rate of 17% per annum. The loan was secured by inventory in the amount of $4,559 as of December 31, 2001.

In 2001, ZAO KomplektAtomIzhora obtained two loan tranches of $2,200 and $1,237 from the Kolpino Branch of Bank Petrovsky. The loans were denominated in US dollars and bore interest at a rate of 14-14.5% per annum. The loans are due in August 2002 and are secured by inventory in the amount of $8,166 as of December 31, 2001.

In 2001, Uralmash received a $2,322 loan from Vneshtorgbank. The loan was denominated in rubles and bore interest at a rate of 18% per annum. The loan was secured by inventory in the amount of $4,916 as of December 31, 2001.

On February 20, 2001, TK Izhorskiye Zavody received a $1,700 loan from Avtobank. The loan was denominated in US dollars and bore interest at a rate of 14%. The loan was secured by inventory for the amount of $2,149.

14. Short-Term Borrowings (continued)

In December 2001, Uralmash received a $1,019 loan from Gazprombank. The loan was denominated in US dollars and bore interest at a rate of 9–9.8% per annum. The loan was secured by inventory in the amount of $4,609 as of December 31, 2001.

As of December 31, 2000, Uralmash had a loan from Probusinessbank of $5,237. The loan bore interest at the CBR refinancing rate plus 3% per annum (28% as of December 31, 2000).

During 2002, substantial portion of short-term borrowings were either repaid or refinanced.

15. Non-Convertible Bonds

In April 2001, the Holding issued 277,457 bonds (First Tranche) with a nominal value of 1000 rubles per bond. The bonds mature 720 days from the issuance date (April 20, 2001). The entire bond issue was purchased by OOO Russian Funds, an underwriter, for $9,596, net of issuance costs of $93. The bonds bear interest at a constant rate of 18% per annum with the interest payable twice a year. By December 31, 2001, the Company repurchased 138,083 of these bonds, of which 109,788, worth $3,642 at par value, were acquired for a token cash consideration of $360, and the assets of OOO Tube Works (Note 20).

In September 2001, the Holding issued 390,000 bonds (Second Tranche) with a nominal value of 1000 rubles per bond. The bonds mature 900 days from the issuance date (September 6, 2001). The entire bond issue was sold on an action, for $13,227, net of issuance costs of $16. The bonds bear interest at a variable rate determined by the Board of Directors with the interest payable twice a year. The first and second coupons bore interest at 20.85% and 20.50% per annum, respectively.

In October 2001, the Holding issued 390,000 bonds (Third Tranche) with a nominal value of 1000 rubles per bond. The bonds mature 900 days from the issuance date (October 4, 2001). The entire bond issue was sold on an action for $13,213, net of issuance costs of $16. The bonds bear interest at a variable rate determined by the Board of Directors with the interest payable twice a year. The first and second coupons bore interest at 20.85% and 20.15% per annum, respectively. By December 31, 2001, the Company repurchased 161,191 of these bonds.

The bonds of the First, Second and Third Tranches are traded on MICEX. The holders of the Company's non-convertible bonds are not entitled to any additional rights or preferences.

Aggregate maturities of non-convertible bonds as of December 31, 2001 are as follows: 2003 - $4,587, 2004 - $20,269. As of December 31, 2001 $1,331 of interest accrued on bonds held by companies outside the group was included in other accounts payable and accruals. During the year 2001, the total interest expense under three tranches of non-convertible bonds was $2,676.

16. Trade Accounts Payable, Long-term

Trade accounts payable and deferred revenue, long-term consisted of the following:

	December 31, 2001	December 31, 2000
Lentransgaz	**$ 3,769**	$ 5,597
Less current portion	**(1,271)**	(2,042)
	$ 2,498	$ 3,555

As of December 31, 1999, Izhorskiye Zavody had notes payable to Lentransgaz in the amount of $9,594 for the supplies of gas. As part of the restructuring plan, Izhorskiye Zavody signed restructuring agreements with Lentransgaz to repay its accounts payable in installments through 2003. The notes are ruble-denominated and interest-free. $6,667 of such notes are payable through supplies of finished goods manufactured by Izhorskiye Zavody through December 31, 2003, with the remaining balance payable in cash over the same period. In 2001, Izhorskiye Zavody repaid $1,508 to Lentransgaz. As of December 31, 2001 and 2000, the current portion of the notes was $1,271 and $2,042, respectively.

17. Long-term Debt

Long-term debt consists of the following:

	December 31, 2001	December 31, 2000
Rurkela (Ministry of Finance)	**$ 2,639**	$ 2,639
Bhilai (Ministry of Finance)	**1,312**	1,312
Sberbank	**1,000**	–
Other	**762**	–
	5,713	3,951
Less current portion	**(3,255)**	(2,544)
	$ 2,458	$ 1,407

In May 1993, Uralmash obtained a loan from the Ministry of Finance of the Russian Federation for delivery of equipment for the plant in Rurkela, India under an agreement between Uralmash and Steel Authority of India, Ltd. The loan bears interest at 10% annually. The repayment of the loan should be effected in full by July 2005. The loan is secured by the rights to receive payments under an agreement between Uralmash and Steel Authority of India, Ltd. on delivery of equipment to Rurkela Metallurgical Plant in India. The Ministry of Finance can withhold from the Uralmash bank accounts the amount of indebtedness, or the Company's assets in the outstanding amount.

17. Long-term Debt (continued)

In November 1993, Uralmash obtained a loan from the Ministry of Finance of the Russian Federation for delivery of equipment to Bhilai Metallurgical Plant in India. The loan bears interest at 12% annually. The repayment of the loan was to be effected in full by April 1995. Due to this fact the outstanding balance is shown as current portion of long-term debt. The loan is secured by the rights to receive payments under an agreement between Uralmash and Tyazhpromexport on delivery of equipment to Bhilai Metallurgical Plant. The Ministry of Finance of the Russian Federation can withhold from the Uralmash account the amount of indebtedness, or the Company's assets in the outstanding amount. No action has been taken by the Ministry of Finance of the Russian Federation to obtain immediate repayment.

In 2001, Krasnoye Sormovo obtained a US dollar-denominated loan from the Volgo-Vyatsky branch of Sberbank of $1,000. The loan bears interest at a rate of 1.5% per annum during the period from November 16, 2001 to January 25, 2003, and at a rate of 15% per annum for the period from January 25, 2003 through the repayment date (March 25, 2003). The loan is secured by US dollar-denominated promissory notes of Sberbank of $1,068 at par value (Note 5).

As of December 31, 2001, other long-term debt consisted primarily of a long-term liability for the rent of land of Izhorskiye Zavody and long-term promissory notes issued.

Aggregate maturities of long-term debt as of December 31, 2001 are as follows:

2002	**$**	**3,255**
2003		**1,593**
2004		**456**
2005		**351**
2006		**58**
	$	**5,713**

18. Minority Interest

As of December 31, 1999	$ 165,551
Acquisition of Krasnoe Sormovo	40,281
Minority interest in net income of subsidiaries	1,234
As of December 31, 2000	207,066
Acquisition of Burovaya Tekhnika	6,523
Acquisition of additional share in Krasnoe Sormovo	(8,601)
Acquisition of additional share in Izhorskiye Zavody	(1,318)
Minority interest in net losses of subsidiaries	(1,970)
As of December 31, 2001	**$ 201,700**

19. Shareholders' Deficiency

Common and Cumulative Preferred Stock

The Company's original charter provided for 2,830,000 shares of authorized 100-ruble par value common stock. Subsequently, the Board of Directors has authorized the issue of additional charter capital of 9,420,000 shares of common stock in April 1997, 2,750,000 shares of cumulative preferred stock in May 1997, and 4,500,000 shares of common stock in June 1997. On May 27, 1998 the Company additionally issued 18,600,000 shares of common stock with par value of 0.1 ruble. All new issued stock was used by the Company for acquisition of its subsidiaries (Note 4) or transferred to related parties, ZAO Neftyanoi Investitsionnyi Dom and OOO Novye Vozmozhnosti, at a token value.

The shares of cumulative preferred stock do not have a voting right, except for certain issues pertaining to the liquidation or reorganization of the Company or changes in the charter documents, earn dividends at 12% per annum, and have a liquidation value of 0.1 ruble per share.

As of December 31, 1999, the Company's authorized charter capital consisted of 36,250,000 shares of common stock and 2,750,000 shares of cumulative preferred stock with par value of 0.1 ruble per share, of which 35,350,000 and 2,750,000, respectively, were issued and outstanding at that date. In August 2000, the Company additionally authorized 30,000,000 shares of common stock for future issuances.

In February 1998, the Company's shareholders converted 12.2% of shares of its common stock to Global Depositary Receipts and American Depositary Receipts for trading on international stock markets. As of December 31, 2001 and 2000, Global and American Depositary Receipts amounted to 8,259,752 (26.33% of shares of its common stock) and 8,157,133 (23.08% shares of common stock), respectively.

19. Shareholders' Deficiency (continued)

Common and Cumulative Preferred Stock (continued)

As of December 31, 2001 the Company had a stock option agreement to repurchase 32,705 of its preferred stock at par from ZAO Neftyanoi Investitsionnyi Dom.

Treasury Stock

In December 2001, the Company re-acquired 4,424,718 shares of its common stock at a price of 0.1 ruble per share from ZAO Neftyanoi Investitsionnyi Dom and OOO Novye Vozmozhnosti, both related parties. Such repurchase of treasury stock was made under the stock option agreement that had been concluded by the parties in 1998, when these related parties acquired the Company's common stock at similar prices.

In December 2001, 450,000 shares of the treasury stock were sold to the Company's management at a price of 0.27 ruble per share. As of the dates of such sale, the Company's common stock was quoted at $4.00 per share. The Company recognized management compensation expense of $1,800 in its consolidated statement of income being the fair value of the common stock given with a corresponding increase in additional paid-in capital.

As of December 31, 2001, 3,974,718 shares of the Company's common stock remained in treasury stock (nil in 2000).

Additional Paid-In Capital

Additional paid-in capital was formed mainly in 1997-98 as a result of the issuance of the Company's common and cumulative preferred stock for at prices in excess of par value or as a consideration for the acquisition of controlling stakes in Uralmash, ZSMK and Izhorskiye Zavody. As described above, $1,800 of additional paid-in capital originated in 2001 from the re-issuance of the Company's common stock to management as the consideration for the past services.

Distribution of Statutory Earnings

In accordance with Russian legislation, the Company can distribute all profits as dividends or transfer them to reserves. Dividends may only be declared from accumulated undistributed and unreserved earnings as shown in the Russian statutory financial statements. Dividends are subject to a 15% withholding tax which can be reduced or eliminated if paid to foreign owners under certain applicable double tax treaties.

20. Gain on Sale of Non-Core Business Units

As part of its on-going restructuring, effective 2000 the Company has started to dispose of certain of its non-core business units.

In April 2000, Izhorskiye Zavody sold a unique Mill 5000 facility, at carrying value of $5,274, to Severstal plant for $19,930. The realized gain on the sale of Mill 5000 is a result of a presumably better utilization of the facility by Severstal plant, which, by management's estimate, would result in annual savings of approximately $1,000 to be realized by Izhorskiye Zavody during the period when the Company will outsource the pipes manufactured at this facility.

In April 2001, the Company transferred certain tube production equipment of $1,561 at net book value as a 100% capital contribution to a newly organized legal entity, OOO Tube Works. In June 2001, the Company sold these production facilities to a third party for a total consideration of $6,100 paid in cash, various corporate promissory notes and the Company's non-convertible bonds (Note 15). The Company realized a gain of $4,539 on this sale.

21. Gain on Release from Tax Penalties

Prior to September 1, 1999, Izhorskiye Zavody recorded a $15,594 accrual related to tax penalties in respect to road-users' (non-income based) tax and pension funds levied by the St. Petersburg tax authorities.

In the course of 2000, various clarifications from regulatory bodies confirmed that the additional social fund accruals assessed by the tax authorities had been levied in violation of the then current tax and pension fund laws. Whereas Part One of the Tax Code of the Russian Federation, which covered the period under dispute (from January 1, 1999 through August 18, 1999), confirmed the Company's position, Izhorskiye Zavody filed an appeal with the St. Petersburg Arbitration Court. In 2000, Izhorskiye Zavody also filed an appeal in regards to the penalties on road-users' tax of $3,780.

The decision of the St. Petersburg Arbitration Court of May 28, 2001 ruled that the Company be released from the accrued pension fund penalties. In addition, during the period from April 28, 2001 to May 24, 2001, the St. Petersburg Arbitration Court passed several verdicts in the Company's favor and released it from penalties for non-timely payment of road-users' tax. Consequently, in the year ended December 31, 2000, the Company reversed contingent loss accruals made in 1999 of $11,172 and $3,780 on the release from pension fund and road-users' tax penalties, respectively.

In October 2001, following further court hearings, Izhorskiye Zavody recorded an $11,667 accrual related to tax penalties for the non-payment of its contributions to the pension fund in 1998, which was treated as a change in an accounting estimate. Subsequent to December 31, 2001, the decision of the North-West Federal Arbitration Court of June 14, 2002 ruled that the Company be released from $6,718 of such accrued pension fund penalties. Therefore, the accrual of additional pension fund penalties during the year ended December 31, 2001 was recorded net of a reversal of a portion of such penalties, in the amount of $4,949 in the consolidated statement of income.

21. Gain on Release from Tax Penalties (continued)

Following decisions of court hearings held in June 2001–February 2002, the Company reversed tax penalties recorded in 2000 and prior years regarding delayed payments of personal income tax in the amount of $4,313.

22. Provision for Tax Penalties

Provision for tax penalties in the year ended December 31, 2000 consisted of penalties assessed by the St. Petersburg tax authorities for the Izhorskiye Zavody non-timely payment of the following taxes: $2,460 - personal income tax, $1,748 – payroll fund related taxes, $1,242 – VAT, $1,334 – road-users' tax and $1,215 – other taxes.

In addition to pension fund penalties of $4,949 as discussed in Note 21, provision for tax penalties in the year ended December 31, 2001 consisted of penalties assessed by the Ekaterinburg and St. Petersburg tax authorities for the Uralmash and Izhorskiye Zavody non-timely payment of the following taxes: $1,721 - road-users' tax, $1,693 - VAT, $1,326 - payroll fund related taxes, $622 – personal income taxes, $924 – other taxes.

23. Commitments and Contingencies

Tax Optimization

The Company uses a number of methods to reduce or minimize its tax obligations, including transfer of its profits offshore or to domestic tax havens (Note 7). This resulted in significant tax savings to the Company in 2001 and prior years, which approximated $5,000 per annum. There is a risk that certain tax optimization transactions may be challenged by authorities and result in significant penalties and other liabilities, or the opportunities to execute such transactions may cease.

Management believes that that the Company will continue to manage and adapt to any amendments or new regulations which may impact upon current business practice and operations to avoid any material adverse effect.

Economic and Political Environment in Russia

The Russian economy displays emerging market characteristics. These characteristics include high inflation, lack of liquidity in the capital markets, and the existence of currency controls that causes the national currency to be illiquid outside of the Russian Federation. The success and stability of the Russian Federation's economy may be significantly impacted by the government's actions with regard to supervisory, legal, and economic reforms.

23. Commitments and Contingencies (continued)

Economic and Political Environment in Russia (continued)

The taxation system in Russia is evolving as the central Government transforms itself from a command to a market oriented economy. There were many Russian Federation tax laws and related regulations introduced in 2001 and previous years, which were not always clearly written and their interpretation is subject to the opinions of the local tax inspectors, Central Bank officials and the Ministry of Finance. Instances of inconsistent opinions between local, regional and federal tax authorities, and between the Central Bank and Ministry of Finance are not unusual.

As of December 31, 2001, the Company does not believe that any material matters exist relating to the developing markets and evolving fiscal and regulatory environment in Russia, including current pending or future governmental claims and demands, which would require adjustment to the accompanying consolidated financial statements for those statements not to be misleading.

The Company may be subject to loss contingencies pursuant to Russian national and regional environmental claims that may arise from past and current operations. As Russian laws and regulations evolve concerning environmental assessments and cleanups, the Company may incur future costs, the amount of which is currently indeterminable due to such factors as the current state of the Russian regulatory process, the ultimate determination of responsible parties associated with these costs and the Russian government's assessment of respective parties' ability to pay for these costs related to environmental reclamation.

The Company's operations and financial position will continue to be affected by Russian political developments including the application of existing and future legislation and tax regulations. The likelihood of such occurrences and their effect on the Company could have a significant impact on the Company's ability to continue operations. The Company does not believe that these contingencies as related to its operations, are any more significant than those of similar enterprises in Russia.

24. Subsequent Events (unaudited)

In 2002, the Company purchased controlling or significant interests in various engineering and heavy machinery entities involved in shipbuilding and manufacturing of drilling equipment in Russia, Ukraine, Romania and the United States. The total cost of such investments was $27,700, of which $4,100 was recorded as investments as of December 31, 2001. Included in this cost is the Company’s acquisition of a controlling 75% interest in the US-based Friede & Goldman Limited, that is one of the world leaders in the construction and design of the sea drilling platforms, for which the Company paid $15,000. The Company believes that these investments would significantly increase its domestic and foreign customer base especially in the drilling equipment segment.

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