



OIL COMPANY  
**LUKOIL**

2002

ANNUAL REPORT  
**2002**

C O N T E N T S

<b>LUKOIL Today</b>	3
<b>Letter to Shareholders</b>	4
<b>Events in 2002</b>	8
<b>Oil &amp; Gas Exploration &amp; Production</b>	10
<b>Supply &amp; Transportation</b>	22
<b>Refining, Petrochemicals &amp; Marketing</b>	26
<b>Energy Efficiency in Production &amp; Refining Sectors</b>	32
<b>Caring for the Environment, Health &amp; Safety</b>	34
<b>Development Opportunities for Personnel</b>	38
<b>Charity &amp; Sponsorship Activities</b>	42
<b>Corporate Governance</b>	48
<b>The Komi Republic – A Promising Oil &amp; Gas Production Region for LUKOIL</b>	57
<b>Management's Discussion and Analysis of Financial Condition and Results of Operations</b>	63
<b>Consolidated Financial Statements prepared in accordance with US GAAP Standards</b>	83
<b>Reference Information</b>	116



### Basic Financial Indicators

Operating revenues (mln dollars)	<b>15 334</b>
Income from operating activities (mln dollars)	<b>2 662</b>
Income before income taxes (mln dollars)	<b>2 582</b>
Net profit (mln dollars)	<b>1 843</b>
Capital expenditures (monetary and non-monetary, mln dollars)	<b>2 072</b>
Investment (mln dollars)	<b>302</b>
Dividends to shareholders (recommended, mln dollars)	<b>532</b>

### Basic Operating Indicators

Oil and gas reserves as of 1 January, 2003 (proven, bln boe)	<b>19.3</b>
Oil production (subsidiaries and affiliates, mln tons)	<b>79.8</b>
Gas production (subsidiaries and affiliates, bcm)	<b>5.1</b>
Refinery throughput (LUKOIL refineries in Russia and abroad, mln tons)	<b>41.7</b>
Oil exports from Russia (subsidiaries and affiliates, mln tons)	<b>34.2</b>
Petroleum products exports from Russia (mln tons)	<b>14.2</b>
Petrochemical production (mln tons)	<b>1.6</b>
Number of retail sales outlets (proprietary and rented)	<b>4,076</b>



## LUKOIL – RUSSIA'S LEADING OIL COMPANY

LUKOIL today is:

✘ 1.3% of global oil reserves and 2% of global oil production.

✘ 20% of total Russian oil production and 18% of total Russian oil refining.

✘ The 2<sup>nd</sup> largest private oil company worldwide by proven reserves.

✘ The 6<sup>th</sup> largest private oil company worldwide by production.

✘ 13<sup>th</sup> by net profit among the world's top-100 private and national oil companies.

✘ 30<sup>th</sup> by sales among the world's top-100 private and national oil companies.

✘ 25<sup>th</sup> by assets among the world's top-100 private and national oil companies.

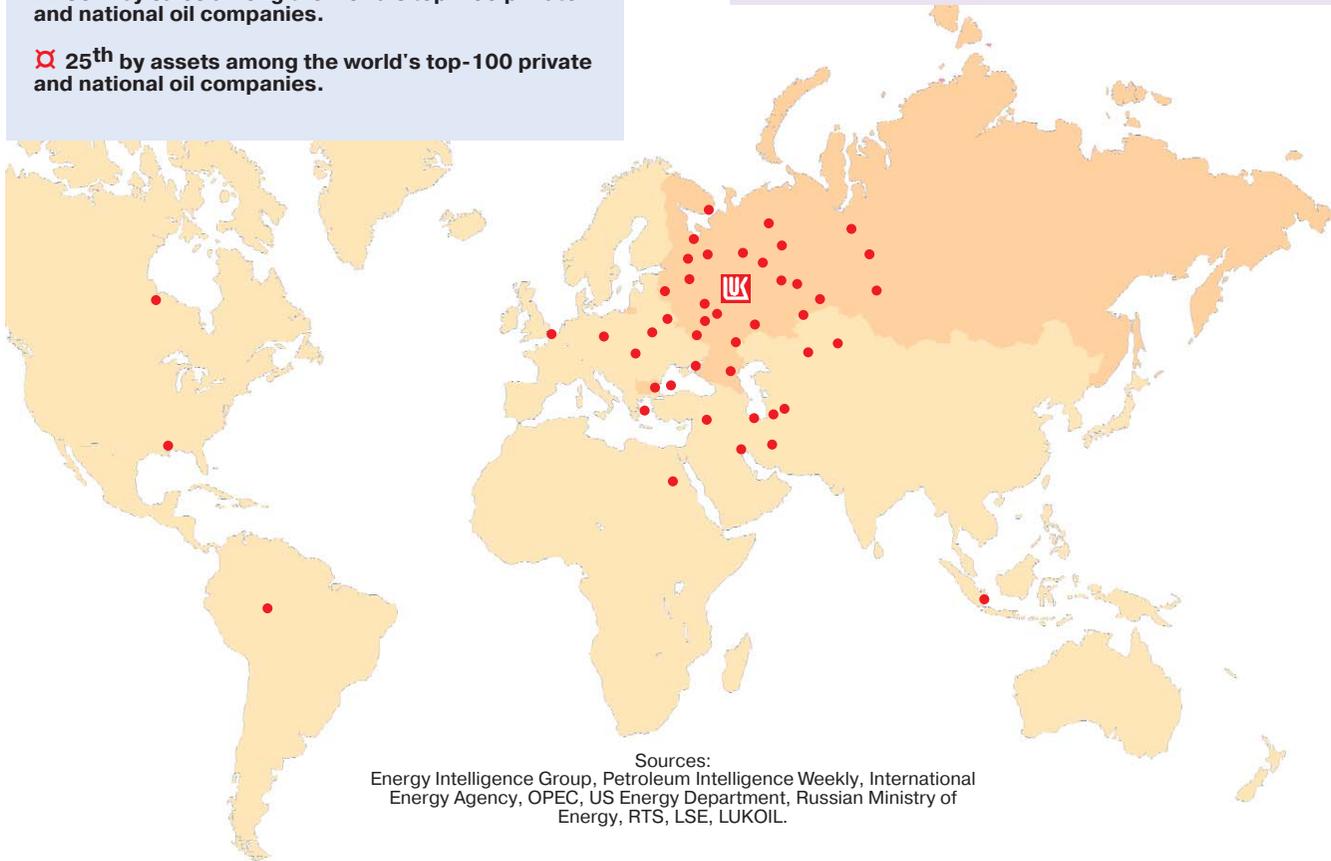
✘ The leading Russian oil business group with annual turnover of \$15 bln.

✘ The most liquid among Central and Eastern European stocks on the London Stock Exchange (LSE).

✘ The most liquid oil stock and second most liquid stock overall on the Russian Trading System (RTS).

✘ A leader among Russian oil companies for openness and transparency. The first Russian company to be listed on the London Stock Exchange.

✘ The only private Russian oil company whose share capital is dominated by minority stakeholders



Sources:  
Energy Intelligence Group, Petroleum Intelligence Weekly, International Energy Agency, OPEC, US Energy Department, Russian Ministry of Energy, RTS, LSE, LUKOIL.



## LETTER TO SHAREHOLDERS

***LUKOIL continued its growth in 2002, remaining the largest Russian oil company in terms of both production and reserves. Expansion through exploration and acquisitions made LUKOIL the 2nd largest public oil company in the world in terms of reserves, and the 6th largest in terms of oil and gas production volumes. We have continued exploration and development in our new production regions — Timan-Pechora, the Yamalo-Nenetsk Autonomous Okrug and the Northern Caspian — laying the foundations for further growth. We were able to maintain previous year levels of profitability despite a tightening of the Russian tax regime. Our internal restructuring program had positive impact on efficiency in 2002, increasing company value. Profitable operations and huge future potential have earned LUKOIL a place among the international energy sector elite.***

Last year was a break-through year for LUKOIL, seeing the beginning of our deep restructuring program aimed at efficiency and share price increases. The key aspects of the program are improvement of operating and investment efficiency, streamlining of corporate structure, and sale of non-core assets.

The program has already boosted company earnings thanks to increase in the export share of production, rationalization of production expenses, and closure of wells with low profitability. The relevant figures for 2002 show:

✘ Growth of 6% in exports of oil and petroleum products to 57% of total sales.

✘ Reduction of production expenses by 5% to \$2.60/barrel.

✘ Closure of about 4% of the company's operational wells, representing the least productive and least profitable wells.

The company has made significant progress in consolidating its assets both in the exploration and production sector and in the refining and marketing sector. Efforts have been focused on streamlining group structures whilst rationalizing selling, general and administrative expenses.

In 2002 LUKOIL defined three blocks of activity for improving management and streamlining corporate structure. These three blocks are: Finance, Oil Exploration and Production, and Refining and Marketing. Investment and Budget Committees were also set up with remits to improve the quality of decision making in these areas.

The restructuring program represents an unprecedented effort by LUKOIL management to increase company efficiency and raise the share price. The market has responded well, and there has been strong growth of the LUKOIL share price since the program's announcement in April 2002.

In 2002 serious attention was also paid to improvement of corporate governance and informational openness. Key steps were as follows:

✘ The Board of Directors welcomed three independent representatives of minority shareholders (Mark Mobius, Richard Matzke and Oleg Kutafin).



✘ A Main Department for Control and Internal Audit was created.

✘ LUKOIL shares underwent the full procedure of listing on the London Stock Exchange, which led to significantly increased liquidity and improved company transparency.

LUKOIL commands an impressive portfolio of production assets. We are the only Russian oil company with significant reserves in two new hydrocarbon provinces: Timan-Pechora and the northern Caspian. It is anticipated that these fields will be operational within a couple years, providing a basis for the company's successful, long-term growth.

Our key operating regions — Western Siberia and Perm Oblast ('oblasts' are the main regional sub-divisions within the Russian Federation) — continue to provide stable output. LUKOIL intends to maintain its significant presence in these regions, improving operational efficiency and optimizing its production portfolio.

Our natural gas assets on the Tazovsk peninsula (Yamalo-Nenetsk region) and newly discovered natural gas fields in the northern Caspian provide a solid foundation for development of the company's natural gas business. We have set a goal of developing our gas business to a comparable size with our oil business: natural gas production should be in the range of 50 bcm by 2010. We are currently developing a marketing strategy for our gas reserves, discussing partnership options with Russian and foreign players in the gas and energy sector.

In December 2002, LUKOIL signed an agreement to sell its share in the Azeri-Chirag-Gyuneshli project. That deal, which has been closed and will be reflected in 2003 financial results,

is the first major step in optimization of our portfolio, and underscores our ability to reshape the company reserve portfolio via asset sales. We intend to continue this optimization process, but we feel that the market value of the majority of our reserves has not yet reached its fair level.

LUKOIL remains a leader in oil refining, owning seven refineries with total capacity of 58.5 mln tons/year. Significant increase in production at the Nizhegorodnefteorgsintez Refinery, acquired in 2001, brought overall production by LUKOIL refineries in Russia to 33.9 mln tons in 2002. Our petroleum products are sold through



4,076 retail outlets<sup>1</sup> as well as through wholesale channels.

LUKOIL retained its level of profitability in 2002. This was a considerable achievement in view of continued high inflation in Russia, strengthening of the Russian rouble against the US dollar and tightening of the tax regime.



<sup>1</sup> As of 1 January, 2003 including proprietary, leased and franchised.



**Inflation**

In 2002, inflation in the Russian Federation was 15.1%, compared with 18.8% in 2001.

**Strengthening of the rouble against the US dollar**

During 2002, the Central Bank of Russia pursued a policy of currency intervention aimed at suppressing growth of the US dollar exchange rate. As a result, the rouble strengthened by 9% against the US dollar forcing extra efforts by LUKOIL to reduce its expenses in dollar terms, as 80% of overall expenditures are in roubles.

**Prices on Russian and international markets**

**Export prices for crude oil**

The average sales price for Urals crude oil rose from \$21.13/barrel in 2001 to \$21.95/barrel in 2002 (growth of 3.9%)

**Domestic prices for crude oil**

During the accounting period, the average domestic sales price fell by \$2.55/barrel (23.5%) to \$8.28/barrel.

**Prices for petroleum products on international markets**

The average price of petroleum products increased by \$10.55/ton (4.7%) to \$236.85/ton

**Prices for petroleum products on the domestic market**

The average price of petroleum products inside Russia increased by \$4.19/ton (2.9%) to \$146.14/ton.

**Changes to the tax regime**

Several taxes were repealed with effect from 1 January 2002, including the tax on sub-soil resources, the tax on replacement of the mineral resource base, and the excise tax on oil production. These taxes were replaced by a unified production tax. Introduction of the new unified extraction tax led to increase of tax liabilities other than income tax of LUKOIL by \$737 mln (including the influence of increase in crude oil excise), or by 100% compared to 2001.

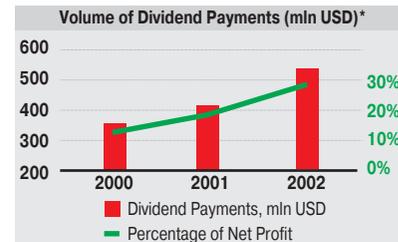
LUKOIL achieved the following production results in 2002:

- ✘ Oil production (including all LUKOIL's subsidiaries and affiliated companies) grew by 2% to 79.8 mln tons.
- ✘ The company's reserve replacement ratio was 246%. LUKOIL remains the unchallenged leader for geological exploration in Russia and consistently augments existing reserves at low cost.
- ✘ The company recorded a 15% increase in oil refined at its Russian refineries, allowing reduction of crude sales on the domestic market.

Maintenance of profitability levels makes it possible for LUKOIL to fulfill its obligations to increase payments to shareholders. Based on year-end results, dividend payments will be 19.5 roubles per share, which is 30% higher than in 2001.

LUKOIL intends to pay \$532 mln (or 29% of net profit) in dividends.

Dividend income plus share price growth gave total yield per share (total shareholder return) of 24% in 2002.



\* In calculation of dividend payment amounts in US dollars, exchange rates on the date of announcement were used.

LUKOIL's concerns are not limited to production. The company is also aware of the importance of ecological and social issues. In 2002, KPMG completed a full-scale external eco-



\* Total Shareholder Return (TSR) — the ratio of the sum of the difference between price of a share at the end of the period, and at the beginning of the period, and the dividends paid for that period, to the price of a share at the beginning of the period.

logical audit of LUKOIL, confirming the company's high standards on issues of ecological safety. LUKOIL's Social Code, adopted in 2002, has helped the company to provide better social welfare standards for employees. LUKOIL has also continued to create and sponsor other social and charitable programs.

LUKOIL has shown itself to be a worthy leader of the Russian oil industry by constant strategy reviews and more ambitious operational goals. We continue to set standards of stability



and success in today's harsh market conditions in order to secure growth for shareholders in 2003 and beyond.

In 2003 LUKOIL is continuing its program of restructuring to increase overall efficiency of activities. The company intends to work toward its goal of minimum 4% annual growth of oil production. Consolidation of assets across various sectors will continue, as will rationalization of production expenditures, streamlining of LUKOIL's corporate structure and sale of assets in the construction, finance and transport sectors, which do not fit the company's profile. Through this efforts, transparency will be increased and corporate governance improved. Management efforts will be focused on increasing the share price and providing shareholders with a high yield on their invested capital.

Long-term development efforts are concentrated on oil production (which provides stable, long-term growth) and on carving a place for



LUKOIL in the natural gas and energy sector. Refining, petrochemical and marketing sectors will also be developed to assure adequate production of high value-added products and distribution channels for them. Maintenance of balance between various activities should ensure stability of the company's future development under any conditions. We also have ambitious goals for production of oil and gas abroad, and for international marketing of our petroleum products.

The internal changes currently underway at LUKOIL are designed to transform the company's production successes into steady, strong growth in

share price and capitalization. A higher, more intensive production growth rate over the next decade will boost the share price to a new level, and increase the attractiveness of LUKOIL stock. All of our company's management and employees are working to strengthen LUKOIL's position as the leading domestic oil company, while pursuing the medium-term goal of a more prominent position in the global oil and gas industry.

Chairman of the Board of Directors, OAO LUKOIL  
Valery Graifer

President of OAO LUKOIL  
Vagit Alekperov



## EVENTS IN 2002

### January

Company shareholders proposed Richard Matzke, ex-Vice-Chairman of Chevron, and Mark Mobius, Managing Director of Templeton Asset Management Ltd., as candidates for LUKOIL's Board of Directors.

### February

LUKOIL opened Russia's first privately owned trunk oil pipeline, running from Perm to Andreyevka. The pipeline links LUKOIL's Perm Oil Refinery to the state-owned Transnefteprodukt system for transportation of refined products.

### March

A Department for Internal Audit was established to help refine management systems, and to increase the efficiency of risk management and internal control systems.

### April

LUKOIL management announced a program of restructuring up to 2010. The main goals are to increase profitability and the company share price. In the short term, these goals will be supported by growth in the company's export ratio, increased earnings, optimization of LUKOIL's well stock, cost-cutting, increased production efficiency, and streamlining of company structure.

A contract was signed with the Columbian state oil and gas company, Ecopetrol, for joint geological exploration of the promising Condor Block in Columbia's Llanos Basin.

### May

Lukinter Finance B.V., part of LUKOIL Group, fully retired \$230 mln of convertible bonds issued in April 1997 (including interest and premium).

A coupon payment was made on \$350 mln of convertible bonds issued in November 1997 and due for redemption in 2003.

LUKOIL and Miller & Lents (USA) completed a review of company reserves as of 1 January, 2002. The review was carried out to the standards of the US Society of Petroleum Engineers (US SPE). Proven oil and gas reserves were 16.6 bln barrels oil equivalent (2.3 bln tons). Year-on-year reserve growth was 11%.

### June

LUKOIL began construction of a terminal for transportation of petroleum products on Vysotsk Island (Leningrad Oblast). The terminal will have capacity of 10.7 mln tons and opening of the first loading complex at the terminal is planned for Q4 2003.

LUKOIL Overseas Holding Ltd., a fully owned subsidiary of LUKOIL, acquired a share in the WEEM Concession (Hurgada, Egypt) from Canada's Naftex Energy Corporation and became the sole contractor, investor and project operator under terms of the concession agreement for exploration and production of oil. Other parties to the concession agreement are the Egyptian State Oil Company (EGPC) and the government of the Arab Republic of Egypt.

Richard Matzke, ex-Vice-Chairman of Chevron Group, Mark Mobius, Managing Director of Templeton Asset Management Ltd., and Oleg Kutafin, Rector of the Moscow State Academy of Law, joined the Board of Directors of LUKOIL as independent directors.





### **August**

LUKOIL became the first Russian company to receive a full secondary listing on the London Stock Exchange (LSE), after securing inclusion in the Official List of the UK Listing Authority (UKLA). All of LUKOIL's ordinary shares and first-level ADRs have been listed, yet only ADRs are traded at LSE.

### **October**

As part of the second stage of its restructuring program, LUKOIL initiated a deal to sell its service company, LUKOIL-Drilling, and presented the company's assets to potential buyers in Houston (USA).



### **November**

A General Agreement on Strategic Partnership for the period 2002-2005 was signed between LUKOIL and the Russian gas monopolist, Gazprom. The agreement envisages mutually beneficial partnership in exploration, production, transport, oil and gas refining, sales of oil, gas, petroleum and gas refined products, chemicals and petrochemicals, and in production of electrical and thermal energy.



LUKOIL issued \$350 mln of convertible bonds, which are convertible into GDRs issued on LUKOIL shares.

LUKOIL, Sibneft, TNK and YUKOS signed a Memorandum of Mutual Understanding on construction of the pipeline from Western Siberia through Timan-Pechora to Murmansk. This will be the first-ever joint project by major Russian oil companies for domestic pipeline transportation of crude oil.

### **December**

LUKOIL reached agreement with Inpex Corporation on sale of LUKOIL's share in the Azeri-Chirag-Gyuneshli project.

LUKOIL common shares owned by the Russian state and equivalent to 5.9% of authorized share capital were placed on the London Stock Exchange (LSE) for a total of \$775 mln at \$15.5 per share. After the sale of this share stake, government participation in LUKOIL's authorized share capital decreased to 7.6%.

LUKOIL management decided to create a Main Department for Control and Internal Audit based on the company's Department for Internal Audit. The new division is dedicated to analysis and evaluation of LUKOIL's production and financial activities from the standpoint of efficiency, observance of shareholder and investor rights, and Russian and international law.



## **OIL & GAS EXPLORATION & PRODUCTION**





## Oil and Gas Reserves & Exploration

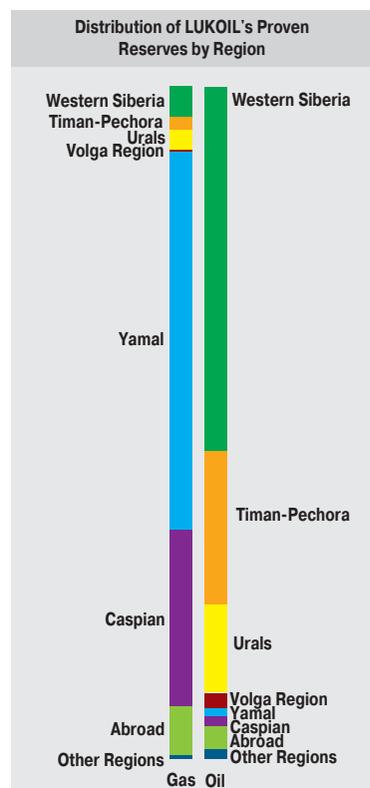
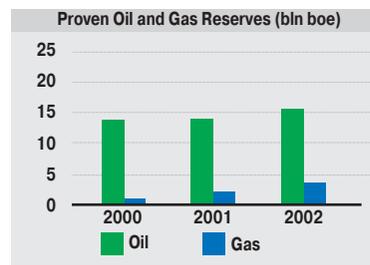
LUKOIL has always been attentive to renewal of its mineral resource base, which is one of the most important indicators of the company's potential for growth and increase in share price. LUKOIL invests consistently to improve its exploration performance.

LUKOIL is currently the second largest private oil company in the world by proven hydrocarbon reserves.

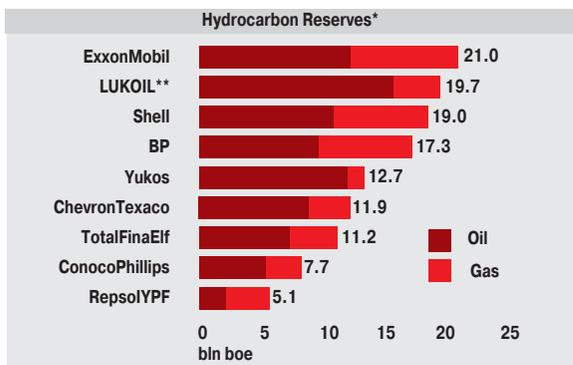
### Reserves

**Reserves measured by Russian classification** — LUKOIL's remaining recoverable hydrocarbon reserves (category ABC1) as of 1 January 2003, without counting foreign assets, were 2.416 bln tons of oil, 37.1 mln tons of gas condensate, and 855.9 bcm of natural gas.

**Reserves measured by international classification** — In 2002, LUKOIL completed its eighth annual technical and economic audit of reserves by US firm, Miller & Lents. Reserves were audited as of 1 January, 2003. In connection with



consolidation of assets in the Komi Republic at the beginning of 2003 (involving TEBUKneft, Ukhtaneft, RKM-oil and YNTK), and reclassification of LUKOIL share in several affiliated companies (owing to an increase of stakes after the Miller & Lents audit), reserves were subsequently recounted.



\* Source: Company reports for 2002.

\*\* Taking into account consolidation of assets in the Republic of Komi at the beginning of 2003 and change of share stakes in several affiliated companies.

### Proven Oil and Gas Reserves using methods and requirements of US SPE

	Oil, mln bbl	Natural Gas, bcm	Oil and Gas, mln boe
Reserves as measured before the recounting / reclassification	15,258	24,164	19,293
Reserves as measured after the recounting / reclassification	15,622	24,253	19,664



LUKOIL's reserve base grew by 16% in 2002, according to the international classification system (5% growth in oil reserves and 83% growth in gas reserves). The growth was due to discovery of new reserves and increased estimates as a result of exploration work, as well as acquisition of several new assets.

**Additions to LUKOIL Proven Reserves in 2002**

	Oil, mln barrels.	Natural Gas, bcm	Total, mln barrels oil equivalent
<b>Proven reserves on 1 January, 2002</b>	<b>14,612</b>	<b>13,210</b>	<b>16,818</b>
Revisions of previous estimates	873	712	992
Extensions and discoveries	308	5,401	1,210
Purchase of hydrocarbons in place	36	4,967	865
Sales of reserves	(7)	—	(7)
Production	(564)	(126)	(585)
<b>Proven reserves on 1 January, 2003</b>	<b>15 258</b>	<b>24,164</b>	<b>19,293</b>

In 2002, four new Caspian fields (Kvalynskoye, Rakushechnaya, Sarmatskoye, and the 170th km field) underwent audits by state and independent experts. Medium-sized discoveries were made in the Komi Republic and the Nenetsk Autonomous Okrug (an "okrug" is a regional sub-division in Russia's federal structure).

As of January 2003, a total 47 affiliates of LUKOIL held licenses for development of sub-soil resources.





### Exploration

Until the tax for renewal of the mineral-resource base was repealed in 2001, geological exploration work in Russia was primarily financed by this tax. The methods used in administering receipts from this tax meant that most prospecting for new reserves took place in regions where oil production was already developed, while promising new regions tended to be ignored.

In order to compensate this tendency LUKOIL has, since 1997, increased the share of its own expenditure used for geological exploration, and has directed this spending exclusively to the most promising new regions, which are Timan-Pechora and the Caspian Sea. Meanwhile, changes in economic aspects of the exploration business have enabled the company to regroup its exploration resources and concentrate efforts in these regions.

LUKOIL's geological exploration work in 2002 was all internally funded and based on strict guidelines aimed at maximizing efficiency. Key principles were as follows:

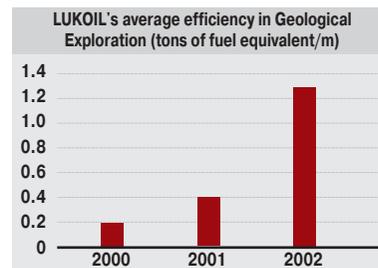
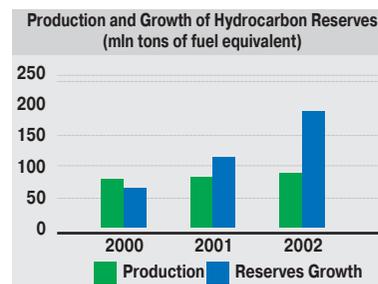
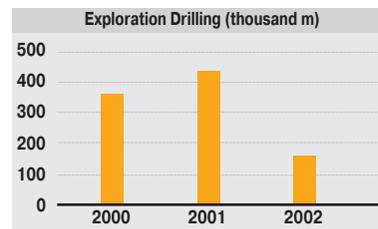
- ✘ A more thorough decision process in selecting sites for exploration.
- ✘ Curtailment of geological exploration work in regions, which have already been well-explored (regions developed by LUKOIL-Western Siberia, and LUKOIL-Permneft) and concentration on new, highly promising regions such as the Timan-Pechora oil and gas province, the Caspian Sea, and the Bolshekhetsk Depression in Yamalo-Nenetsk Autonomous Okrug.

✘ Use of new technologies at all stages of geological exploration work, resulting in better information and lower costs.

LUKOIL's push for efficiency in exploration and focus on the most promising regions brought positive results in 2002 despite reduction in the volume of exploration work (meters of exploration drilling were down by 58% compared with 2001 to 181,000 meters, of which 168,000 meters in Russia). Reserve replacement ratio from exploration in 2002 was 246%, which is the highest level of this indicator in company history. Reserves



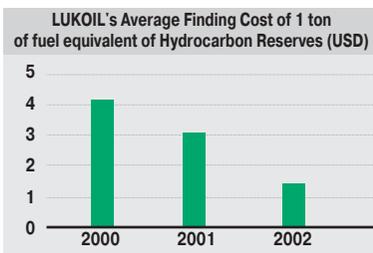
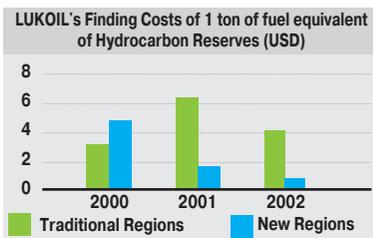
grew by 197 mln tons of fuel equivalent (including 55 mln tons of liquid hydrocarbons), which is 53% more than in 2001.





LUKOIL discovered 16 new hydrocarbon fields in 2003 as well as 15 new deposits of oil, gas and condensate at previously-known fields. Efficiency of geological exploration work was 1,280 tons of fuel equivalent per meter drilled, including 399 tons of oil and condensate.

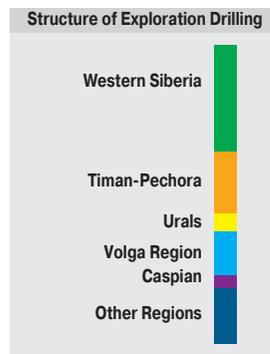
The average cost of geological exploration per ton of hydrocarbon reserves in 2002 was \$1.5/ton of fuel equivalent, which is down by 57% times from the same indicator in 2001 and one of the best results amongst leading oil companies worldwide.



In 2002 LUKOIL prospected 10,900 kilometers using 2D seismic testing and 2,100 square kilometers using 3D seismic testing.

**Russia**

The company's exploration work in 2002 was focused in Western Siberia, Timan-Pechora, and Yamal. Most of the important hydrocarbon discoveries in Russia in recent years have been in LUKOIL's new regions of activity, particularly Timan-Pechora and the Caspian, confirming efficient targeting of exploration efforts by the company.



In **Timan-Pechora** seismic exploration work and drilling of deep wells led to total growth in C1 category reserves by more than 13 mln tons of fuel equivalent. Work was carried out at the Osvanyursk Structure, the Yuzhno-Usinsk, Centralno-Vozeisk, Mamylyskaya and Kostyyskaya sites and at the Yu. Rossokhin field.

In **Western Siberia** growth of C1 hydrocarbon reserves in 2002 was 72 mln tons of fuel equivalent, of which 58 mln tons was added to reserves of LUKOIL subsidiary Yamalneftegazdobycha at the Khalmerpayutinsk field.

In **Perm Oblast** recoverable C1 reserves of LUKOIL-Permneft grew by 1.6 mln tons, and recoverable C1 category reserves of LUKOIL-Perm grew by 7.3 mln tons thanks to exploratory drilling and seismic testing.

On the **Caspian Sea Shelf**, a fourth test well was drilled at the Khvalynsk field resulting in discovery of new gas condensate and oil deposits. A first exploration well at the Sarmatsk elevation discovered the fifth multi-layer oil and gas condensate field since the beginning of deep drilling on the Shelf. Growth of C1 hydrocarbon reserves at the Severny licensing sector was 91.5 mln tons fuel equivalent, including 82 bcm of natural gas.



Left to right: D. Cheloyants, R. Maganov, S. Rakhmetov, A. Novikov



### International Projects

On January 1, 2003 total ABC1 and C2 recoverable hydrocarbon reserves of LUKOIL's foreign projects were 153 mln tons of oil, 36.8 mln tons of condensate and 157.5 bcm of natural gas. Potential reserves from new projects were approximately 400 mln tons.

Future reserve additions abroad will come from projects that are already at the development stage and from new projects located primarily in the Caspian region, the Middle East and Northern Africa.

Spending on international exploration work in 2002 was \$7.4 mln. Main international projects were as follows:

**WEEM (West Esh el-Malahha) and Meleiha, Egypt.** 12,754 meters of exploration wells were drilled in 2002 in Egypt (4,609 for the WEEM project and 8,145 for the Meleiha project). Three wells, two of which were productive, were drilled as part of the WEEM project. Additional analysis of seismic testing data and an estimate of reserves were also completed. Exploration drilling gave reserve growth of 3.1 mln tons.

**D-222 (Yalama), Azerbaijan.** Field work for analysis of the region where the first exploration well is to be drilled has been completed, and data are now being processed. A reinterpretation of previous 2D and 3D seismic test results has been completed. A more accurate structural map of the deposit has increased current estimates of potential reserves from 35 to 153 mln tons.

**Condor, Columbia.** In July 2002, LUKOIL signed a contract with the Columbian company Ecopetrol, specifying that LUKOIL would carry

out geological exploration work. Geological and geophysical materials have been collected and a program of geological exploration has been devised. LUKOIL has sub-contracted 3D seismic exploration work on a territory of 100 square kilometers. Early estimates suggest that potential oil reserves are around 73 mln tons.

**Kungradsky Block, Uzbekistan.** This 3,700 square kilometer block is located in the southern Aral region. Four test wells were drilled and two local elevations were revealed (Kungradskoye and Shege) with total estimated potential hydrocarbon



reserves of 78 bcm of natural gas and 3 mln tons of gas condensate. This exploratory work by LUKOIL was envisaged by its commitment to the 'Uzbekistan' project, which includes starting development of the Khauzak, Shady field, and Kandymskaya group of fields.

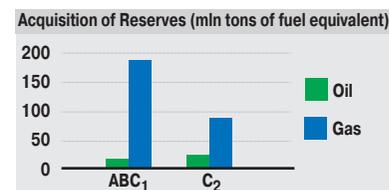
### Restructuring the Exploration and Production Sector

LUKOIL's strategic goals in restructuring of its production business are the creation of five or six major production centers and reduction of production-related operating expenses and capital expenditure.

#### Principles of consolidation:

- ❑ Control of production assets
- ❑ Consolidation of production assets under one holding company with management functions
- ❑ Optimizing expenditures, reduction of selling, general and administrative costs
- ❑ Acquisition of assets with a rapid rate of production growth
- ❑ Divestiture of non-core assets

Addition to LUKOIL of three Russian production companies (Nakhodka-neftegaz, Tugra-Neft and UralOil) in 2002 increased the company's ABC<sub>1</sub> recoverable reserves by 194.6 mln tons of fuel equivalent, and by 106.7 mln tons of fuel equivalent of provisionally estimated C<sub>1</sub> reserves.



Consolidation of LUKOIL's exploration and hydrocarbon production facilities continued in 2002.



### Restructuring the Exploration and Production Sector in Russia

In **Perm Oblast**, a number of production companies (Kama-Neft, Russian Fuel Company, Vishersk Oil and Gas Production Company, and Maikorskoye) were annexed to LUKOIL-Perm. The share of LUKOIL-Perm in Permteks was increased to 100%.

LUKOIL-Perm divested all of its service enterprises including Technical Service Centre, Technical Transport Management, SMU-1 Construction Company, Permglavneftesnab, Permtorgservis, Permlessvyaz, Flek, and the Chaika and Vita sanatoria (all located in Perm Oblast).

In the **Komi Republic**, the number of legal entities and other organizations included in LUKOIL-Komi was reduced from 87 to 35 through mergers, acquisitions and sales. Of the 52 legal entities eliminated, 43 were non-core businesses of LUKOIL-Komi in transport, financial, service, trade and other sectors. In addition, 15 licenses belonging to Nobel Oil and Komi-TEK were transferred to LUKOIL-Komi.

In the **Volga Region**, the core oil production business of LUKOIL-Nizhnevolzhkneft was strengthened by annexation of several companies with production licenses: LUKOIL-Astrakhanmorneft, LUKOIL-Saratovneftedobycha, Geo-As, and LUKOIL-Astrakhanmorneftegaz.

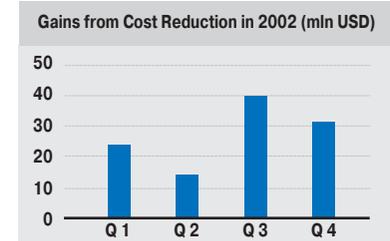
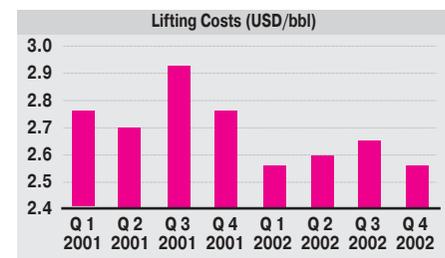
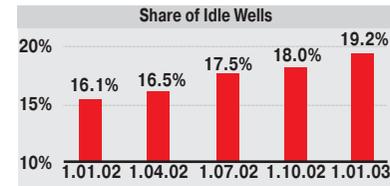
LUKOIL began restructuring of its drilling assets in 2002. The program for restructuring of LUKOIL's largest drilling assets, LUKOIL-Drilling, envisages:

- ❑ Divestiture of non-core divisions.
- ❑ The sale of a stake in LUKOIL-Drilling to a foreign investor.

Sale of a stake in LUKOIL-Drilling should increase its value by:

- ❑ Increasing efficiency and profitability of oil production.
- ❑ Cutting costs.
- ❑ Creating a competitive environment in the drilling and service sectors.
- ❑ Integration of new technologies and attraction of top-quality specialists.
- ❑ Long-term cooperation with international drilling and service companies, which will help to meet LUKOIL's needs in both of these areas.
- ❑ An injection of financial resources from sale of the stake.

A total 1,138 low-production and high-cost wells (approximately 4% of all operating wells) were decommissioned in 2002, reducing production costs from \$2.74/barrel in 2001 to \$2.60/barrel in 2002.





## Restructuring the Exploration and Production Sector in International Projects

In December 2002, LUKOIL agreed to sell its 10% stake in the Azeri-Chirag-Gyuneshti project to Japan's Inpex Corporation for \$1.375 bln as part of the company's asset optimization program. LUKOIL is also considering reduction of its share in other projects, in which the company does not have the role of project operator. Resources from sale of these assets will be directed to high-efficiency projects that represent LUKOIL's core business profile both at home and abroad, including privatization projects.

### The Azeri-Chirag-Gyuneshti Project

Project Participants: BP (project operator, 34.14%), Unocal (10.28%), SOCAR (10%), LUKOIL (10%), Statoil (8.56%), Exxon Mobil (8%), Turkish Petroleum (6.75%), Devon Energy (5.63%), Itochu (3.92%), Delta Hess Khazar (2.72%).

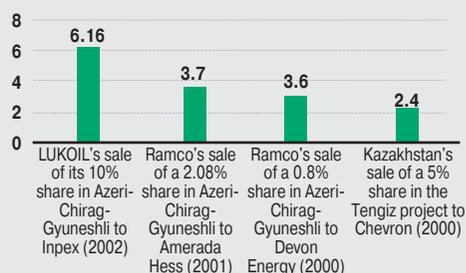
The project operator, the Azerbaijan International Operating Company (AIOC), estimated in 2002 that the project's recoverable oil reserves had increased by more than 700 mln barrels (from 4,645 mln to 5,410 mln barrels) during the agreement period.

On 1 January, 2003 Miller and Lents estimated the Azeri-Chirag-Gyuneshti project PSA proven reserves at 785 mln barrels of oil.

LUKOIL's share of oil reserves in the Azeri-Chirag-Gyuneshti project was 78.5 mln barrels of proven reserves, 32.0 mln barrels of possible reserves, and 35.4 mln barrels of probable reserves.



Sales Price of Reserves (USD/bbl)



## Field Development and Production

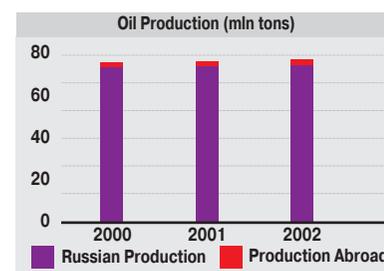
### Russia

Capital expenditures in oil production in 2002 was \$1,411 mln, of which \$384 mln was spent in Timan-Pechora and Caspian regions.

LUKOIL produced 79.8 mln tons of oil<sup>1</sup> in 2002, up 2% from 2001. Company subsidiaries produced 71.3 mln tons (against 68.2 mln tons in 2001) and LUKOIL's share in the oil produced by affiliated companies was 5.7 mln tons.

LUKOIL produced 76.9 mln tons of oil inside Russia, accounting for 20.3% of total Russian production for the year.

On 1 January, 2002 LUKOIL had 368 fields on its

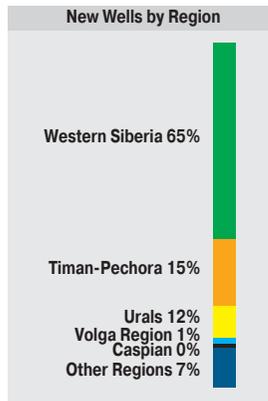
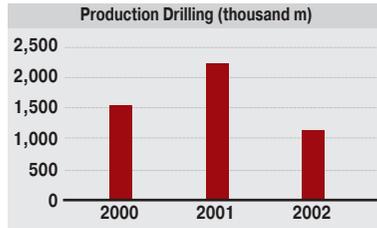


balance sheet, including 269 under development, 67 under exploration, 31 prepared for production activities and 1 temporarily closed. By 1 January, 2003 the number of fields under development had risen to 291, including new acquisitions. Production was launched at 10 new fields in 2002.

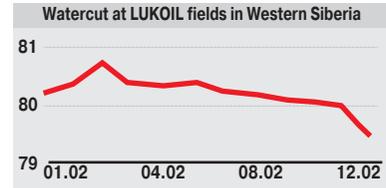
<sup>1</sup> Production in Russia and abroad, including all subsidiaries and affiliated companies.



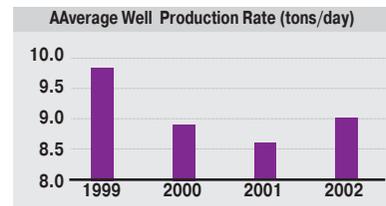
The company completed 1.358 mln meters of production drilling and built 640 new wells in 2002. The company had 28,100 operational wells as of 1 January, 2003, of which 5,400 (19.2%) were idle.



Measures taken in 2002 made it possible to curb growth in watercut and reduce pumping of water. LUKOIL-Western Siberia, which accounted for 62% of company production in 2002, reduced pumping and production of water by more than 50,000 tons per day by closure of water-bearing, unprofitable wells and other measures. In addition, LUKOIL carried out 5,614 operations on wells to enhance production rates.



Improved production techniques in 2002 reversed the decline in average well production rate for the first time in several years, increasing this indicator to 9.0 tons/day from 8.6 tons/day in 2001.





### **International Projects**

In 2002 LUKOIL was involved in 11 international projects for exploration and production of hydrocarbons in Azerbaijan, Kazakhstan and Egypt. Six of these projects produced oil and gas condensate (Azeri-Chirag-Gyuneshli, Karachaganak, Tengiz, Kumkol, Meleiha and WEEM) and three of the projects produced natural gas (Karachaganak, Tengiz and Kumkol). LUKOIL's share of oil and gas condensate from these projects was 2.9 mln tons (around 3.6% of total company production in 2002), up 31% from the 2001 figure. LUKOIL's share of the natural gas produced by these projects was 0.84 bcm, up 25% from 2001. 55 new wells were drilled in foreign oil and gas developments involving LUKOIL through 176,600 meters of rock in 2002.

Average production cost of LUKOIL's international projects in 2002 was \$1.43 per barrel of oil equivalent.



<b>Project</b>	<b>LUKOIL project share</b>	<b>Events in 2002</b>
<b>Azerbaijan</b>		
Zykh-Govsany	50.0%	LUKOIL is the operator of this project, and carried out work in 2002 to prepare production wells for rehabilitation.
Azeri-Chirag-Gyuneshli	10.0%	<p>LUKOIL's share in oil production was 551,400 tons. As of 1 January, 2003, the project had 28 oil wells and 74 gas wells, 17 and 40 of which were idle, respectively.</p> <p>In December 2002, LUKOIL agreed to sell its share in the Azeri-Chirag-Gyuneshli project to Japan's Inpex Corporation. The sale price (subject to particular conditions) was \$1.375 bln.</p>



<b>Project</b>	<b>LUKOIL project share</b>	<b>2002 events</b>
Shakh-Deniz	5.0%	A pilot well was drilled and detailed project-planning work completed for the first well on the TPG 500 installation platform. Tender participants for the contract to build the TPG 500 platform was evaluated, and tenders for the laying of pipeline and equipment installation carried out. In Azerbaijan, the first stage of the pipeline land allocation program was officially completed.
D-222 (Yalama)	60.0% %(increased to 80% at the beginning of 2003)	A tender for drilling of the first exploration well was announced. Tender materials were sent out to interested parties on 3 December, 2002.
<b>Kazakhstan</b>		
Karachaganak	15.0%	LUKOIL's share of oil and gas condensate at the field was 720,000 tons; its share of natural gas was 676 mcm. The project had 130 wells as of 1 January, 2003, of which 56 were active. Workovers was completed on 41 wells and seven wells were deepened (two injection wells and five production wells).
Kumkol	50.0%	LUKOIL's share of production was 1.1 mln tons of oil and 7.5 mcm of associated gas. The project has 189 oil wells, of which 176 are active, 1 idle and 13 under development. Average production rate of a new well was 47 tons/day, 26 wells were transferred to a mechanized work regime, 63,400 meters of production drilling were completed in 2002.
Tengiz	2.7%	LUKOIL's share of production at the Tengiz and Korolevsk fields in 2002 was 355,000 tons oil and 155 mcm of associated gas. A total 44,300 meters of production drilling were completed. As of 1 January, 2003 the project had 61 wells including 12 idle wells.
<b>Egypt</b>		
Meleiha	12.0%	LUKOIL's share of production was 45,000 tons, and 8,150 meters of production drilling were completed in 2002. The project has 81 wells including 26 idle wells.
WEEM	50.0%	LUKOIL's share of production was 170,200 tons, and 5,280 meters of production drilling were completed in 2002. The project has 16 wells, including one idle well. Average production rate of a new well was 223 tons/day.
<b>Columbia</b>		
Condor Block	70.0%	Geological and geophysical data were collected.
<b>Iraq</b>		
Western Kurnah	68.5%	The project was frozen due to UN sanctions against Iraq.

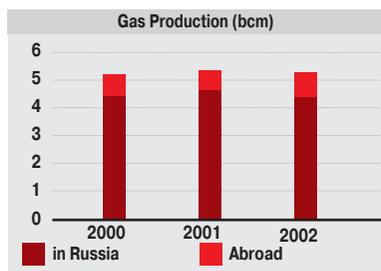


### Gas Field Development and Production

Development of gas business is an important part of LUKOIL's strategy, as demonstrated by two reports produced by the company in 2002: The Concept of Development of LUKOIL's Gas-Energy Business, and Investment Program for Construction of Gas Collection Facilities in 2002-2005.

The company produced 5.14 bcm of gas in 2002, including 3.95 bcm of associated gas and 1.19 bcm of natural gas. The overall output figure represents a rise of 72.9 mcm (6.6%) from 2001. LUKOIL delivered 3.14 bcm of gas to users in 2002, and the largest part of gas deliveries were supplied to oil and gas production associations in the Western Siberian region (42.5% of total supply).

In Russia LUKOIL produced 4.3 bcm of gas in 2002, including 3.79 bcm of associated gas and 0.51 bcm of natural gas. International gas production was 0.84 bcm, including 0.16 bcm of associated gas and 0.68 bcm of natural gas. The company has 253 gas wells, of which 76 are idle.



In November 2002, LUKOIL signed a strategic partnership agreement with Gazprom for 2002-2005. The agreement envisages various forms of cooperation for transport of LUKOIL's natural and associated gas through the Gazprom system.

The strategic partnership also envisages joint oil and gas exploration and development projects in the Yamalo-Nenetsk Autonomous Okrug, the Nenetsk Autonomous Okrug and in the Russian sector of the Caspian, specifying joint participation in contests and auctions for the right to use



natural resources in these regions. Development of partnership in sea transport of oil and gas condensate from the Nenetsk and Yamalo-Nenetsk Autonomous Okrug is also anticipated.

The companies agreed to support relations between their subsidiaries, coordinating utilization of production throughput capacity, refining and sales.

The Mortymya-Teterevsk vacuum compressor station was brought into operation in 2002, and gas deliveries were organized to meet the needs of the city of Uray. This made it possible to end uneconomical deliveries of gas to the Krasnoleninsk Gas Processing Plant (the deliveries were uneconomical because LUKOIL could not make use of the processed gas).





## SUPPLY & TRANSPORTATION





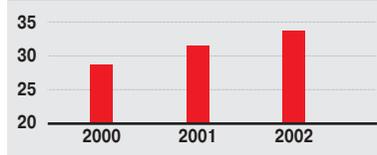
## Oil Supply

In 2002, LUKOIL supplied 79.3 mln tons of oil to users (exclusive of international projects), of which 76.9 mln tons were its own oil. The company delivered 33.9 mln tons of oil to its own refineries (15% more than in 2001) and 9.5 mln tons to other refineries (39% less than in 2001). Other deliveries of oil within Russia were 0.2 mln tons. Export oil was 34.2 mln tons (a 4% increase from 2001), and 8.7 mln tons of oil were delivered to LUKOIL refineries and other refineries abroad,

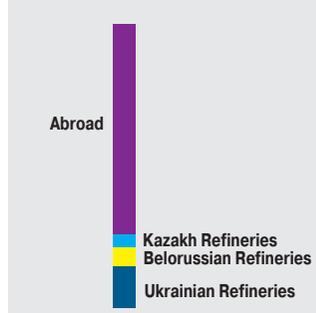
### Oil Distribution in 2002 (mln tons)

Oil Supply to Users	79.3
Supplied within Russia	43.6
<b>To refineries</b>	<b>43.4</b>
<b>To LUKOIL refineries</b>	<b>33.9</b>
Export	34.2
<b>Non-CIS</b>	<b>28.8</b>
Oil Purchased Abroad	1.5

### LUKOIL Crude Oil Exports (mln tons)



### LUKOIL Crude Oil Export Structure



including 7.2 mln tons of the company's own oil.

LUKOIL refineries in Bulgaria, Romania and Ukraine took 5.9 mln tons of total crude export volumes, and the

### Means of Crude Oil Supply / Delivery



company's refineries abroad purchased 1.4 mln tons of oil from other producers.

Users were mainly supplied via the Transneft trunk pipeline system (92% of oil supplied).

## Oil Transportation

The company continued its involvement in pipeline projects in 2002, including development of the Timan-Pechora transportation system. Reconstruction of oil collection and processing systems was begun along the Kharyaga-Usa pipeline, which connects the Kharyaginsk field to the Kharyaga-Usinsk pipeline. The goal of the reconstruction is an increase in throughput capacity from 10 to 13 mln tons per year. Renovation of LUKOIL-Komi's processing and transport systems is due for completion at the end of 2003.

Over 11 mln tons of export oil was routed through the Caspian Pipeline Consortium (CPC) pipeline system in 2002 by CPC project participants, and an engineering survey was commenced with the purpose of increasing CPC capacity.

Plans are being developed for a pipeline to connect the Korobkovsky oil treatment center, the Volgograd Refinery and the CPC in order to deliver light crude from the lower Volga region to refineries and for export. The project has been presented to administrations in Volgograd and Astrakhan Oblasts.





In 2002, oil shipments from the Timan-Pechora oil province continued year-round from the Varandei shipping terminal to Rotterdam, using Arctic tankers. Construction of a stationary shipping terminal is planned at Varandei in order to accommodate increasing volumes, and plans for the construction project have been submitted to required Russian government experts.

LUKOIL, YUKOS, Sibneft, TNK, and Surgutneftegaz signed a Memorandum of Mutual Understanding in November 2002, stating their intent to create a pipeline system for transport of oil through a bulk-oil terminal in Murmansk region in order to accommodate growing oil export volumes from Western Siberia and Timan-Pechora,

The company continued to develop its tanker fleet. The 'Saratov' and the 'Usinsk', both reinforced, ice-class tankers, were launched in 2002. Construction of a second series of five river-sea tankers is under way at the Volgograd Shipbuilding Factory and three such tankers — the 'Inta', the 'Tambei', and the 'Pokachi' — were launched in 2002.

In 2002, LUKOIL transported 0.6 mln tons of oil and 2.5 mln tons of petroleum products using its own tankers.

### **Transportation of Petroleum products**

The initial stage of the **Perm-Andreyevka trunk pipeline**, connecting the Perm Refinery (LUKOIL-Permnefteorgsintez) to the Transnefteprodukt system, was brought on line in 2002. This is the first private petroleum product pipeline to be linked to the state-owned system. The first section is 335.3 kilometers long and has throughput capacity of 2.4 mln tons of petroleum products per year. Its cost was over \$95 mln with a seven-year payback period.

The Perm-Andreyevka petroleum product pipeline will facilitate supplies from LUKOIL-Permnefteorgsintez to the southern portion of Perm Oblast, the regions of Udmurtiya and Bashkiria and other adjoining regions. The pipeline will also facilitate exports and create new jobs in these mainly rural regions.

The pipeline includes a main pumping station at Perm, the pipeline itself, underwater connectors, metered junctions (to measure passage of petroleum product), and automatic loading stations. Emergency recovery posts are spaced along the pipeline





with special equipment for localizing and liquidating spills. The pipeline is fitted with Honeywell automated tele-mechanical systems, providing maximum levels of ecological security.

Construction work on the **Vysotsk Export Terminal** began in June 2002. The terminal will receive petroleum products shipped in by rail (heavy fuel oil, ecologically friendly diesel fuel, gasoline and motor oils) with capacity for 10.7 mln tons of petroleum products per year. The Vysotsk Terminal will enable LUKOIL to significantly increase product deliveries to Europe and the USA, as well as improving its system of transport and storage for petroleum products. The first loading complex, with capacity of 2.5 mln tons, should start to operate in Q4 2003.

LUKOIL is also building an **Astrakhan Terminal**, which should be able to take up to 8 mln tons of petroleum products per year. The Astrakhan Terminal may also be used for transport of crude oil. In its initial stages the Terminal will be able to take throughput volumes of around 1.1 mln tons of light petroleum products, with potential to increase capacity to 5.2 mln tons and later to 8 mln tons.

Petroleum products will be delivered to the Terminal year round by ship. Oil will be delivered using river-sea tankers and rail transport.

Construction of the bulk-oil complex at Astrakhan will be completed between 2003 and 2005. Two oil loading racks, a pumping station and a boiler installation will be built. At present work is being completed on a 17-kilometer railway line between Trusovo and the oil storage facilities, linking them to the Volga region rail system.





## **REFINING, PETROCHEMICALS & MARKETING**





### Oil Refining

LUKOIL owns significant oil refining capacity both in Russia and abroad. The company's Russian refineries (Volgograd Refinery, Permnefteorgsintez, Nizhegorodnefteorgsintez, and the Ukhta Refinery) can refine 40.4 mln tons of oil per year, representing 16% of total Russian refining capacity. LUKOIL's refineries abroad have combined capacity of 17.8 mln tons per year. The company's foreign refineries are LUKOIL-Odessa Refinery (Odessa, Ukraine), LUKOIL-Neftokhim Burgas (Burgas, Bulgaria), and Petrotel-LUKOIL (Ploesti, Romania).

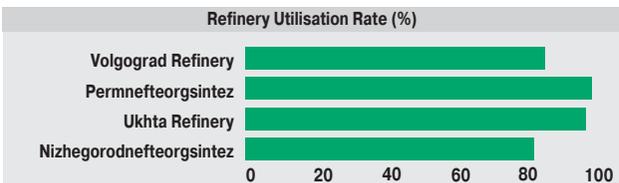
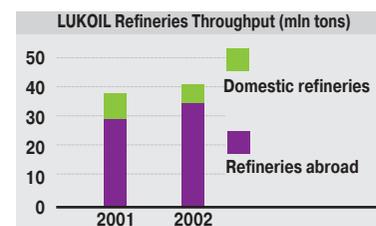
In 2002, LUKOIL refined 44.9 mln tons of oil at its own and third-party refineries. Capacity utilization rate at LUKOIL's Russian refineries was increased as part of the company's restructuring program, and 33.9 mln tons of oil (15% more than in 2001)

were refined. This created \$355 mln extra income from sale of petroleum products, and made it possible for LUKOIL to reduce the amount of crude oil sold on the domestic market.

The company's refineries abroad processed 7.7 mln tons of crude, which is 10% less than in 2001. The lower volumes are mainly due to temporary closure of LUKOIL's Romanian refinery (Petrotel-LUKOIL) for modernization as part of the company's restructuring program. The modernization will equip the refinery for production of Euro-3 and Euro-4 standard petroleum products.

Production of high-octane gasoline at LUKOIL refineries rose by 16.9% in 2002 thanks to modernization, and the share of high-octane gasoline in total automotive fuel produced was 50.6% (2% higher than in 2001). The share of high-octane gasoline in total automotive fuel produced at LUKOIL's foreign refineries rose from 88.6% to 94.1%. Production of packaged motor oils grew by 5.3% compared with 2001.

LUKOIL refined 41.6 mln tons of oil at its own refineries, including 33.9 mln tons at its Russian refineries (18% of total oil refined in Russia). Increased share of processing by Russian plants contributed to capacity optimization.



Left to right: A. Smirnov, Y. Storozhev, D. Tarasov, V. Zhuravleva, V. Rakitsky



**LUKOIL Refining Capacity**

Refinery	Capacity (mln tons/year)	Nelson Complexity Factor	Refinery throughput in 2002 (mln tons)
Permnefteorgsintez	12.1	5.4	11.1
Volgograd Refinery	9.9	3.9	8.4
Ukhta Refinery	3.7	1.8	3.6
Nizhegorodnefteorgsintez	15.0	3.6	10.6
Mini-Refineries in Uray and Kogalym			0.2
<b>Subtotal for Russian Refineries</b>	<b>40.7</b>	<b>3.7</b>	<b>33.9</b>
Odessa Refinery (Ukraine)	3.6	3.0	2.5
Petrotel-LUKoil (Romania)	3.5	5.7	—
LUKOil-Neftokhim Burgas (Bulgaria)	10.7	7.1	5.2
<b>Subtotal for Refineries Abroad</b>	<b>17.8</b>	<b>5.3</b>	<b>7.7*</b>
<b>Total</b>	<b>58.5</b>		<b>41.6</b>

\* Including 400 thousand tons of fuel oil from the Odessa Refinery refined in Burgas.

**Production of Basic Petroleum Products at LUKOIL's Russian Refineries**

Petroleum product name	Production of petroleum product (mln tons)		LUKOIL's share in overall Russian production
	LUKOIL's Russian Refineries	All Russian Refineries	
Gasoline	4.4	27.3	15.9
Jet fuel	1.6	6.7	23.9
Diesel fuel	9.8	49.6	19.8
Fuel and heating oil	9.2	46.9	19.6
Bitumen	1.2	4.1	28.4
Coke	0.5	1.0	43.6
Oil	1.1	2.5	42.0

LUKOIL carried out \$260 mln capital investment in 2002 for integration of new technologies, modernization and production expansion at its refineries.

Licensed hydrode-waxing technology, developed by Chevron, was installed at the Volgograd Refinery, enabling the first production in Russia of high-index isoparaffin-based (group III) oils, which are the basic component of high-grade motor oils.

The atmospheric distillation unit AVT-5 at the Nizhegorodnefteorgsintez Refinery was repaired, increasing crude oil refining capacity. Construction of a T-star hydrocracking complex continued at the Perm refinery.

The company's refineries outside Russia pursued a process of integration: the Odessa Refinery and the Burgas Refinery are increasingly run as an integrated operation.

LUKOIL is continuing efforts to raise quality and competitiveness of its products. The international standards body BVQI (Bureau Veritas Quality International) has certified LUKOIL's foreign refineries as meeting ISO 9001:2000 standards for quality management.

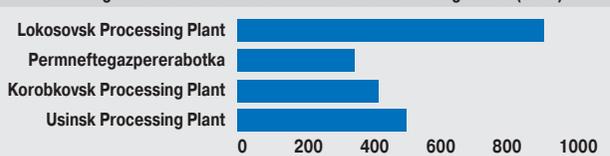




## Natural Gas Processing

Refining of gas is a vital step toward increasing the utilization of gas produced. In 2002, the company acquired the Lokosovsk Gas Processing Plant, enabling increase of gas refining from 2.3 bcm in 2001 to 2.7 bcm in 2002. LUKOIL delivered 2.7 bcm of gas to in 2002, of which 2.1 bcm went to the company's own processing plants.

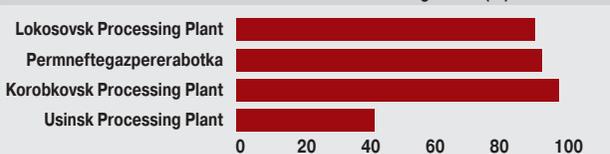
Refining of Associated Gas at LUKOIL's Gas Processing Plants (mcm)



LUKOIL produced 400,400 tons of liquid natural gas via processing, and the Lokosovsk Processing Plant produced 292,900 tons of natural gas plant liquids in 2002. A portion of gas production also goes to Permneftegazpererabotka, a processing facility in Perm, increasing capacity usage of this business unit and providing additional output of liquid production.

Production of liquid hydrocarbons (stable gasoline and isopentane) was 126,400 tons and refinery gas output was 1.3 bcm.

Utilisation Rate of LUKOIL's Gas Processing Plants (%)



## Petrochemicals

LUKOIL petrochemical plants (Stavrolen, Saratovorgsintez and LUKOR) refined 1.99 mln tons of crude oil in 2002 (24% more than in 2001), working at 74.3% of capacity (57% in 2001).

Output of polyethelene, the principle product in the petrochemical and refining sector, was 431,600 tons, representing 17% increase from 2001 levels. Exports of petrochemicals were 70.5% of total production.



Petrochemical units increased their integration with the rest of the company: 78.4% of raw materials for petrochemical production were produced by LUKOIL itself, compared with 70.7% in 2001, enabling reduction of purchase costs.

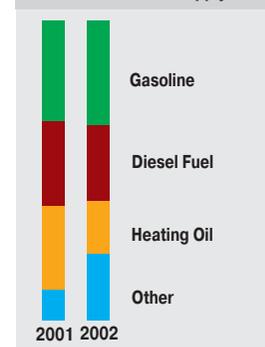
LUKOIL invested \$15 mln in re-equipment and modernization of its petrochemical business in 2002.

## Petroleum Products Supply

LUKOIL delivered 35.5 mln tons of petroleum products in 2002, or 99% of the volume in 2001. Of this amount, 21.3 mln tons were supplied to Russian users (down 15% from 2001 levels) while export was 14.2 mln tons. Supply by refineries abroad was 6.9 mln tons.

The structure of oil product sales on the domestic market changed in 2002, with an increase in automotive gasoline sales and a significant decrease in heating oil sales.

Change in the Structure of Oil Product Supply



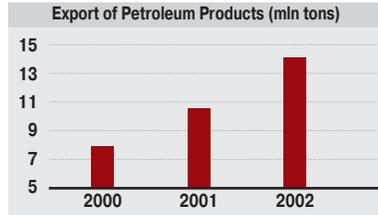
In domestic supplies there was a significant increase in the share of products supplied to the company's own distributors. This share rose by 50% compared with 2001, to 9.1 mln tons.

Petroleum products are delivered by rail, river and pipeline. LUKOIL's subsidiary, LUKOIL-Trans, carried 12.3 mln tons of petroleum products by rail in 2002 (41% more than in 2001) using its own rolling stock

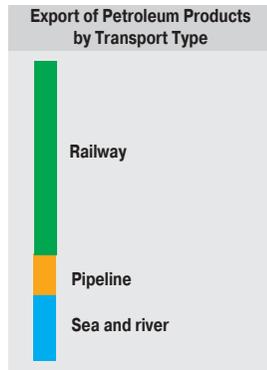


## Petroleum Products Exports

LUKOIL exported 14.2 mln tons of petroleum products from Russia in 2002, representing a 32% increase from 2001.

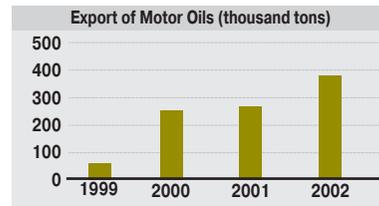


Increased exports of petroleum products are largely due to production at the Nizhegorodnefteorgsintez Refinery, which has made it possible to reduce specific commercial costs across the entire company. Construction of a petroleum product terminal at Vysotsk on the Gulf of Finland, which began last year, is



intended to redirect export deliveries from high-cost routes through the Baltic republics to more cost-efficient routes via Russian ports. Capacity of the first loading complex at Vysotsk will be 2.5 mln tons per year, and ultimate capacity of the complex will be 4.3 mln tons/year. Construction of the terminal will facilitate maximum profitability whilst allowing for fluctuations in the volume of oil refined at Russian refineries, exported by rail, and sold on the domestic market

Export supplies of motor oils increased in 2002 to 388,200 tons, representing 41% growth from 2001.



Export of packaged motor oils rose to 8,980 tons in 2002, up 6.5 times from 2001.

## Petroleum Products Marketing

LUKOIL's sales network covers 58 regions in Russia, the CIS, the Baltic countries, Europe and the USA. It consists of 263 tank farms and 4,076 filling stations, including 215 tank farms and 1,691 filling stations in Russia (including franchises), and 48 tank farms and 2,385 filling stations (including leases) in Europe and the USA.



Sales of petroleum products through the retail network in 2002 were 5.8 mln tons (2% more than in 2001), of which 2.4 mln tons in Russia, 0.9 mln tons in Europe, and 2.4 mln tons in the USA.

Russian petroleum product distributors showed 20% growth in sales through the LUKOIL retail/filling station network compared with 2001.



All told, the company's sales structures sold 25.8 mln tons of petroleum products including 13.6 mln tons in Russia, 9.2 mln tons in Europe, and 3.0 mln tons in the USA.

Restructuring of the company's domestic petroleum product sales sector was completed in 2002. This involved creation of 13 regional petroleum product distributors in 50 Russian regions. LUKOIL incorporated 16 of its previous regional sales companies into the new structure, while the remaining 15 were closed or sold. Capital expenditures to the marketing sector amounted to \$553 mln in 2002.

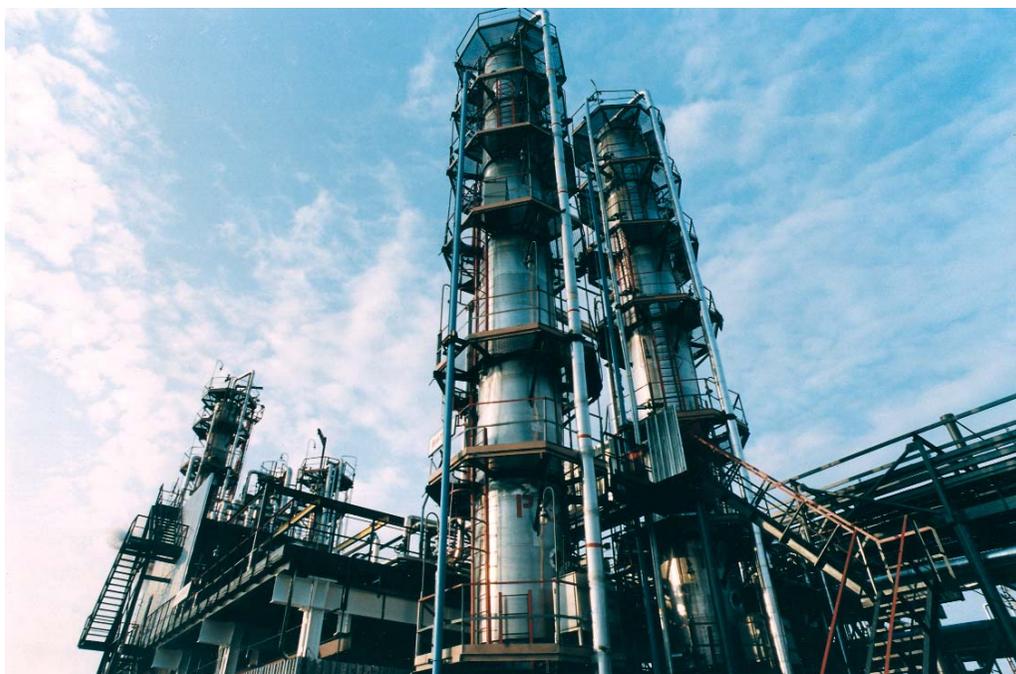


Closure of tank farms was continued (18 were eliminated inside Russia). Organizational structure of remaining facilities was streamlined, and cost of internal transport was reduced.

Work is continuing on development of the LICard purchase system, and introduction of internationally recognized payment (credit and debit) cards. The number of filling stations equipped with LICard rose to 1096 in 2002 (39% growth from 2001). The number of LICards in circulation was 105,900, up 40% from 2001. Card sales of petroleum products rose to 247,000 tons, representing a 45% increase from 2001.



**ENERGY EFFICIENCY  
IN THE PRODUCTION  
& REFINING SECTORS**





Energy saving and increased energy efficiency is a key aspect of LUKOIL's drive to reduce costs and boost overall efficiency of the company. Energy use reviews at subsidiary companies are an important way of locating potential for savings, and LUKOIL has developed and adapted norms and methodology for energy auditing that are specially designed for the company's business structure. Technical equipment, and optimal analysis and inspection techniques allow location and explanation of inefficient fuel/energy use so that energy-saving solutions can be implemented.

Such energy reviews, along with strict regulation of fuel and energy use, and setting of targets for increased efficiency, have helped LUKOIL to break a trend toward increasing energy consumption. Since Q3 2002, a system for regulating fuel and energy use has been in place at the company's subsidiary enterprises, allowing reduction of energy use in oil refining by 9.3% in 2002 compared with 2001. Reduced expenditure of thermal energy (the most expensive type of energy) in oil-refining was particularly important. The absolute amount of thermal energy used in the refining process decreased by 6.3% in 2002 despite increase in volumes of oil refined. LUKOIL also began to generate more of its own thermal energy, mainly by harnessing heat created by operations at its installations. Thermal energy purchases were reduced by 8.3%.

Energy usage in oil production was reduced to 58.0 kg of fuel equivalent/ton (down from 59.1 in 2001), mainly through intensification of oil production at wells and implementation of strict controls over systems for flooding reservoirs to maintain pressure levels.

Efficiency of LUKOIL's energy-saving policies is supported by a unique system of regulations and methods for analysis of energy use. The company has developed a method for measuring specific regulated fuel and energy usages, including an automated program/technical package for monitoring of the oil-production and (primary) refining sectors. This work will be intensified, and development of principles and program support for regulation of fuel/energy resources at the company's petroleum product distributors will also be extremely important.

Overall energy savings in 2002 thanks to LUKOIL's program were 220.7 mln kilowatt hours (electricity), 256.4/Gcal (thermal energy), and 9,477.5 tons of fuel equivalent (heating fuel). Resulting financial savings in 2002 were \$7 mln.





**CARING FOR THE ENVIRONMENT,  
HEALTH & SAFETY**





LUKOIL acknowledges its responsibility to ensure safety, protect the environment and make wise use of natural resources. The company gives priority to safe working conditions for employees, health of personnel and local populations living near LUKOIL projects, and environmental conservation.

In 2002, the LUKOIL Board approved company policy on industrial safety, employee welfare and the environment. The following goals were set:

- ✘ Constant improvement of industrial safety and employee welfare conditions, and efforts to preserve the environment, along with company controls to measure progress in these areas.
- ✘ Rational use of natural resources involved in production or adjacent to areas where the company is pursuing activities.
- ✘ Achievement of industrial and ecological safety levels appropriate to contemporary standards of development in science, technology and society.
- ✘ Increased industrial and ecological safety at company production sites, reduction of damage to the environment through increased equipment reliability, and support of a safe and emergency-free working environment.
- ✘ Creation of an effective company procedure for preparation and implementation of safety, employee welfare and environmental programs, assisting rapid discovery and solution of key issues facing LUKOIL in the spheres of industrial and environmental safety.
- ✘ Stabilization and eventual reduction of outputs of toxins, pollutants, and other waste accompanying increase of production volumes, by use of the latest technologies, equipment and materials and by increase in the level of automated management control.
- ✘ Reduction of impact on the environment at new sites through improved pre-project and project documentation, including improved expertise on questions relating to the environment and industrial safety.
- ✘ Reduction of impact on the environment at new sites through improved pre-project and project documentation, including improved expertise on questions relating to the environment and industrial safety.

LUKOIL activities and the activities of its subsidiaries in 2002 fully complied with requirements of Russian law on industrial safety, employee welfare and environmental protection.





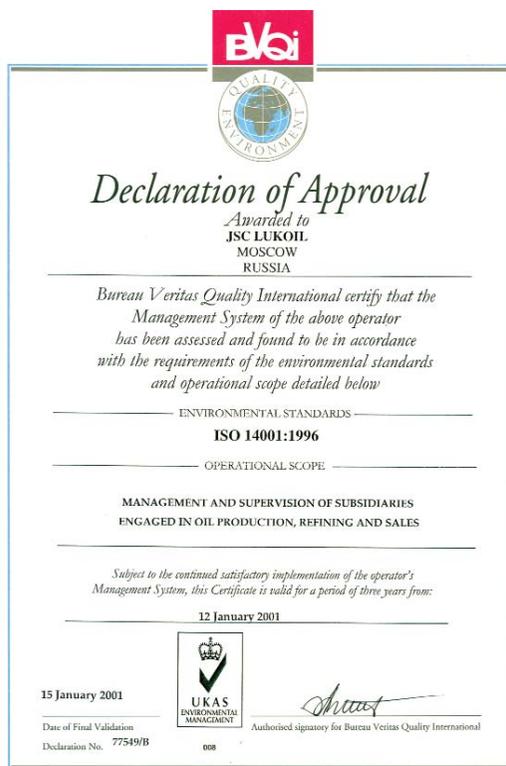
LUKOIL has traditionally been a leader amongst Russian companies in terms of industrial safety and environmental protection. In December 2002 LUKOIL was named winner of the 'Best Russian Businesses' competition, organized by the Russian Chamber of Commerce and Industry and the Russian Union of Industrialists and Entrepreneurs. LUKOIL was also awarded a special prize 'For highest achievement in ecological policy and quality of operations.'

The company's environmental protection and industrial safety policies are laid out in its 'Environmental Protection Management System' and 'System for the Management of

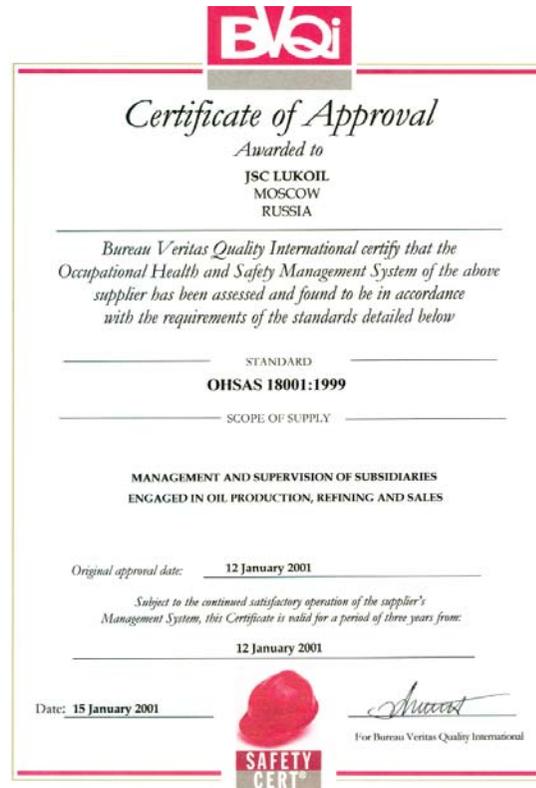
Industrial Safety and Employee Welfare.' The first audit of these systems was performed in January 2002, and results confirm that LUKOIL is indeed working according to the standards, at which it has been certified (ISO 14001 and OHSAS 18001).

In 2002, the company began a program to certify its subsidiaries according to international standards for: quality control (ISO-9000 series),

environmental protection (ISO-14000 series) and industrial safety and employee welfare (OHSAS 18000). This certification is due to be completed by 2007. LUKOIL-Permneft and LUKOIL-Permnefteorgsintez were certified in December 2002



The use of Accreditation Mark indicates accreditation in respect of those activities covered by the accreditation certificate, number 008 SF06/EMAS (04/97)



Certificate No: 77549/A



Many of the environmental measures, carried out by LUKOIL subsidiaries last year, were connected with the company's environmental program for 2000-2003. Action was also taken as part of Kominert's five-year program to clean up polluted land-blocks and avoid crude oil leakages, and as part of an ongoing environmental program in Timan-Pechora

LUKOIL spent \$170 mln for environmental purposes in 2002, of which \$40 mln on construction of installations.

LUKOIL's project to develop the Kravtsovskoye offshore field (D-6) in the Baltic won environmental approval in 2002. The company is also carrying out successful environmental maintenance of the project to construct an export terminal at Vysotsk in Leningrad Oblast.

In the first half of 2002 KPMG completed a full-scale external ecological audit of LUKOIL to prepare the company for listing on the London Stock Exchange. The result of the audit was positive, contributing to full secondary listing of LUKOIL shares on the LSE.

LUKOIL spent \$160 mln last year as part of its 2002-2005 program for industrial safety, employee welfare and avoidance of accidents.





## **DEVELOPMENT OPPORTUNITIES FOR PERSONNEL**





The company pays special attention to professional training for its employees. Employee qualification is one of the most important factors influencing the company share price, so investment in employee training is as important as investment in other areas.

LUKOIL's HR policy aims to maintain the high professional level of its top management team and to integrate international experience into the company's corporate culture. These goals are met through a system of professional training for company employees at all levels, since lower-ranking employees are candidates for the company's top positions in the future.

By allocating significant resources to social programs and personnel programs, LUKOIL can support a high level of employee ability, strengthen its professional team and maintain its reputation as an employer of excellence on the external job market.

The key to development of staff potential is work with younger employees. The company hired more than 700 young specialists in 2002 and special attention was paid to work with educational institutions, including signing of a number of training agreements. A total 530 students and LUKOIL employees are currently studying at the Gubkin Russian State Oil and Gas University and at Perm, Ukhta and Tyumen Universities, assisted by commercial contracts with the company. LUKOIL has cooperated with the universities to select the best students, with whom internship and preliminary employment agreements have been signed.

## Social Policy

The company's social policy seeks to increase work efficiency, promote the social welfare of employees and create stability in the company's work force. Good social policies attract qualified specialists, reduce staff turnover rates, strengthen team spirit and form the basis of a well-run business.

The basic tenets of LUKOIL's social policy, in use across all company subsidiaries, are laid out in LUKOIL's Social Code, which was approved in 2002. The Code supports basic labor rights and principles, international norms, and acting laws in Russia and other countries where LUKOIL has activities.





The Basic Provisions of LUKOIL's Social Policy are:

- ✘ Corporate insurance and social security.
- ✘ Voluntary medical insurance.
- ✘ Insurance for accidents in the workplace.
- ✘ Private pension provisions.

An agreement between the company and its employee union for the years 2003-2005 was approved in December 2002 on the basis of LUKOIL's Social Code.

This agreement represents significant improvements in guaranteed social and economic welfare of employees as compared to provisions in Russian legislation. In particular, it contains the following points:

- ✘ Benefits and other payments made, as per the 'Benefits, guarantees and compensation' section, will be determined based on the wage rate, and will be indexed together with wage rates and should reflect favorably on the social stability of the employee team.

- ✘ The percentage of relief paid is increased compared to the previous agreement (the increase is between 20% and 55 % for various cases).

- ✘ A housing program for employees of LUKOIL and organizations controlled by LUKOIL was announced. The program will help employees to solve their housing difficulties taking account of the financial resources of the organizations involved and specifics of the housing market in different regions.

LUKOIL also provides significant funds to supplement social payments from the government's Social Insurance Fund, as per the following articles:

- ✘ Employee refunds toward holiday, rest and recuperation expenses.
- ✘ Payments to support sport and health pursuits of employees.
- ✘ Social support for women and families with children.



Left to right: A. Yashchenko, A. Barkov, A. Moskalenko



The company spent \$14 mln on social payments in 2002.

LUKOIL spent \$24.5 mln on medical and health care in 2002, and made \$13.8 mln worth of contributions to voluntary employee medical plans

(1.6 times more than in 2001). In total, 65,263 company and subsidiary employees were taking advantage of LUKOIL's voluntary health coverage as of 31 December, 2002.

### **Pension Provisions**

An integral portion of the company's social policy is its commitment to private pensions for employees.

LUKOIL and its subsidiaries granted 1,330 private pensions in 2002 and has granted a total of 5,226 pensions to date. Pensions were indexed to the rate of inflation during the accounting period.

PricewaterhouseCoopers completed an independent actuarial audit of the company's pension obligations in 2002.





## **CHARITY & SPONSORSHIP ACTIVITIES**





Charity and sponsorship activities have become a significant part of corporate strategy for major companies, which have understood that operations for the benefit of shareholders cannot neglect the good of society as a whole. By helping to create the conditions for a flourishing society, a company is also laying the foundations for its own long-term success. Charitable activity is therefore a pillar of LUKOIL's social policy.

LUKOIL organizes and implements numerous charitable events and activities, based on the following principles:

- ✘ Provision of direct support to organizations and individuals.
- ✘ Systematization of long-term programs, in order to maximize their effectiveness.
- ✘ Openness and publicity, including information on every program.

LUKOIL's main charity programs are the following:

**Support for Children's Homes and Schools.** For many years, LUKOIL and its subsidiaries, together with the LUKOIL Charity Fund, have sponsored a number of orphanages in Western Siberia, in the cities of Kirov, Usinsk, Saratov, Syktyvkar, Arkhangelsk, St. Petersburg, Velikiy Ustyug, and Perm, and in Astrakhan, Volgograd, Kaliningrad and Nizhny Novgorod Oblasts. The objective of these programs is to give parentless children a place to live, help them to find professions and enable them to grow up with a sense of being important members of society.

As part of this program, LUKOIL supports the Katolikov Agricultural Internat (Orphanage) in Syktyvkar, and in the Volgograd Oblast the company has rebuilt orphanages in Zhirinovsk and Frolovo, as well as providing a new building for the orphanage in Kotovo.

Every year children from orphanages in Uray, Ishim, Langepas, Kirov and Usinsk take a holiday on the Black Sea paid for by LUKOIL.

In Langepas, LUKOIL has provided the only rehabilitation center for handicapped children in Western Siberia, supplying the center with wheel chairs

and medicine, and installing a computer-learning facility.

In 2002, LUKOIL gave 10 buses to schools in Leningrad Oblast, mostly as part of a program to support transport for educational institutions, which are far from urban centers.

For a number of years LUKOIL and a UNESCO have run a joint program called 'Every blind child gets a book as a gift', providing 'illustrated' books for blind children.

**Keeping Cultural Heritage.** The goal of this program is development of Russian culture, renewal of spirituality and preservation of national tradi-





tions. LUKOIL supports a number of leading museums including the Pushkin Museum of Fine Art, the Moscow Kremlin Museum, the Russian State Museum, the Vasnetsov Museum of Art (Kirov Oblast), the 'Maliye Korely' Arkhangelsk State Museum of Wooden Architecture and Folk Art, the Ukhta Regional Museum (of folklore, history and culture), and the Astrakhan Kremlin. LUKOIL is participating in a project to restore the atomic icebreaker 'Lenin' as a museum of the history and development of atomic-powered shipping in Russia.

LUKOIL has helped to finance the Tchaikovsky State Academic Symphony Orchestra, the Perm State Theatre of Opera and Ballet, the

Berezka State Academic Ballet Ensemble, the Academic Choir of Russian Song, and the Kalinka National Dance Ensemble. LUKOIL has places on the Trustee Board of the Bolshoi Theater and the Tchaikovsky Conservatory of Music in Moscow.

LUKOIL's initiative to support revival of the Church and spiritual life in Russia includes major projects in large cities and throughout Russia's regions. Churches and monasteries, which have benefited from LUKOIL support, include: the Antonievo-Siyskiy Monastery of the Holy Trinity in Arkhangelsk Oblast, the Church of Michael the Archangel and the Constantino-Eleninsk Church in Volgograd Oblast, the Ferapontov Monastery in Vologda Oblast, the Church of Faith, Hope, Love and their mother Sophia in Kaliningrad Oblast, the Monastery of St. Nicholas in Belogorsk, the Stefanov Monastery of the Holy Trinity in Perm, the Monastery

of the Assumption in Obninsk, and the Church of St. Nicholas in Perm Oblast.

**Educational Programs.** LUKOIL's educational programs help to prepare a new generation of oil and gas professionals. The company has set up a LUKOIL Scholarship to support the most promising students at Russia's leading oil institutes, including: the Gubkin Russian State University of Oil and Gas, St. Petersburg State Mining Institute, Perm State Technical University, Ukhta State Technical University, Tyumen State Oil and Gas University, Ufa State Oil and Technical University, Volgograd State Technical University, Samara State Technical University, and Arkhangelsk State Technical University. LUKOIL also purchases equipment for these institutions, ensuring that courses are up-to-date. LUKOIL has allocated funds for cre-





ation of a geo-physical computer modeling laboratory at the Gubkin University, equipped a computer laboratory at Tyumen University, donated a well-repair simulator to Perm University, and has donated modern printing equipment and a trial stand for training of deep-well drilling specialists to Ukta University.

**Support of Medical Institutions.**

LUKOIL helps to fund major centers for specialist medical research in Moscow and St. Petersburg. These include the Centre for Obstetrics and Gynecology, the Blood Research Centre, the Vishnyevsk Central Military Clinical Hospital, the Burdenko Military Hospital, the Central Institute for Radiological Research, and the Leningrad Oblast Clinical Hospital. LUKOIL also helps to fund hospitals in regions where it has activities. Modern diagnostic equipment was provided for the Vologda Oblast Children's Hospital,

Volgograd Municipal Hospital No.16, and the Kaliningrad Port Hospital. LUKOIL also paid for a special mobile incubator for transport of newborn babies at the Vologda Oblast Children's Hospital and a resuscitation unit at Ukhta City Hospital was renovated using funds provided by LUKOIL.

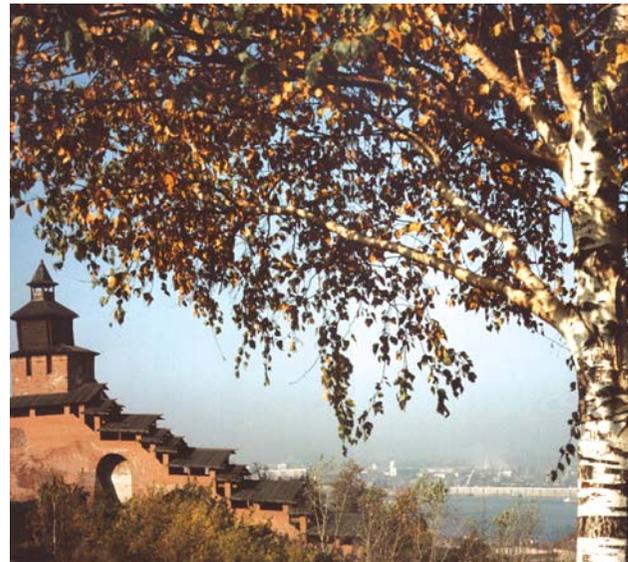
In Kstovo, where the LUKOIL-Nizhegorodnefteorgsintez Refinery is located, LUKOIL sponsors a health program for company employees and the local population. The factory has opened a modern health care center for women, a state-of-the-art modern

dentistry facility, a modern clinic with x-ray equipment and workstations for doctors. LUKOIL also funded renovation of the children's wing at Kstovo Regional Hospital.

**Aid to servicemen, veterans, and victims of natural disasters.**

Working through the military commissariats of Moscow, Vologda, Astrakhan, Kaliningrad, Tyumen, and other oblasts, LUKOIL provides aid to families of servicemen who have been killed on active service or disabled in the Chechen War. Every year on the eve of WWII Victory Day, LUKOIL makes payments to WWII veterans, particularly those who have also worked in the oil and gas industry.

After the Kursk submarine tragedy, the company provided financial assistance to families of the sailors who





died and financed construction of a health and sport camp for sailors of the Northern fleet in the village of Vidyaevo at the request of the Russian Navy.

Tens of thousands of villages and towns suffered as a result of flooding in the south of Russia in 2002. The company provided aid to regional government administrations in the affected areas and financed the building of new homes.

**Aid to Peoples of the Far North.** LUKOIL is active part in sponsoring social support programs for indigenous peoples of regions in the Russian Far North, where the company has production activities.

LUKOIL-Western Siberia, the company's main production unit, has taken responsibility for well-being of the local population in the Khanti-Mansiysk Autonomous Okrug through the agreement 'For Partnership in the socio-economic development of sites populated by indigenous peoples' and through agreements with community leaders. Communities are

given financial compensation for land use by LUKOIL and are also provided with snow-mobiles, boats, gas-powered saws, hunting equipment, combustible lubricants and fishing rigs. Well-built housing is also constructed for indigenous peoples.

Arkhangelskgeoldobycha, the company's main holding in the Nenets Autonomous Okrug, is implementing a number of programs in the region in association with Yasavei (the Association of Nenet Peoples). Programs concentrate on the development of this sparsely populated region, protection of the environment

and the natives' traditional way of life. Major projects in the region include medical aid to deer-herders in the Kaninsk Tundra. LUKOIL organizes a 'Day of the Deer', and helps with publication projects.

**Sporting Projects.** LUKOIL is the general sponsor of Spartak football





team (nine-times Russian football champion), and an official partner of the Russian Olympic Committee.

Other teams that play under the LUKOIL flag are also serious contenders in Russian sport: the LUKOIL Racing Team has achieved numerous championship successes in motor racing, LUKOIL-Spartak (Volgograd) won the Russian water-polo cup in 2002, Vodnik (Arkhangelsk) were Russian hockey champions for the seventh time and became European cup holders, and LUKOIL-Dynamo (Astrakhan) came second in the Russian handball championships. Baltica (Kaliningrad) football team is the leading team in their region. In

2002, LUKOIL was an official sponsor of the European Boxing Championships, which were held in Perm. The company is active in developing child sports in Russia, cooperating with the Child Football League on a regional level.

**Charity and Sponsorship Activities Abroad:**

- ✘ Co-founder of charity activities to restore and protect bio-resources of the Caspian, and protect the Aral Sea.
- ✘ Aid to medical institutions in regions of the company's activity in Columbia.
- ✘ Organized a parish of the Russian Orthodox Church in Bogota, Columbia.
- ✘ Participant of environmental protection projects in the Arab Republic of Egypt.





## CORPORATE GOVERNANCE

### Dividends

The company acknowledges dividend levels as one of the key indicators of its attractiveness to investors and is committed to increasing dividend payments through consistent growth in profit and/or growth in the share of retained earnings used for dividends.

Dividends for 2002 increased both in absolute terms and as a share of net profit. Dividends announced for 2002 were \$532 mln, 30% more than for 2001. The share of dividends in net profit was 29% (up from 19% in 2001).



LUKOIL Management Committee



## Board of Directors and Management Committee

### Board of Directors

#### Valery Graifer (Chairman) 73 years of age

Graduated in 1952 from Moscow's Gubkin Oil Institute. Doctoral candidate in Technical Sciences. Awarded three honors and two medals. Honored Scientist of the Tatar ASSR, Honored Oil and Gas Industrialist of the Russian SSR. Deputy to the USSR Oil Industry Minister from 1985, Head of the Tyumen Main Office for the Oil and Gas Industry. From 1992, General Director of the Russian Innovative Fuel and Energy Company. Chairman of the Board of Directors of LUKOIL from 2001.

#### Vagit Alekperov 52 years of age

Graduated in 1974 from the Azizbekov Institute of Oil and Chemistry in Azerbaijan. Doctor of Economics. Awarded three honors and a medal. Worked from 1968 in the oil industry in Azerbaijan and Western Siberia. From 1990 to 1992, Deputy, then First Deputy to the USSR Oil Industry Minister. Chairman of the Board of Directors of LUKOIL from 1993 to 2000. President of LUKOIL from 1992.

#### Mikhail Bereznoi 57 years of age

Graduated in 1974 from the Saratov Institute of Law. General Director of the Non-state pension fund LUKOIL-Garant from 1995. President of the Board of Directors of New Wave Radio.

#### Oleg Kutafin 66 years of age

Graduated in 1959 from Moscow State University. Professor and Doctor of Law. Associate of the Russian Academy of Science. Rector of Moscow State Academy of Law from 1987. Chairman of the Russian Presidential Commission on Nationality.

#### Ravil Maganov 48 years of age

Graduated in 1977 from Moscow's Gubkin Oil Institute. Honored Employee of the Oil and Gas Industry of the Russian Federation. Awarded two honors and a medal. From 1988 to 1993, Deputy CEO of Langepasneftegaz. From 1993 to 1994, Vice-President of LUKOIL. From 1994 First Vice-President of LUKOIL.



**Vladimir Malin**  
**43 years of age**

Graduated in 1982 from Moscow State University. Doctoral candidate in Economics. From 1995 to 1996, Director of Currency Operations and Financial Management, First Vice-President of the Federal Stock Corporation. From 1996 to 2002, Head of Securities Sales, Deputy Chairman, then First Deputy Chairman of the Russian Federal Property Fund. Chairman of the Russian Federal Property Fund from 2002.

**Richard Matzke**  
**66 years of age**

Graduated with a bachelor's degree in geology from Iowa State University (1959), a master's degree in geology from Pennsylvania State University (1961), and a master's degree in business administration from St. Mary's College of California (1977). President of Chevron Overseas Petroleum and member of the Board of Directors of Chevron Corporation from 1989 to 1999. Vice-Chairman of Chevron Corporation from 2000 until February 2002.

**Mark Mobius**  
**67 years of age**

Graduated in 1964 from MIT (Massachusetts Institute of Technology). Doctor of Economics and Political Science. General Director of Templeton Asset Management since 1997. Elected to the Board of Directors by decision of the annual general meeting of shareholders on 27 June, 2002.

**Yury Medvedev**  
**55 years of age**

Graduated in 1971 from the Tambov Institute of Mechanical Engineering. Doctoral candidate in Philosophy. Honored Engineer of the Russian Federation. From 1991, Chairman of the Volgograd Oblast Committee for the Management of State Property and Privatization. From 1992 to 1997, Deputy Head of the Oblast Administration, Committee for the Management of State Property and Privatization in Volgograd Oblast. From 1997 to 1998, Official Representative of the President of the Russian Federation in Volgograd Oblast. From 1998, First Deputy Minister of Property Relations of the Russian Federation.

**Nikolai Tsvetkov**  
**43 years of age**

Graduated in 1988 from the Zhukov Air-Force Academy and in 1996 from the Plekhanov Russian Economics Academy. Doctoral candidate in Economics. From 1994 to 1996, President of NIKoil, Executive Director of LUKOIL's Department of Securities, Vice-President of LUKOIL. President of IBG NIKoil from 1997.

**Igor Sherkunov**  
**39 years of age**

Graduated in 1985 from the Moscow Finance Institute, in 1993 from the All-Union Friendship of the Nations Academy of Foreign Trade. From 1993 to 1996, Vice-President of LUKOIL Insurance Company. General Director of LUKOIL-Reserve-Invest from 1996

**LUKOIL Management Committee****Vagit Alekperov****President, Chairman of the Board**  
**52 years of age**

Graduated in 1974 from Azerbaijan's Azizbekov Petrochemical Institute. Doctor of Economics. Awarded three honors and a medal. Worked from 1968 in the oil industry of Azerbaijan and Western Siberia. From 1990 to 1992, Deputy, then First Deputy to the USSR Oil Industry Minister. Chairman of the Board of Directors of LUKOIL from 1993 to 2000. President of LUKOIL from 1992.

**Anatoly Barkov****Vice-President**  
**55 years of age**

Graduated in 1992 from Ufa Oil Institute. Honored Employee of the Oil and Gas Industry of the Russian Federation. Awarded four medals. From 1987 to 1992, head of TzBPO, head of NGDU, Senior Engineer at Kogalymneftegaz. From 1992 to 1993, Executive Director, then Director of the Department of External Projects at LUKOIL. From 1993, Vice-President of LUKOIL and Head of Administration, Transport and Communications.

**Anatoly Kozyrev****Vice-President**  
**61 years of age**

Graduated in 1971 from Moscow's Ordzhonikidze Engineering-Economics Institute, and in 1982 from the All-Union Academy of Foreign Trade. From 1991 to 1998, Head of the main consolidated office, Deputy to the Minister of Fuel and Energy of the Russian Federation. From 1998, Vice-President of LUKOIL and Head of Corporate Economic Planning and Investment.

**Sergey Kukura****First Vice-President**  
**49 years of age**

Graduated in 1979 from the Ivano-Frankov Institute of Oil and Gas. Doctor of Economics. Honored Economist of the Russian Federation. Awarded two medals. From 1992 to 1994, Vice-President, then First Vice-President of Langepasuraikogalymneft. From 1994, First Vice-President of LUKOIL.

**Ravil Maganov****First Vice-President**  
**48 years of age**

Graduated in 1977 from Moscow's Gubkin Oil Institute. Honored Employee of the Oil and Gas Industry of the Russian Federation. Awarded two honors and medals. From 1988 to 1993 Deputy General Director of Langepasneftegaz. From 1993 to 1994, Vice-President of LUKOIL. From 1994, First Vice-President of LUKOIL.

**Ivan Maslyayev****Head of the Main Department for Legal Affairs**  
**45 years of age**

Graduated in 1980 from Moscow State University. Doctoral candidate in Law. From 1992, Head of the LUKOIL Legal Department. From 2000, Head of the Main Department for Legal Affairs at LUKOIL.

**Alexander Matytsyn****Vice-President**  
**41 years of age**

Graduated in 1984 from Moscow State University. Doctoral candidate in Economics. From 1993 to 1997, Senior Consultant on Tax, then General Director of KPMG-Revikonsult. From 1997, Vice-President and Head of Treasury and Corporate Finance at LUKOIL.

**Vladimir Nekrasov****Vice-President, General Director of LUKOIL-Western Siberia**  
**46 years of age**

Graduated in 1978 from Tyumen Industrial Institute. Doctoral candidate in Technical Science, member of the Academy of Mining Sciences. Awarded a medal. From 1997 to 1999, Senior Engineer, First Deputy, General Director of Kogalymneftegaz. From 1999, Vice-President of LUKOIL and General Director of LUKOIL-Western Siberia.

**Anatoly Novikov****Vice-President**  
**63 years of age**

Graduated in 1961 from Grozny Oil Institute, in 1981 from the Academy of National Economy of the USSR. Doctoral candidate in Geological-Mineral Science. From 1990 to 2001, General Director of Nizhnevolzhskneft. From 2001, Vice-President of LUKOIL and Head of Geology and Development.

**Serik Rakhmetov****Vice-President**  
**54 years of age**

Graduated in 1973 from the Rudny branch of the Kazakh Polytechnical Institute. From 1993 to 1994, Deputy General Director for Construction at LUKOIL-Kogalymneftegaz. From 1994 to 2000, Executive Director, then Director and Head of LUKOIL Construction. From 2000, Vice-President of LUKOIL and Head of Construction, Project Planning and Corporate Services.

**Alexander Smirnov****Vice-President, General Director  
of LUKOIL-Energogaz  
54 years of age**

Graduated in 1976 from Moscow's Plekhanov Institute of National Economy. Doctoral candidate in Economics. Awarded a medal. From 1992, Executive Director for Internal Market Affairs at Langepasuraikogalymneft. From 1992 to 1998, General Director of the LUKOIL Trading House. From 1996 to 1998, Head of Tangible Assets, Mechanical Engineering and the Marketing of Oil Industry Equipment for LUKOIL. From 1998, Vice-President of LUKOIL and General Director of LUKOIL-Energogaz.

**Yury Storozhev****Vice-President  
56 years of age**

Graduated in 1977 from Moscow's Gubkin Oil Institute. Honored Employee of the Ministry of Fuel and Energy of the Russian Federation. From 1987 to 1993, Head of Department, then Deputy Senior Engineer at Kogalymneftegaz. From 1993 to 1998, Director of Department, Deputy Head, and Head of Oil Delivery and Petroleum Product Export at LUKOIL. From 2000, Vice-President of LUKOIL and Head of Procurement and Sales.

**Dmitry Tarasov****First Vice-President  
50 years of age**

Graduated in 1973 from Moscow's Mendeleev Chemical-Technical Institute. From 1997 to 2002, Vice-President of LUKOIL-Romania, Vice-President of LUKOIL-Europe Holdings Ltd, Director of LUKOIL Black Sea Ltd. From 2002, First Vice-President of LUKOIL.

**Leonid Fedun****Vice-President  
47 years of age**

Graduated in 1977 from Rostov's Nedelin Higher Military School. Doctoral candidate in Philosophy. Awarded five medals. From 1993 to 1994, General Director of LUKOIL Consulting. From 1994, Vice-President of LUKOIL and Head of Strategic Planning and Investment Analysis.

**Lyubov Khoba****Senior Accountant, Vice-President  
46 years of age**

Graduated in 1992 from the Sverdlov Institute of National Economy. Honored Economist of the Russian Federation. Awarded a medal. From 1991 to 1993, Senior Accountant at Kogalymneftegaz. From 1993 to 2000, Senior Accountant at LUKOIL. From 2000 to 2003, Vice-President of LUKOIL, Head of Financial Accounting and Control. From 2003, Senior Accountant and Vice-President of LUKOIL.

**Giovan Cheloyants****Vice-President  
43 years of age**

Graduated in 1981 from Grozny Oil Institute. Honored Employee of the Oil and Gas Industry. From 1990 to 1993, Department head, then Deputy General Director of Internal Economic Affairs of Langepasneftegaz. From 1993, Vice-President of LUKOIL; from 2001, Vice-President of LUKOIL and Head of Oil and Gas Production.

**Vagit Sharifov****Vice-President  
57 years of age**

Graduated in 1968 from Azerbaijan's Azizbekov Institute of Oil and Gas. Doctor of Economics. Honored Employee of the Oil and Gas Industry of the Russian Federation. Awarded two honors and two medals. From 1985 to 1994, Senior Engineer, General Director of Volgogradnefteprodukt. From 1994 to 1995, General Director of the Volgograd branch of LUKOIL Finance. From 1995 to 1996, General Director of LUKOIL regional office in Volgograd. From 1996, Vice-President of LUKOIL; from 2003, Vice-President of LUKOIL and Head of Control and Internal Audit.

**Anatoly Yashchenko****Chairman of LUKOIL's Employee Union  
60 years of age**

Graduated in 1971 from Moscow's Gubkin Oil Institute. Honored Employee of the Russian Ministry of Fuel and Energy. From 1987 to 1994, Chairman of the Union at LUKOIL-Langepasneftegaz. From 1994, Chairman of the Employees' Union at LUKOIL.

**Changes in the LUKOIL  
Management Committee  
during the Accounting Period**

Ralif Safin was removed from the Management Committee by a decision of the Board of Directors on 17 June, 2002 (Protocol No. 13).

Nikolai Chumak was removed from the Management Committee by a decision of the Board of Directors on 10 July, 2002 (Protocol No. 17).

Vladislav Bazhenov and Albert Galustov were removed from the Management Committee by a decision of the Board of Directors on 13 January, 2003 (Protocol No. 1).

Lili Khisyametdinova was removed from the Management Committee by a decision of the Board of Directors on 3 April, 2003 (Protocol No. 14)



## Board of Directors and Management Committee Members Stake in LUKOIL Authorised Share Capital

Percentage of LUKOIL authorized share capital owned by BoD members

Name	Stake (%)
V. Alekperov	1.36
M. Berezhnoi	0.005
V. Graifer	0.002
O. Kutafin	0
R. Maganov	0.22
V. Malin	0
R. Matzke	0
Yu. Medvedev	0
M. Mobius	0
N. Tsvetkov	0.34
I. Sherkunov	0.05

Percentage of LUKOIL authorized share capital belonging to company management (as of 31 December, 2002)

Name	Stake (%)	Conditional stake, dependent on fulfillment of performance criteria (%)
V. Alekperov	1.36	0.118
A. Barkov	0.06	0.059
A. Kozzyrev	0	0.059
S. Kukura	0.34	0.071
P. Maganov	0.22	0.071
I. Maslyaev	0.007	0.047
A. Matytsyn	0.14	0.059
V. Nekrasov	0.01	0.059
A. Novikov	0.002	0.053
S. Rakhmetov	0.05	0.059
A. Smirnov	0.001	0.059
Yu. Storozhev	0.01	0.059
D. Tarasov	0	0
L. Fedun	0.90	0.059
L. Khoba	0.19	0.059
D. Cheloyants	0.06	0.059
V. Sharifov	0	0.059
A. Yashchenko	0.002	0.047

Shares in LUKOIL owned by members of the Board of Directors and the Management Committee are shown in accordance with requirements of Russian legislation for disclosure of such information, including shares held directly by Board/Management Committee members, and those held by nominee investors in their names. Share in authorized capital stock may be counted differently in other countries. Specifically, percentages of authorized share capital recorded here are not shown in exactly the same fashion as they were for purposes of listing on the London Stock Exchange.

Remuneration of Members of the Management Committee and the Board of Directors

Remuneration packages consist of:

- ✘ Base pay (the sum agreed in employee contracts).
- ✘ Annual bonuses.
- ✘ Long-term bonuses.
- ✘ Compensation.

The sum of annual bonus payments is determined as a percentage of annual income in accordance with an agreed formula and is dependent upon fulfillment of basic targets for company activity.

The basis for determination of long-term bonus payments is the quantity of 'conditional shares' belonging to a member of management, on which 'conditional dividends' are paid. In case profit targets are not met, long-term bonuses are not paid.

Total management and Board remuneration for the accounting period was \$13.35 mln.<sup>1</sup>

<sup>1</sup> The figure shown does not include remuneration or compensation of expenses paid to Board Members in 2002, as these figures will be determined at the general shareholders meeting on 26 June, 2003.



## The Market for LUKOIL Shares

In 2002, LUKOIL became the first Russian company to receive full secondary listing on the London Stock Exchange (LSE), after its shares were included in the Official List of the UK Listing Authority (UKLA).



LUKOIL shares are among the most liquid on the Russian market. LUKOIL accounted for 20% of total volume traded through the Russian Trading System (RTS) in 2002, representing a 4% rise from 2001.

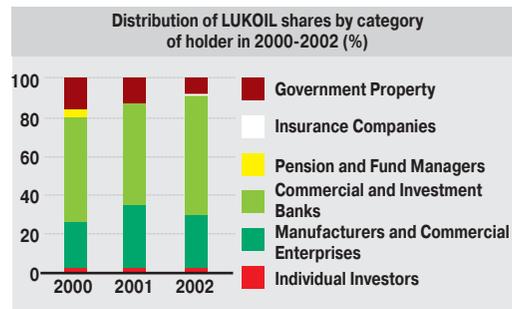
LUKOIL is the only Russian oil company, in which minority shareholders own more than 50% of shareholder equity.

LUKOIL's share price has lagged growth of the Russian stock market over recent years because of low operational efficiency. The proposed solution is LUKOIL's program of restructuring, rolled out in April 2002, and intended to increase profitability and the share price.



LUKOIL has outperformed the RTS Index (RTSI) in the period since the program was begun, making company management even more eager to press ahead with the program implementation. LUKOIL's capitalization rose by 19% to \$13 bln in 2002, which top managers find unsatisfactory compared to 34% growth in the RTSI.

In 2002, LUKOIL shares traded on the RTS, MICEX, SPICEX, and the St. Petersburg Stock Exchange. ADR and GDR programs on company shares continued in 2002, and the receipts were traded on the over-the-counter market in the USA as well as in London, Berlin, Frankfurt, Munich and Stuttgart.



In November 2002, Lukinter Finance B.V., a subsidiary of LUKOIL, issued \$350 mln five-year convertible bonds, convertible into GDRs issued on LUKOIL shares. The bonds have a semi-annual coupon payment based on an annual rate of 3.5%.



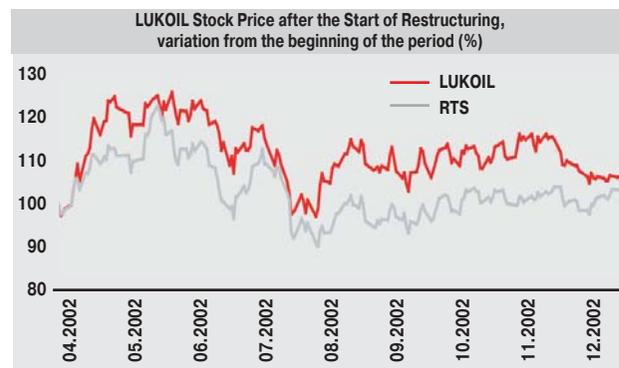
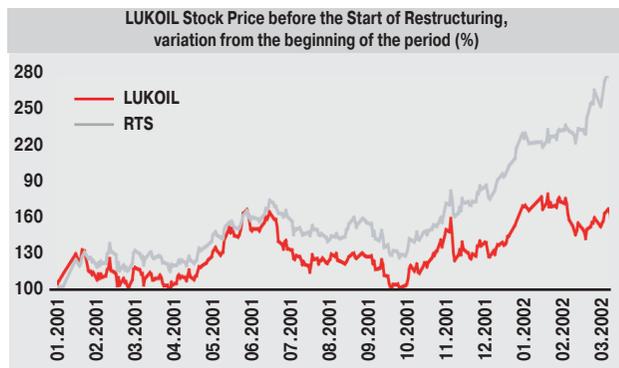
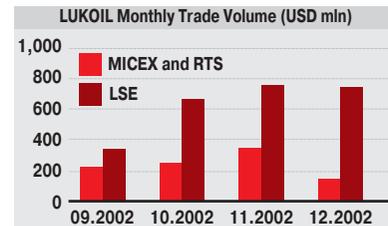
List of major LUKOIL shareholders  
(as of 1 January, 2003)

Shareholder Name	Number of Shares	% of total voting stock
ING BANK (ADR and GDR)*	534 100 000	62.8%
Of which:		
Capital Group	86 000 000	10.1%
CDK-Garant*	90 800 000	10.7%
Ministry of Property Relations of the Russian Federation	64 640 000	7.6%
NIKoil Depository Company*	44 600 000	5.2%
National Depository Centre*	37 200 000	4.3%
Depository-Clearing Company*	24 800 000	2.9%
Brunswick UBS Warburg*	10 300 000	1.2%
ABN Amro Bank*	4 800 000	0.6%
ING Bank (Eurasia)*	3 100 000	0.4%

\* Nominee shareholder.

At the end of 2002, more than 57% of authorized share capital had been converted into ADRs or GDRs.

Investor interest in LUKOIL is growing. In September 2002, trading volume on the LSE was \$365 mln, but this had doubled to more than \$700 mln by the end of December.





## Corporate Governance and Transparency

Targeting improved manageability and streamlining in the framework of its restructuring program, LUKOIL was divided into three main parts in 2002, matching the structure used by other large international oil companies:

- ✘ Finance (First Vice-President, S. Kukura)
- ✘ Exploration and Production of Oil and Gas (First Vice-President, R. Maganov)
- ✘ Oil Refining and Marketing (First Vice-President, D. Tarasov)

The company also set itself the following corporate governance objectives in 2002:

- ✘ Strict observance of time-scales and presentation standards in published results of company activity.
- ✘ Quarterly publication of financial results, prepared in accordance with international standards.
- ✘ Increase in the number of independent representatives of shareholders on the Board of Directors.
- ✘ Frequent meetings between top-management, shareholders and investors.
- ✘ Development of a Corporate Code.
- ✘ Introduction of employee shareholding schemes, with the goal of increasing motivation.
- ✘ Strict observance of international standards in trading with affiliates.

- ✘ Increased transparency to the company's investment policy, clarity of criteria and efficiency indicators for acquired assets and projects.

- ✘ Listing on the London Stock Exchange.

- ✘ Increased transparency of shareholder equity structure.

- ✘ Improved quality of information disclosed and improvement of standards of information transparency.

In its corporate activities, LUKOIL observes basic recommendations of



the Federal Securities Commission of the Russian Federation.

LUKOIL continues to improve its corporate governance. At its next general shareholders meeting, LUKOIL plans to make changes and additions to its bylaws and to the document which specifies how general shareholders meetings should be prepared and run. The changes and additions will bring these documents into line with the resolution of the Federal Securities Commission No.17/ps from 31 May, 2002, 'On Approval of the Statute on Additional Requirements for Preparation,

Notification and Procedures for General Shareholders Meetings', and will take account of regulations in the Federal Securities Commission's Code of Corporate Conduct.

The following changes are planned:

- ✘ Mandatory publication of meeting notification in two main newspapers ('Izvestia' and 'Rossiiskaya Gazeta') no later than 30 days before the date of the general shareholders meeting (the law 'On public companies' requires notification in one newspaper no later than 20 days before the meeting).

- ✘ Preparation of accounts by the Board of Directors in accordance with recommendations. Such accounts will be presented to shareholders at the next meeting, in 2004.

- ✘ Proposal of three candidates to the Board, who are independent representatives of minority shareholders.

- ✘ Fulfillment of the functions of Corporate Secretary in the company by the Office of the Board of Directors and the Department for Shareholder Relations (the Federal Securities Commission's Code of Corporate Conduct recommends introduction by companies of the position of Corporate Secretary).

- ✘ Establishment of a Staff and Rewards Committee in Q3 2003, as per recommendations of the Federal Securities Commission.



## Internal Audit

In 2002, the company created a Main Department for Control and Internal Audit. The creation of a system of internal audit is a way of guaranteeing company efficiency and defending the interests of shareholders. LUKOIL considers a system of internal audit to be a constituent part of its total systems of corporate governance, and is dedicated to international standards for running its business. Internal Audit's main objectives are: the independent evaluation of work efficiency in the company's divisions, guaranteeing the reliability of internal control and the effectiveness of risk management, and ensuring that divisions work in accordance with company regulations.

The Main Department for Control and Internal Audit (until December 2002 the Department for Internal Audit) performed 35 internal audits in 2002 (31 at company subsidiaries). In addition, the Department completed:

- ✘ An audit of operations record keeping.
- ✘ An audit of the Main Department for Geology and Development (as part of requirements to meet licensing requirements for fields that have not yet been developed).
- ✘ Constant audits of investment projects valued at more than \$30 mln.

The company's Management Committee has developed and approved a 'Policy on Internal Audit at LUKOIL', and 'Internal Audit Standards for LUKOIL'.

## Information Technologies

Key business objectives, governing development of Information Technologies at LUKOIL in 2002, were:

- ✘ Supporting control and management of company activities.
- ✘ Developing the company's information base.
- ✘ Refining the decision making process.
- ✘ Developing methods of assessing management.
- ✘ Automating GAAP accounting.

In order to achieve these objectives, the infrastructure of LUKOIL's information management system was prepared for launch in 2002.

Work on creation of the LUKOIL-Permnefteorgsintez integrated management system continued. The system is to be a prototype for information management systems at the company's refining and petrochemical facilities.

A project was begun for specifying corporate standards in the content and format of data presented for construction of geological models of oil and gas fields.

Work was continued on a system for cataloguing geological-geophysical and trade information and another system to consolidate and analyze production data. Development of a system to audit oil and gas reserves was also continued. A methodology for running and regulating internal audits is being developed.

The company's Department of Information Technology and Department for the Export Sale of Petroleum Products have begun to use the OILSpace trading system for work with dealers and for selling surplus volumes of refined products.





**THE KOMI REPUBLIC — A PROMISING  
OIL & GAS PRODUCTION REGION  
FOR LUKOIL**

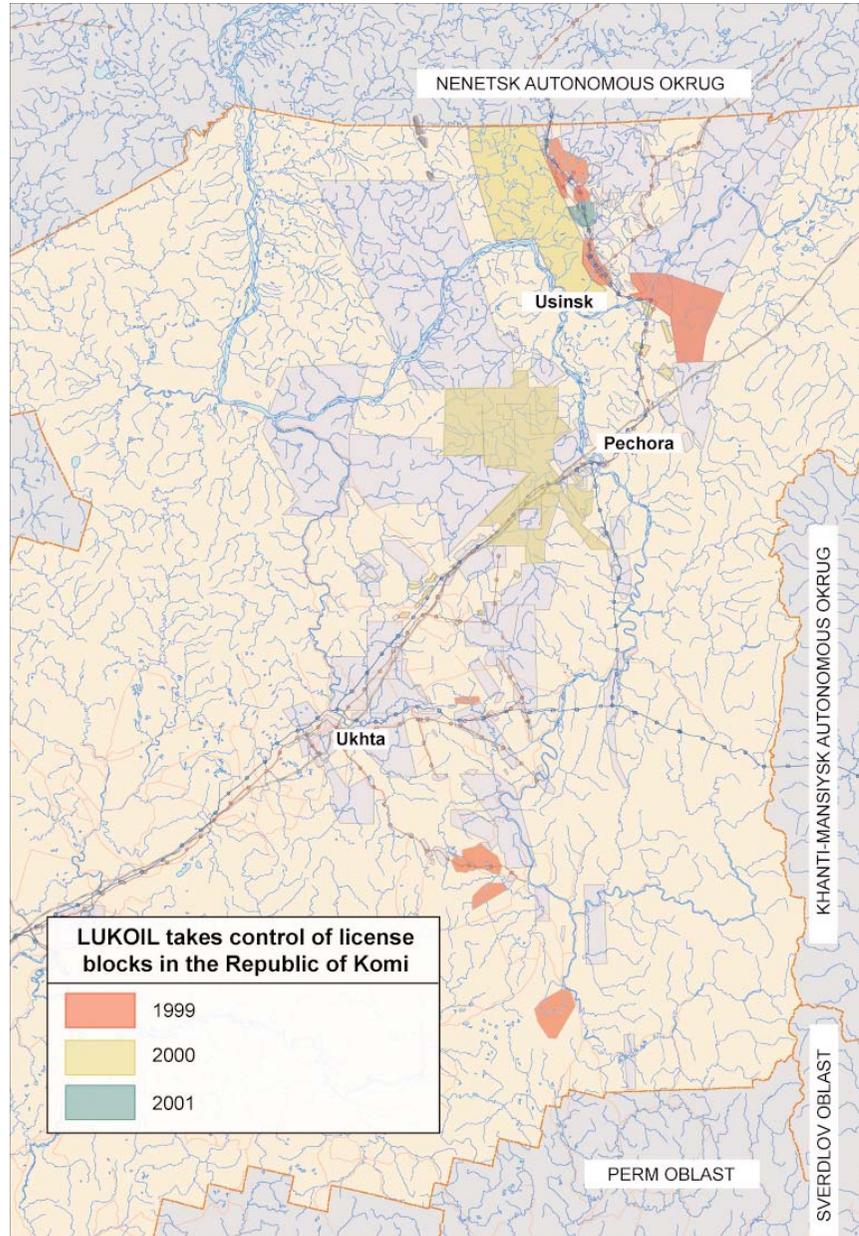


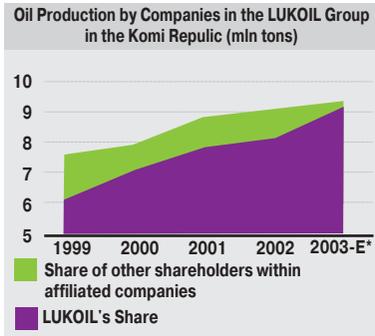


*Oil and gas companies in the Komi Republic are developing 40 hydrocarbon fields located both on the territory of the Republic and in the Nenetsk Autonomous Okrug. The fields have total recoverable reserves of 468.6 mln tons. (The 28 fields on the territory of the Komi Republic alone have 194.7 mln tons of recoverable reserves).*

*A total 28 oil and gas companies in the region are already producing hydrocarbons.*

LUKOIL began its activities in the Komi Republic in September 1999, when it acquired the company KomiTEK.

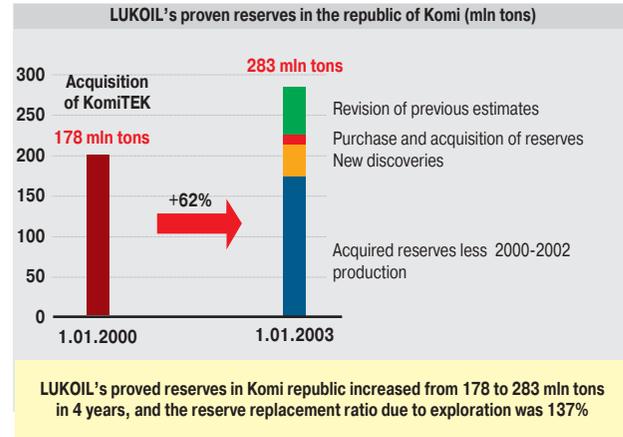




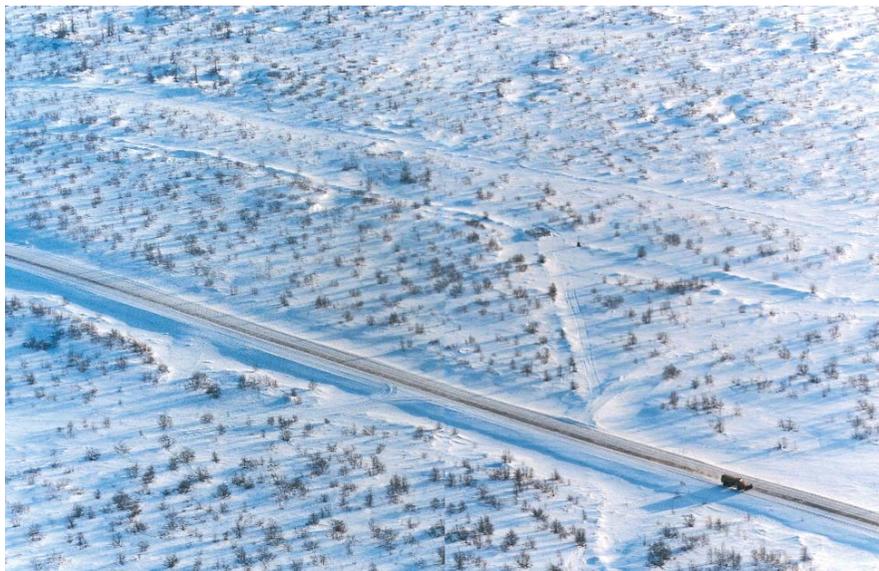
\*Taking account of 2003 acquisitions.

On 1 January 2003, LUKOIL and its subsidiaries in the Komi Republic and the Nenetsk Autonomous Okrug (NAO) had a resource base of 392 mln tons of recoverable ABC1 reserves.

According to a Miller & Lents estimate by international standards, the company's proven reserves in the Komi Republic and the NAO increased from 178 mln tons (at the time of LUKOIL's market entry) to 283 mln tons by 1 January, 2003.



LUKOIL, its subsidiaries and affiliated companies produced 9.2 mln tons of oil in the Komi Republic in 2002, which is 2.7% more than in 2001.





Since 2000, LUKOIL has been executing a program to restructure its companies in the Komi Republic, with the aim of consolidating assets of separate companies into a single production company, LUKOIL-Komi.

LUKOIL-Komi was created by combining the assets of KomiTek, Komineft, Nobel Oil and KomiArktikoil in May 2002. The new company is divided into three divisions:

- ✘ Komitermneft (Usinsk Region)
- ✘ Komiarktikneft (Usinsk Region)
- ✘ Voivozhneft (Sosnogorsk Region)

Komineft operates in the Timan-Pechora oil and gas province, which has the largest resource base of raw hydrocarbons in northwest Russia. The company has licenses for devel-



opment of the largest explored fields in the region, including the Usinsk, Vozeisk and Karyaginsk fields.



Sever-TEK (a joint venture of LUKOIL-Komi and the Finnish company Fortum) has begun development of the Yuzhno-Shapkinsk oil and gas condensate field. Overall investment in this project will be \$370 mln. Confirmed category C1 hydrocarbon reserves at Yuzhno-Shapkinsk are estimated at 23 mln tons, while all oil deposits in the region are thought to be 41 mln tons. Commercial oil production at this field will begin in 2003 and reach a peak of 2.6 mln tons in 2005.



In 2001 the company acquired Bitek-Silur, Parma-Oil, and AmKomi, companies working on the Pechoro-Kozhvisk field group in the Pechorsk and Ukhta regions in the south of the Komi Republic. These three companies produced 625,800 tons of oil in 2002, and their output is expected to rise to 2 mln tons per year. Work on a pipeline from the Severo-Kozhvisk field to the Chikshino terminal on the Transneft trunk pipeline was begun in 2002.

LUKOIL's is implementing a broad-ranging ecological program, including restoration of 350 hectares of land, which had been polluted as a result of oil production. The company has increased its spending on environmental protection in the region by

six times since starting its operations there.

LUKOIL and its subsidiaries in the region are pursue an active social policy, sponsoring educational, health care and cultural institutions.

Significant charitable contributions are made to the region's leading educational institution, which is Ukhta State Technical University. LUKOIL purchases modern equipment for the University and helps in the training of oil and gas specialists. LUKOIL has

donated a trial stand for the training of deep-well drilling specialists, and many of the most promising students participate in LUKOIL's scholarship program.

LUKOIL-Komi divisions have signed a social partnership agreement with Usinsk schools, according to which LUKOIL will purchase educational materials, computer and electronic equipment and ensure repair work at the schools.

LUKOIL has renovated the emergency unit at Ukhta City Hospital. The company also repaired the municipal swimming pool in the town of Voi-Vozh, assisted the local administration in mending the town heating sys-





tem, and purchased equipment for concerts and other activities at the local cultural center. Playgrounds have also been built in Usinsk and Voi-Vozh.

In accordance with an agreement between the government of the Komi Republic and LUKOIL, the company is

repairing gas pipelines, which links Severniy Dzebol with Komsomolsk-na-Pechora and Uhkta with Voi-Vozh, and building a gas pipeline in the village of Sedyu.

