NLMK

Open joint stock company
NOVOLIPETSK IRON AND STEEL CORPORATION

Consolidated financial statements
December 31, 2002 and 2001

(with Independent Auditors' Report thereon)

Contents

Independent Auditors' Report

To the Board of Directors
Open joint stock company Novolipetsk Iron and Steel Corporation

We have audited the accompanying consolidated balance sheets of open joint stock company Novolipetsk Iron and Steel Corporation and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for the years then ended. These consolidated financial statements, as set out on pages 4 to 27, are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of open joint stock company Novolipetsk Iron and Steel Corporation and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG Limited

KPMG Limited
Moscow, Russian Federation
June 9, 2003

(All amounts in thousands of US dollars, except for share data)

	As at December 31, 2002	As at December 31, 2001
ASSETS		
Current assets		
Cash and cash equivalents	390,472	190,029
Short term investments	43,255	-
Accounts receivable, net of allowance for doubtful debts	305,004	241,102
Inventories, net	198,978	180,030
Other current assets	9,618	5,529
	947,327	**616,690**
Non-current assets		
Investments, net of current portion	71,164	74,212
Property, plant and equipment, net book value	1,167,714	1,174,682
Other non-current assets	23,537	29,659
Intangible assets	-	997
	1,262,415	**1,279,550**
Total assets	**2,209,742**	**1,896,240**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Short term borrowings	3,346	92,367
Accounts payable and accrued expenses	164,242	108,235
Income tax	17,106	10,266
	184,694	**210,868**
Non-current liabilities		
Long term borrowings	2,988	3,162
Obligation under capital lease, net of current portion	2,468	-
Deferred income tax	15,523	19,780
	20,979	**22,942**
Total liabilities	**205,673**	**233,810**
Minority interest	**12,891**	**10,407**
Stockholders' equity		
Common stock, 1 RUB par value – 5,987,240 and 5,985,241 shares authorized, issued and outstanding at December 31, 2002 and 2001, respectively	14,440	14,435
Preferred stock, 1 RUB par value – 1,999 shares authorized, issued and outstanding at December 31, 2001	-	5
Additional paid-in capital	680	680
Accumulated other comprehensive income	3,723	2,986
Retained earnings	1,972,335	1,633,917
	1,991,178	**1,652,023**
Total liabilities and stockholders' equity	**2,209,742**	**1,896,240**

Commitments and contingencies (refer note 21)

The consolidated financial statements as set out on pages 4 to 27 were approved on June 9, 2003.

Chief executive
Frantsenjuk I.V.

Chief accountant
Sokolov A.A.

(All amounts in thousands of US dollars, except for earnings per share amounts)

	For the year ended December 31, 2002	For the year ended December 31, 2001
Net sales	1,711,657	1,322,431
Cost of sales	(1,096,385)	(1,048,635)
Gross profit	**615,272**	**273,796**
Selling, general and administrative expenses	(103,359)	(68,432)
Operating income	**511,913**	**205,364**
Loss on disposals of property, plant and equipment and impairment	(8,895)	(15,600)
(Loss) / gain from sale and permanent diminution in value of investments	(31,327)	651
Net interest income	18,940	6,315
Foreign currency exchange loss, net	(18,247)	(21,428)
Other expense	(5,510)	(12,710)
Income before income tax and minority interest	**466,874**	**162,592**
Income tax expense	(129,699)	(75,515)
Income before minority interest	**337,175**	**87,077**
Minority interest	1,243	455
Net income	**338,418**	**87,532**
Earnings per share of common stock (US dollars)		
Basic and diluted	56.54	14.62

Consolidated statements of stockholders' equity and comprehensive income for the years ended December 31, 2002 and 2001 (thousands of US dollars)

	Common stock	Preferred stock	Additional paid in capital	Other comprehensive income	Retained earnings	Treasury stock	Total
Balance at December 31, 2000	**14,435**	**5**	**680**	**1,699**	**1,546,385**	**(68)**	**1,563,136**
Net income	-	-	-	-	87,532	-	87,532
Net unrealized gain on available for sale securities	-	-	-	1,287	-	-	1,287
Sale of treasury stock	-	-	-	-	-	68	68
Balance at December 31, 2001	**14,435**	**5**	**680**	**2,986**	**1,633,917**	-	**1,652,023**
Net income	-	-	-	-	338,418	-	338,418
Net unrealized gain on available for sale securities	-	-	-	737	-	-	737
Converting preferred shares into ordinary shares	5	(5)	-	-	-	-	-
Balance at December 31, 2002	**14,440**	-	**680**	**3,723**	**1,972,335**	-	**1,991,178**

(thousands of US dollars)

	For the year ended December 31, 2002	For the year ended December 31, 2001
OPERATING ACTIVITIES		
Net income	**338,418**	**87,532**
Adjustments to reconcile net income to net cash provided by operating activities		
Minority interest	(1,243)	(455)
Depreciation and amortization	146,327	159,688
Loss on disposals of property, plant and equipment and impairment	8,895	15,600
Loss / (gain) from sale and permanent diminution in the value of investments	31,327	(651)
Deferred income tax benefit	(4,257)	(8,177)
Other movements, net	(9,536)	946
Changes in operating assets and liabilities		
Increase in accounts receivables	(63,902)	(3,860)
Increase in inventories	(5,646)	(16,048)
Increase in other current assets	(4,089)	(2,453)
Increase / (decrease) in accounts payable and accrued expenses	54,280	(21,833)
Increase in income tax payable	6,840	4,468
Net cash provided by operating activities	**497,414**	**214,757**
INVESTING ACTIVITIES		
Proceeds from sales of property, plant and equipment	846	3,284
Purchase of property, plant and equipment and other non-current assets	(153,632)	(140,579)
Proceeds from sale of investments	29,108	1,494
Purchase of investments	(85,051)	(54,071)
Purchase of short-term investments	(7,055)	(427)
Net cash used in investing activities	**(215,784)**	**(190,299)**
FINANCING ACTIVITIES		
Proceeds from issuance of debt	3,576	4,645
Repayment of borrowings	(87,925)	(1,666)
Proceeds from issuance of stock in subsidiaries to minority holders	3,727	3,316
Payments under capital lease	(565)	-
Proceeds from sale of treasury stock	-	80
Net cash (used in) / provided by financing activities	**(81,187)**	**6,375**
Net increase in cash and cash equivalents	**200,443**	**30,833**
Cash and cash equivalents at beginning of year	190,029	159,196
Cash and cash equivalents at end of year	**390,472**	**190,029**
Supplemental disclosures of cash flow information:		
Income taxes paid	126,482	99,756
Interest paid	790	901

1. Background

(a) Organization and operations

Open joint stock company Novolipetsk Iron and Steel Corporation (the "Company" or the "Parent company") and its subsidiaries (together the "Group") is one of the largest iron and steel holdings in the Russian Federation with an entire steel production cycle. The Company is a Russian Federation open joint stock company in accordance with the Civil Code of the Russian Federation. The Parent company was originally established as a State owned enterprise in 1934 and was privatized on January 28, 1993. On August 12, 1998 the Company's name was reregistered as an open joint stock company in accordance with the Law on Joint Stock Companies of the Russian Federation.

The Company's principal activity is the production and sale of ferrous metals, primarily consisting of pig iron, steel slabs, hot rolled steel, cold rolled steel, galvanized cold rolled sheet and cold rolled sheet with polymeric coatings. These products are sold both in the Russian Federation and abroad.

The Group's main operations are in the Lipetsk region of the Russian Federation and are subject to the legislative requirements of both the Russian Federation and the Lipetsk regional authorities.

The Company's primary subsidiaries, located in Lipetsk and other regions of the Russian Federation, are:

- Commercial bank OJSC Lipetskcombank, Lipetsk. A controlling interest was acquired by the Group in 2000. The bank possesses a general license from the Central Bank of the Russian Federation, a license for foreign currency operations and a license for brokerage activity. The bank provides general banking services for commercial and retail customers.

- Trading company Stahl Ltd., Uglich, Yaroslavhl region, was established in 1998 as a 100% subsidiary of the Company. The principal activity of this company is the purchase of raw materials for the Group's metallurgical production and sales of metal products.

- Trading company Vimet Ltd., Lipetsk. A controlling interest was acquired by the Group in 2002. The principal activity of this company is the purchase of raw materials for the Group's metallurgical production and sales of metal products.

- Mining company OJSC Combinat KMAruda, Gubkin, Belgorod region, was purchased by the Group in 2000. The principal activity of the company is mining, processing of iron-ore raw concentrate for the metallurgical production.

- Insurance company LIS Chance Ltd., Lipetsk. A controlling interest was acquired by the Group in 1994. The principal business activities of the Company are property and casualty, life, medical insurance, vehicle insurance, civil liability insurance.

- Trading company Larmet Ltd., Moscow. A controlling interest was acquired by the Group in 2002. The principal activity of this company is the purchase of raw materials for the Group's metallurgical production and sales of metal products.

- Mining company OJSC Studenovskaya joint stock mining company, Lipetsk. A controlling interest was acquired by the Group in 1999. The principal activity is mining and processing of fluxing limestone.

- Mining company OJSC Dolomite, Dankov, Lipetsk region. A controlling interest by the Group was acquired in 1997. The principal activity is mining and processing of metallurgical dolomite.

(b) Russian business environment

The Russian Federation has been experiencing political and economic change which has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks, which do not typically exist in other markets.

The accompanying consolidated financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

2. Basis of preparation

(a) Statement of compliance

The Group maintains its accounting records in accordance with the legislative requirements of the Russian Federation. The accompanying consolidated financial statements have been prepared from those accounting records and adjusted as necessary to comply, in all material respects, with the requirements of accounting principles generally accepted in the United States of America ("US GAAP").

(b) Functional and reporting currency

The accounting records of the Group are maintained in Russian rubles and the Company prepares its statutory financial statements and reports in that currency to its shareholders in accordance with the laws of the Russian Federation.

As the Russian economy was considered to be hyperinflationary, the US dollar is the functional and reporting currency of the Group in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, *Foreign Currency Translation.*

Monetary assets and liabilities have been measured into US dollars at the exchange rates prevailing at each balance sheet date. Non-monetary assets including fixed assets and liabilities have been measured into US dollars at historical rates. Revenues, expenses and cash flows have been translated into US dollars at weighted average rates for the periods of the transactions. Foreign currency gains and losses are included in the consolidated income statement.

The Central Bank of the Russian Federation closing rates of exchange ruling at December 31, 2002 and 2001 were 1 US dollar to 31.78 Russian rubles and 1 US dollar to 30.14 Russian rubles, respectively. The annual weighted average exchange rates were 31.35 and 29.16 Russian rubles to the US dollar for the years ended December 31, 2002 and 2001, respectively.

(c) Convertibility of the Russian ruble

The Russian ruble is not a convertible currency outside the Commonwealth of Independent States. Accordingly, any conversion of Russian ruble amounts to US dollars should not be construed as a representation that Russian ruble amounts have been, could be, or will be in the future, convertible into US dollars at the exchange rate shown or at any other exchange rate.

(d) Going concern

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The recoverability of the Group's assets, as well as the future operation of the Group, may be significantly affected by the current and future economic environment (refer note 1(b)). The accompanying consolidated financial statements do not include any adjustments should the Group be unable to continue as a going concern.

(e) Consolidation

The financial position and results of subsidiaries of which the Company directly or indirectly owns more than 50% of the voting interest and which the Company controls, are included with the financial position and results of the Company in these consolidated financial statements. All significant intercompany transactions have been eliminated upon consolidation.

3. Significant accounting policies

The following significant accounting policies have been applied in the preparation of the consolidated financial statements. These accounting policies have been consistently applied.

(a) Use of estimates

Management of the Group has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with US GAAP. Actual results could differ from those estimates.

(b) Cash and cash equivalents

Cash and cash equivalents comprise cash balances, cash on deposit and other highly liquid short-term investments with original maturities of less than three months.

(c) Accounts receivable

Receivables are stated at cost less allowance for doubtful debts. Management quantifies this provision based on current information regarding the customers' ability to repay their obligations. Amounts previously written off which are subsequently collected are recognized as income.

(d) Inventories

Inventories are stated at the lower of cost or market value. The cost of inventories is based on the weighted average principle and includes expenditures incurred in acquiring inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads.

(e) Investments in marketable debt and equity securities

Marketable debt and equity securities consist of investments in corporate debt and equity securities where the Group does not exert control or significant influence over the investee. The Group classifies marketable debt and equity securities in one of three categories: trading, held to maturity and available for sale. The specific identification method is used for determining the cost basis of all such securities.

(i) Trading securities

Trading securities are bought and held principally for the purpose of selling them in the near term. Trading securities are carried in the consolidated balance sheet at their fair value. Unrealized holding gains and losses on trading securities are included in the consolidated statement of income.

(ii) Held to maturity securities

Held to maturity securities are those securities in which the Group has the ability and intent to hold until maturity. Held to maturity securities are recorded at amortized cost.

Premiums and discounts are amortized to the consolidated statement of income over the life of the related security held to maturity, as an adjustment to yield using the effective interest method.

(iii) Available for sale securities

All marketable securities not included in trading or held to maturity are classified as available for sale.

Available for sale securities are recorded at their fair value. Unrealized holding gains and losses, net of the related tax effect, are excluded from earnings and reported as a separate component of accumulated other comprehensive income until realized. Realized gains and losses from the sale of available for sale securities, less tax, are determined on a specific identification basis.

Premiums and discounts on available for sale securities are amortized to the consolidated statement of income over the life of the related available for sale security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned.

(f) Investments in affiliates and non-marketable securities

(i) Investments in affiliates

Affiliates are those enterprises in which the Group has significant influence, but not control, over the financial and operating policies. Investments in affiliates are accounted for using the equity method of accounting and the consolidated financial statements include the Group's share of the total recognized gains and losses of affiliates from the date that significant influence effectively commences until the date that significant influence effectively ceases.

(ii) Investments in non-marketable securities

Investments in non-marketable securities where the Group does not exercise control or significant influence over the investee are carried at cost less provision for any permanent diminution in value.

(g) Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses (refer note 3(i)). The cost of self-constructed assets includes the cost of materials, direct labor and an appropriate proportion of production overheads.

Property, plant and equipment also includes assets under construction and the equipment for installation.

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Leased assets

Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as capital leases. Plant and equipment acquired by way of capital lease is stated at an amount equal to the lower of its fair value or the present value of the minimum lease payments at inception of the lease, less accumulated depreciation (refer below) and impairment losses (refer note 3(i)).

Payments for operating leases, under which the Group does not assume substantially all the risks and rewards of ownership, are expensed in the period they are incurred.

(iii) Subsequent expenditures

Expenditures incurred to replace a component of an item of property, plant and equipment that is accounted for separately, are capitalized with the carrying amount of the component subject to depreciation. Other subsequent expenditures are capitalized only when they increase the future economic benefits embodied in an item of property, plant and equipment. All other expenditures are recognized in the consolidated statement of income as incurred.

(iv) Capitalized interest

Interest is capitalized in connection with the construction of major facilities. The capitalized interest is recorded as part of the asset to which it relates, and is amortized over the asset's useful life.

(v) Depreciation

Depreciation is charged on a straight-line basis over the estimated useful lives of the individual assets. Plant and equipment under capital leases and leasehold improvements are amortized on a straight-line basis over the shorter of the lease term or the estimated useful life of the individual assets. Depreciation commences from the time an asset is put into operation. Land is not depreciated. Depreciation is not charged on assets to be disposed of. The range of estimated useful lives are as follows:

Buildings	20 – 45 years
Machinery and equipment	2 – 40 years
Vehicles	5 – 25 years
Software	6 – 12 years

(h) Goodwill and intangible assets

Goodwill represents the excess of purchase price over the fair value of net assets acquired. The Group adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* as of January 1, 2002. Under SFAS No. 142 goodwill and intangible assets with indefinite useful lives are no longer amortized as they were prior to 2002, but are instead tested for impairment at least annually.

Intangible assets that have limited useful lives are amortized on a straight-line basis over the shorter of their useful or legal lives.

(i) Impairment

Long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset, generally determined by reference to the discounted future cash flows. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(j) Pension and post retirement benefits other than pensions

The Group follows the Pension and Social Insurance legislation of the Russian Federation, which requires contributions to the Russian Federation Pension Fund by the employer calculated as a percentage of current gross salaries. Such contributions are expensed as incurred.

The Company also sponsors other post retirement benefits for its employees. All of these benefits are part of an annually negotiated Trade Union agreement. These benefits do not vest and may be cancelled when the Trade Union agreement is negotiated annually.

The Parent company and some other Group companies have an agreement with a non-Government pension fund (the "Fund") in accordance with which contributions are made on a monthly basis. Contributions are calculated as a certain fixed percentage of the employees' salaries. These pension benefits are accumulated in the Fund during the employment period and distributed by the Fund afterwards. As such, all abovementioned benefits are considered as made under a defined contribution plan and are charged to expense as incurred.

In addition, lump sum benefits are paid on retirement depending on the employment period and the salary level of the individual employee. The expected future obligations to the employees are assessed by the Company's management and accrued in the consolidated financial statements. The scheme is considered as a defined benefit plan.

(k) Long-term borrowings

Long-term borrowings are recognized initially at cost, net of any transaction costs incurred. Subsequent to initial recognition, long-term borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in the consolidated statement of income over the period of the borrowings.

When borrowings are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is recognized immediately in the consolidated statement of income.

(l) Commitments and contingencies

Liabilities for loss contingencies, including environmental remediation costs, arising from claims, assessments, litigation, fines, penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment and / or remediation can be reasonably estimated.

Estimated losses from environmental remediation obligations are generally recognized no later than completion of remedial feasibility studies. Group companies accrue for losses associated with environmental remediation obligations when such losses are probable and reasonably estimable. Such accruals are adjusted as further information becomes available or circumstances change. Costs of expected future expenditures for environmental remediation obligations are not discounted to their present value.

(m) Income tax

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the temporary differences, unused tax losses and credits can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(n) Stockholders' equity

(i) Treasury stock

When shares are repurchased, the amount of the consideration paid, including directly attributable costs, is recognized as a change in equity. Repurchased shares are presented as a deduction from total equity.

(ii) Dividends

Dividends are recognized as a liability in the period in which they are declared.

(o) Revenue recognition

(i) Goods sold

Revenue from the sale of goods is recognized in the consolidated statement of income when the significant risks and rewards of ownership have been transferred to the buyer.

(ii) Interest income

Interest income is recognized in the consolidated statement of income on an accrual basis.

(thousands of US dollars)

(p) Expenses

(i) Operating lease payments

Payments made under operating leases are recognized in the consolidated statement of income as expenses as incurred.

(ii) Interest expense

All interest and other costs incurred in connection with borrowings are expensed as incurred as part of interest expense, except for interest which is incurred on construction projects and is capitalized (refer note 3(g)).

(q) Non-cash settlement arrangements

Non-cash settlements represent offset transactions between customers and suppliers, when exchange equivalent is defined and goods are shipped between the parties without physical movement of cash.

The related sales and purchases are recorded in the same manner as cash transactions.

(r) Related parties

The following are considered to be related parties:

- affiliates of the Group;
- the Group's principal owners and their immediate families;
- enterprises and trusts for the benefit of the employees, including pension and profit sharing trusts that are managed by or under the trusteeship of the Group's management;
- directors and officers of the Group and their immediate families;
- enterprises in which principal shareholders, officers and directors and their immediate families have control or significant influence;
- other parties with which the Group deals if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

4. Cash and cash equivalents

	As at December 31, 2002	As at December 31, 2001
Cash – Russian rubles	45,571	10,164
Cash – foreign currency	841	32,741
Deposits – Russian rubles	13,552	-
Deposits – foreign currency	128,500	145,397
Cash in trust – foreign currency	197,900	-
Other cash equivalents	4,108	1,727
	390,472	**190,029**

(thousands of US dollars)

Cash in Russian rubles as at December 31, 2002 and 2001 includes the amounts of obligatory reserve, placed with the Central Bank of the Russian Federation by a subsidiary bank in accordance with statutory requirements for credit institutions of $7,515 and $1,500, respectively.

Other cash equivalents as at December 31, 2002 and 2001 include the amounts of letters of credit amounting to $3,352 and $1,517, respectively.

In 2002 the Company transferred surplus cash into a cash management account with a Russian bank with international share in equity. This cash is available at the Company's call.

5. Investments

(a) Available for sale securities

Available for sale securities as at December 31, 2002 and 2001 consist of Russian Government bonds: OVGVZ and OFZ securities, and deposit certificates.

	As at December 31, 2002	As at December 31, 2001
Government bonds		
Cost	921	1,200
Gross unrealized holding gains	3,723	2,986
Deposit certificates	6,844	-
Fair value	**11,488**	**4,186**

Maturities of debt securities classified as available for sale as at December 31, 2002 are presented below.

	Fair value
Due within one year	5,151
Due in one to five years	4,018
Due after five years	2,319
	11,488

Russian Government OVGVZ securities with a face value of $3,180 are pledged to secure the redemption of the Company's promissory notes issued in 2000 for the purchase of shares in CJSC Korpus (refer note 9). These promissory notes are denominated in Russian rubles and mature in 2008.

Unrealized gains and losses, determined as a difference at the balance sheet date between purchase price and fair value of the securities, are taken directly to equity and included in accumulated other comprehensive income.

(thousands of US dollars)

(b) Investments in affiliates

	For the year 2002 Ownership	For the year 2001 Ownership	As at December 31, 2002	As at December 31, 2001
CJSC Korpus	40.00%	40.00%	3,042	3,042
CJSC Stalconverst	36.80%	36.80%	1,974	1,974
OJSC AKB Lipetskcredit	22.19%	22.19%	1,034	1,034
OJSC Avron	26.70%	26.70%	376	376
OJSC Lipetsky Gipromez	43.44%	43.44%	7	7
OJSC Bank ZENIT	-	20.00%	-	13,714
OJSC Bryanskmetallresources	-	28.30%	-	21
			6,433	20,168
Provision for permanent diminution in value			(3,384)	(3,405)
			3,049	**16,763**

(c) Non-marketable securities

	For the year 2002 Ownership	For the year 2001 Ownership	As at December 31, 2002	As at December 31, 2001
OJSC Coal Mining Company Kuzbassugol	17.70%	17.70%	39,787	39,787
OJSC Lebedinsky GOK	11.96%	11.96%	8,546	8,546
OJSC Yakovlevsky rudnik	9.48%	9.48%	5,372	5,372
OJSC Lipetskenergo	12.21%	12.21%	2,102	2,102
OJSC Lipetskoblgaz	19.40%	19.40%	644	644
OJSC Almetievsky pipe plant	14.53%	14.53%	516	516
OJSC Moscow pipe plant Filit	12.00%	12.00%	392	392
Other	-	-	1,659	1,497
			59,018	58,856
Provision for permanent diminution in value			(7,827)	(5,593)
			51,191	**53,263**

(d) Loans given

	As at December 31, 2002	As at December 31, 2001
Long-term loan	48,691	-
	48,691	-

The balance of the long-term loan represents an amortized cost of a Russian ruble denominated interest free loan payable before December 31, 2004. At the date of issue the long term loan of $85,000 was accounted for at its fair value. The difference between face and fair value of $28,652 was accounted for as a loss from investments in the consolidated statement of income. Interest income of $8,108 was recognized in the consolidated statement of income. In 2002 an amount of $13,987 was repaid by the borrower.

The fair value of the loan is calculated based on an annual commercial interest rate of 19% at the date of issue and an assumption that the loan will be repaid at the end of 2004.

(thousands of US dollars)

	As at December 31, 2002	As at December 31, 2001
Total investments	**114,419**	**74,212**
Less current portion	43,255	-
Long term investments, net	**71,164**	**74,212**

6. Accounts receivable and advances given

	As at December 31, 2002	As at December 31, 2001
Trade accounts receivable	165,293	153,093
Advances given to suppliers	15,225	20,738
Taxes receivable other than income tax	85,581	51,021
Accounts receivable from employees	968	902
Other accounts receivable	46,277	27,053
	313,344	252,807
Allowance for doubtful debts	(8,340)	(11,705)
	305,004	**241,102**

As at December 31, 2002 and 2001 the Group had receivables from Tuscany Intertrade, Great Britain, which exceeded 10% of the gross accounts receivable balances. The outstanding balances owed by this debtor totaled $54,290 and $107,100 at December 31, 2002 and 2001, respectively.

As at December 31, 2002 receivables from Steelco Mediterranean Trading Ltd., Cyprus, and Moorfield Commodities Company, Great Britain, also exceeded 10% of the gross accounts receivable balances and totaled $47,093 and $28,590, respectively.

7. Inventories

	As at December 31, 2002	As at December 31, 2001
Finished goods and goods for resale	26,564	31,152
Work in process	54,475	42,908
Raw materials	119,085	119,735
	200,124	193,795
Provision for obsolescence	(1,146)	(13,765)
	198,978	**180,030**

(thousands of US dollars)

8. Property, plant and equipment

	As at December 31, 2002	As at December 31, 2001
Land	32,844	-
Buildings	507,486	508,777
Machinery and equipment	3,485,774	3,508,192
Vehicles	99,531	97,761
Construction in progress	168,717	89,952
Land improvement	633,344	621,089
Leased assets	4,760	-
Other	6,099	12,442
	4,938,555	4,838,213
Accumulated depreciation	(3,770,841)	(3,663,531)
	1,167,714	**1,174,682**

In 2002 the Parent company has reclassified the cost of certain property, plant and equipment previously included in machinery and equipment into other groups. This reclassification has no depreciation effect.

A reclassification table of property, plant and equipment at cost is shown below:

	As at December 31, 2001	Reclassification	As at December 31, 2001 adjusted
Buildings	506,579	2,198	508,777
Machinery and equipment	3,936,362	(428,170)	3,508,192
Vehicles	96,166	1,595	97,761
Land improvement	198,480	422,609	621,089
Other	10,674	1,768	12,442
	4,748,261		**4,748,261**

The cost of property, plant and equipment purchased or constructed prior to 1992 was determined with the assistance of an independent appraiser. The valuer provided US dollar estimates of historical cost and depreciated historical cost of the Company's property, plant and equipment. These historical cost estimates were necessary due to the absence of reliable US GAAP accounting records and impairment calculations.

During 2002 the Parent company has bought property rights on land under its production units.

Starting from second quarter 2002 until the moment of acquisition the Parent company had been renting land and paid rental payments, including land tax. After acquisition the Company pays land tax.

The Company also pays rental payments and land tax for other estate property beyond its production units.

(thousands of US dollars)

9. Borrowings

Short-term borrowings	As at December 31, 2002	As at December 31, 2001
8% US dollar promissory notes at nominal cost	-	76,966
Promissory notes	3,008	-
US dollar denominated loan	-	12,207
Other short-term debts	338	3,194
	3,346	**92,367**

Long-term borrowings		
Interest free own promissory notes	2,832	2,986
Other long-term debts	156	176
	2,988	**3,162**

As of December 31, 2001 the 8% interest bearing promissory notes of $76,966 (at nominal cost) represented ordinary promissory notes, issued by the Company under a loan novation agreement with related party, signed in 2001. During 2002 these promissory notes were completely settled with a discount of $4,535 that was recorded in net interest income.

10. Accounts payable and accrued expenses

	As at December 31, 2002	As at December 31, 2001
Accounts payable	36,727	44,053
Advances received	63,673	22,300
Taxes payable other than income tax	15,933	7,207
Accrued expenses	2,492	3,060
Accounts payable to employees	18,441	15,962
Current portion of lease obligation	1,727	-
Short term loans	-	2,186
Other payables	25,249	13,467
	164,242	**108,235**

11. Stockholders' equity

(a) Stock

The Company has 5,987,240 issued shares with a par value of 1 Russian ruble. As of December 31, 2001 the Company had 5,985,241 common stock and 1,999 preferred stock. The holder of the preferred stock was the Russian Federal Property Fund.

According to the Federal Law *On Privatization of Federal and Municipal Property* of December 21, 2001 #178-FZ, these preferred stock were converted into common stock. The Russian Federal Property Fund's preferred stock were converted into common stock on October 16, 2002.

(thousands of US dollars)

(b) Voting rights, privileges and liquidation

All common stock have voting rights. Upon liquidation of the Company all creditors' requests are to be satisfied, property is to be sold through auction and any remaining proceeds should be distributed proportionally between stockholders.

(c) Dividends

Dividends are paid on common stock at the recommendation of the Board of Directors and approval at the annual stockholders' meeting, subject to certain limitations as determined by Russian legislation. Profits available for distribution to stockholders in respect of any reporting period are determined to by reference to the statutory financial statements of the Parent company. At December 31, 2002 and 2001 the retained earnings, in accordance with the legislative requirements of the Russian Federation, available for distribution amounted to $1,078,193 (unaudited) and $633,063 (unaudited) respectively, converted into US dollars using the year-end exchange rate. No dividends on common stock were declared in either 2002 or 2001.

12. Cost of sales

	For the year ended December 31, 2002	For the year ended December 31, 2001
Production cost	950,058	888,947
Depreciation and amortization	146,327	159,688
	1,096,385	**1,048,635**

13. Selling, general and administrative expenses

	For the year ended December 31, 2002	For the year ended December 31, 2001
Taxes other than income tax	33,632	25,297
Selling expenses	32,072	21,999
Employee costs	13,638	11,194
Penalties and fines	96	1,666
Net movement in the allowance for doubtful debts	(1,747)	(15,261)
Other	25,668	23,537
	103,359	**68,432**

(thousands of US dollars)

14. Income tax expense

	For the year ended December 31, 2002	For the year ended December 31, 2001
Current tax expense	133,956	83,692
Deferred tax benefit		
Origination and reversal of temporary differences	(8,271)	(936)
Foreign exchange differences	(976)	(2,581)
Change in tax rate	-	(11,353)
Change in tax loss carry forwards	4,990	6,693
	(4,257)	(8,177)
Total income tax expense	**129,699**	**75,515**

The corporate income tax rate was 24% and 35% in 2002 and 2001, respectively. The rate used for measuring deferred tax as at December 31, 2002 and 2001 was 24% (the rate effective from January 1, 2002).

Reconciliation of effective tax rate:

	For the year ended December 31, 2002	For the year ended December 31, 2001
Profit before tax	466,874	163,047
Income tax at applicable tax rate	112,050	57,067
Increase / (decrease) in income tax resulting from:		
Non-deductible expenses and non taxable income	17,649	29,801
Change in tax rate	-	(11,353)
	129,699	**75,515**

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

	As at December 31, 2002	As at December 31, 2001
Deferred tax assets		
Investments	5,332	555
Accounts payables and accrued liabilities	2,812	2,085
Accounts receivable	2,573	-
Other current liabilities	346	-
Other non-current liabilities	541	-
Other current assets	3	999
Inventories	-	30,147
Valuation allowance	(1,830)	(480)
	9,777	33,306

(thousands of US dollars)

	As at December 31, 2002	As at December 31, 2001
Deferred tax liabilities		
Property, plant and equipment	(18,602)	(38,617)
Inventories	(6,696)	-
Short term loans	(2)	-
Accounts receivable	-	(19,459)
	(25,300)	(58,076)
Net deferred tax liability on temporary differences	(15,523)	(24,770)
Tax loss carry forwards	-	4,990
Total deferred tax	**(15,523)**	**(19,780)**

Deferred tax assets have not been recognized in respect of the temporary differences, where it is not probable that future taxable profit will be available against which the Group can utilize the benefit there from.

As at December 31, 2001 the Group had tax loss carry forwards of $20,791, which were due to expire in 2003. In 2002 the Group fully utilized this tax loss carried forward.

15. Earnings per share

Basic income per share of common stock is calculated by dividing net income by the average number of shares of common stock outstanding during the applicable period.

The calculation of diluted income per share of common stock takes into account the effect of obligations, such as convertible preferred stock, considered to be potentially dilutive.

	Income for the year ended December 31, 2002	Shares 2002	Income for the year ended December 31, 2001	Shares 2001
Net income and shares	338,418	5,985,657	87,532	5,985,241
Preferred stock dividend requirements	-		-	
Income and shares	**338,418**	**5,985,657**	**87,532**	**5,985,241**
Basic and diluted earnings per share (US dollars)	**56.54**		**14.62**	

16. Non-cash transactions

Management estimates that approximately $5,000 and $10,000 of the Group's 2002 and 2001 revenues, respectively, were settled in the form of mutual offset with the Group receiving raw materials and other related production materials for finished goods shipments.

Prices for goods sold and purchased through non-cash settlement arrangements are fixed in the respective contracts and generally reflect current market prices.

(thousands of US dollars)

17. Fair value of financial instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

The carrying amount of cash and cash equivalents, loans given, accounts receivable, amounts due to / from employees, affiliated companies and other related parties, accounts payable and accrued expenses, short term debts approximate fair value.

The fair values of available for sale securities are based on quoted market prices for these or similar instruments.

18. Obligations under capital and operational leases

	Capital leases
Future minimum lease payments:	
2003	3,153
2004	2,043
2005	1,111
2006	594
2007	305
Remainder	156
Total minimum lease payments	**7,362**
Less: amount representing estimated executory costs, including profit thereon, included in total minimum lease payments	(1,455)
Net minimum lease payments	**5,907**
Less: amount representing interest (at 19%)	(1,712)
Present value of net minimum lease payments	**4,195**
Less: current portion	(1,727)
Long-term capital lease obligations	**2,468**

In 2002 the Group acquired machinery, equipment and vehicles under capital leases with right of acquisition on the expiry of the lease term.

In 2002 $909 was recognized as interest expense in the consolidated statement of income in respect of these capital leases.

Machinery, equipment and vehicles at year end includes the following amounts in respect of capital leases:

	As at December 31, 2002
Machinery and equipment	1,858
Vehicles	2,902
	4,760
Accumulated depreciation	(160)
Net property, plant and equipment under capital leases	**4,600**

The Company has incurred expenses in respect of operational leases of $6,626 and $3,135 in 2002 and 2001, respectively. The contract expires in 2003.

19. Concentration of significant risks

The Group minimizes its sales risks by having a wide range of geographical zones for sales, which allows the Group to respond quickly to unexpected changes in the situation of one or more sales markets. The Group uses executive analysis of the existing and prospective markets.

The Group's exports in monetary terms in 2002 were around 61% (2001: 56%) of the total metal production sales.

The Group has three international traders that account for the majority of its export sales in 2002 in 2001. In 2002, the major dealers Tuscany Intertrade (UK), Steelco Mediterranean Ltd. and Moorfield Commodities Company purchased 55%, 27% and 10% of the Group's export sales, respectively. In 2001, these companies purchased 84%, 6% and 7% of the Group's export sales, respectively.

The Group's major export markets are Asia – 32% (2001: 29%), the European Union – 26% (2001: 27%), North America – 14% (2001: 18%) and other Middle East countries including Turkey – 17% (2001: 13%). The Group relies on export sales to generate foreign currency earnings. As the Group exports the majority of its production, it is exposed to global economic and political events.

Insaur-Slal Ltd. accounted for in excess of 10% of the Group's 2002 domestic sales, Metraznotorg Ltd., Procatpostavka Ltd., OJSC AVTOVAZ accounted for in excess of 10% of the Group's domestic sales in 2001. No other individual customer accounted for in excess of 10% of the Group's export or domestic sales during 2002 or 2001.

The majority of the Group's workers are covered by a Trade Union agreement, which is negotiated annually. Significant disagreements with the Trade Union and industrial action have been historically rare and management does not consider disruption caused by labor disputes to be a significant risk to the Group.

20. Related party transactions

(a) Sales to and purchases from related parties

During 2002 and 2001 the Group had the following transactions with related parties:

(i) Sales and accounts receivable

Sales to a related party controlled by the Group's management were $12,821 and $19,710 for the years ended December 31, 2002 and 2001, respectively. Related accounts receivable equaled $898 and $180 as at December 31, 2002 and 2001, respectively.

(ii) Purchases and accounts payable

Purchases of raw materials and services from a related party controlled by Company's management were $46,003 and $27,014 for the years ended December 31, 2002 and 2001, respectively. Accounts payable to the related party were $5,362 and $362 as at December 31, 2002 and 2001, respectively.

(b) Financing activities

As at December 31, 2001 the Company had an outstanding US dollar loan of $89,173 to a stockholder, which was settled in 2002 (refer note 9).

In 2001 the Group obtained short-term finance from a related party that is controlled by the Group's management, amounting to $1,001 of which $345 was repaid before December 31, 2001. The remaining debt was repaid in 2002.

(c) Transactions with funds under Group control

Total contributions to the pension fund, controlled by the Company's management amounted to $1,876 and $1,571 in 2002 and 2001, respectively.

Contributions to the charity fund under trusteeship of the Company were $5,999 in 2001. There were no such contributions in 2002.

21. Commitments and contingencies

(a) Anti-dumping actions against the Group

The Group's export trading activities are subject to compliance reviews of importers' regulatory authorities. The Company's exports of rolled steel were considered within several anti-dumping investigation frameworks. The Company has taken steps to address anti-dumping investigations and participates in the settlement of such trade disputes as coordinated through the Russian authorities.

No provision arising from any possible agreements as a result of anti-dumping investigations has been made in the accompanying consolidated financial statements.

(b) Litigation

The Group, in the ordinary course of business, is the subject of, or party to, various pending or threatened legal actions. The management of the Group believes that any ultimate liability resulting from legal action will not significantly affect its financial position or results of operations, and no amount has been accrued in the consolidated financial statements.

(c) Environmental matters

Management is of the opinion that the Group has met the Government's federal and regional requirements concerning environmental matters, and therefore believes that the Group does not have any current material environmental liabilities.

Currently, there is no material legislation in Russia regarding environmental damages or restrictions on the Group's activities as a result of environmental concerns.

The Company was subject to an environmental audit in 2001. As a result, the Company has committed itself to carrying out certain environmental activities and to acquire assets of $101,000 to decrease environmental pollution. These investments are part of the Company's Technical Re-equipment Program from 2002 to 2005 (refer note 21(e)).

(d) Insurance matters

The Russian insurance industry is in a developing stage and many forms of insurance protection common in other parts of the world are not yet generally available in the Russian Federation.

The Group has purchased coverage for buildings, property, plant and equipment, environmental pollution as a result of accidents in workshops and medical insurance for employees. Furthermore, the Group has purchased operating entities civil liability coverage for dangerous production units.

Until the Group obtains adequate insurance coverage, there is a risk that uninsured losses could have a certain adverse effect on the Group's operations.

(e) Capital, sale and purchase commitments

In the normal course of business the Group enters into long-term purchase contracts for raw materials and long-term sale contracts. These contracts allow for variations in the quantities and types of goods, as well as for periodic adjustments in prices dependent on prevalent market conditions.

To minimize financial losses resulting from disruption of supplies, the Group, first, creates stocks of inventories and, second, maintains relations with reliable suppliers only.

The Company has been carrying out a Technical Re-equipment Program since 2000. According to this Program, the projected investments from 2003 to 2005 in assets for the main production and environmental programs amount to approximately $674,000.

(f) Social commitments

The Company makes contributions to mandatory and voluntary social programs. The Company's social assets, as well as local social programs, benefit the community at large and are not normally restricted to the Company's employees. The Company has transferred certain social operations and assets to local authorities, however, management expects that the Company will continue to fund certain social programs through the foreseeable future. These costs are recorded in the year they are incurred.

(g) Taxation

The taxation system in the Russian Federation is relatively new and is characterized by numerous taxes and frequently changing legislation, which is often unclear, contradictory and subject to interpretation. Often, differing interpretations exist among numerous taxation authorities and jurisdictions. Taxes are subject to review and investigation by a number of authorities, which are enabled by law to impose severe fines, penalties and interest charges.

These facts may create tax risks in the Russian Federation substantially more significant than in other countries. Management believes that it has adequately provided for tax liabilities based on its interpretation of tax legislation.

(h) Guarantees granted

As of December 31, 2002 and 2001, the Group had issued guarantees to third parties amounting to $7,649 and $138, respectively, in respect of borrowings of non-group companies. No amount has been accrued in the consolidated financial statements for the Group's obligation under these guarantees.