# Management report from the Board of Directors

## Overview of TotalFinaElf's fiscal year

The Group's three business segments are:

– the Upstream segment, which includes exploration, hydrocarbon production, gas, electricity, and other forms of energy;
– the Downstream segment, which includes refining, petroleum product marketing and distribution, specialty products, and the trading and shipping of crude oil and products;
– the Chemicals segment, which includes Base chemicals and polymers, Intermediates and performance Polymers, and Specialties.

Despite the generally less favorable 2002 environment, TotalFinaElf performed well, partially offsetting the impact of the downturn thanks largely to a record level 10% increase in hydrocarbon production and to the ongoing implementation of synergy and productivity programs.

When we express our earnings per share excluding non-recurring items in dollars, in order to be comparable to our peers, TotalFinaElf shows a decline of only 8% year over year, while our major competitors reported decreases ranging between 22% and 34%.

Oil market conditions in 2002 were mixed:
– the average Brent oil price rose slightly (+2%) to 25.0 $/b in 2002 from 24.4 $/b in 2001;
– the European refining margin was sharply lower in 2002, falling 48% to 8.0 $/t in 2002 from 15.4 $/t in 2001;
– the dollar weakened against the euro by 5%, setting the average euro/dollar exchange rate at 0.95 in 2002 versus 0.90 in 2001.

In addition, after signs of improvement in mid-year, petrochemical margins declined during the fourth quarter 2002.

Operating income from the business segments excluding non-recurring items fell by 16% to 10,995 M€ in 2002 from 13,121 M€ in 2001.
Non-recurring items in 2002, comprised mainly of impairments in Argentina related to gas and power assets and the LPG marketing activity, had a negative impact on operating income of 659 M€.

Growth and synergies/productivity programs contributed 1.3 billion euros (B€) to operating income in 2002, partially offsetting the large negative impact of changes in the environment (–3.1 B€) and the effect of an unusually high level of scheduled refinery turn-arounds particularly during the third and fourth quarters of 2002 (–0.3 B€).

Net operating income from the business segments excluding non-recurring items fell by 22% to 5,868 M€ in 2002 from 7,564 M€ in 2001. The percentage decrease in net operating income is larger than the percentage decrease in the pre-tax operating income due primarily to the fact that the Upstream segment, which is more heavily taxed than Downstream and Chemicals, increased its relative share of the operating results in 2002 versus 2001.

Net income excluding non-recurring items fell by 17% to 6,260 M€ in 2002 from 7,518 M€ in 2001.

Earnings per share excluding non-recurring items, based on 666.1 million fully-diluted weighted average shares, declined by 13% to 9.40 euros in 2002 from 10.85 euros in 2001. The limited decline in earnings per share reflects in part the accretive impact of the large share buy-back program.

In 2002, TotalFinaElf repurchased 24.03 (1) million of its shares, or 3.5% of the share capital, for 3.40 B€.
The number of fully-diluted shares was 655.0 million at December 31, 2002 versus 673.0 million at December 31, 2001.

Reported net income was 5,941 M€ in 2002 compared to 7,658 M€ in 2001.
Reported net income includes the impact of non-recurring items which had a net negative effect of 319 M€ in 2002 as compared to a net positive effect of 140 M€ in 2001. Non-recurring items in 2002 were composed primarily of gains on asset sales (notably shares of Sanofi-Synthélabo), impairments of certain gas and power assets and LPG marketing activities in Argentina, and recognition of the impact on deferred taxes from a change in the UK tax law affecting oil companies.

The net-debt-to-equity ratio was 28.6% at year-end 2002 compared to 30.9% at year-end 2001.

In 2002, the Company's return on average capital employed (ROACE (2)) was 15%.

*(1) Includes 2.91 million shares used to cover stock option programs.*
*(2) To be more comparable to its peer group, TotalFinaElf has changed to presenting a return on average capital employed (ROACE) which is net operating income (excluding non-recurring items and before amortization of goodwill for Chemicals) divided by the average of the beginning and ending capital employed, and will no longer present on the basis of return on beginning of year capital employed. This ratio will be presented for the business segments and at the Group level.*

The return on equity (ROE) was at a high level of 20% in 2002.

Cash flow from operating activities decreased by 11% to 11,006 M€ in 2002 from 12,303 M€ in 2001.

Investments fell by 18% to 8,657 M€ in 2002 from 10,566 M€ in 2001, reflecting lower spending in Upstream gas and power activities and in the Chemicals segment.

Divestments, based on selling prices, were 2,313 M€ in 2002, comprised mainly of sales of securities (notably Sanofi-Synthélabo and other financial participations) as well as reimbursements of long-term loans.

Free cash flow (3) was 4,662 M€ in 2002 compared to 8,741 M€ in 2001.

*(3) Free cash flow = cash flow from operations + divestments – investments.*

### Oil market environment

| | 2002 | 2001 | % |
|---|---|---|---|
| €/$ | 0.95 | 0.90 | –5%* |
| Brent ($/b) | 25.0 | 24.4 | +2% |
| European refining margin TRCV ($/t) | 8.0 | 15.4 | –48% |

** Change in the dollar versus the euro.*

### Number of shares

| *(millions)* | 2002 | 2001 | % |
|---|---|---|---|
| Fully-diluted weighted average shares | 666.1 | 693.2 | –4% |
| Fully-diluted shares at year-end | 655.0 | 673.0 | –3% |

### Consolidated accounts - TotalFinaElf

| *(in millions of euros)* | 2002 | 2001 | % |
|---|---|---|---|
| Sales | 102,540 | 105,318 | –3% |
| Operating income from the business segments excluding non-recurring items | 10,995 | 13,121 | –16% |
| Net operating income from the business segments excluding non-recurring items | 5,868 | 7,564 | –22% |
| Net income excluding non-recurring items | 6,260 | 7,518 | –17% |
| Net income | 5,941 | 7,658 | –22% |
| Earnings per share (euros) excluding non-recurring items | 9.40 | 10.85 | –13% |
| Dividend (euros/share) | 4.10* | 3.80 | +8% |
| Investments** | 8,657 | 10,566 | –18% |
| Divestments*** based on selling price | 2,313 | 7,004 | –67% |
| Cash flow from operating activities | 11,006 | 12,303 | –11% |

**Pending approval at the May 6, 2003 AGM.*
***Including increases in long-term loans.*
****Including repayments of long-term loans.*

### Impact of non-recurring items

| (in millions of euros) | 2002 | 2001 |
|---|---|---|
| **Impact of non-recurring items on operating income** | | |
| Restructuring charges | –29 | –24 |
| Impairments | –659* | –50 |
| Other | +29 | –18 |
| **Total** | **–659** | **–92** |
| **Impact of non-recurring items on net income** | | |
| Gain on asset sales | +626 | +1,400 |
| Toulouse-AZF plant impact | –61 | –600 |
| Restructuring charges and early retirement plans | –158 | –226 |
| Impairments | –467** | –224 |
| Other | –259 | –210 |
| **Total** | **–319** | **+140** |

**Includes –500 M€ related to the impact of the situation in Argentina.*
***Includes –310 M€ related to the impact of the situation in Argentina.*

## Upstream

Operating income excluding non-recurring items from the Upstream segment rose by 3% to 9,309 M€ in 2002 from 9,022 M€ in 2001. The positive effects of a large increase in production volume and the higher oil price were partially offset by the negative impacts of the dollar depreciating against the euro and lower natural gas prices.

Net operating income excluding non-recurring items for the Upstream segment was stable at 4,648 M€ in 2002 compared to 4,652 M€ in 2001. Relative to the year-over-year increase in operating income excluding non-recurring items, the flat net operating income reflects the impacts of lower capitalized interest due to a number of start-ups and lower income contributions from equity affiliates.

Upstream ROACE was 23% in 2002.

Hydrocarbon production increased by 10% to 2,416 kboe/d for the full year 2002 compared to 2,197 kboe/d for 2001. Excluding the impact of OPEC quota reductions, production growth would have been 11.5% in 2002.

Liquids production rose by 9% to 1,589 kb/d in 2002 from 1,454 kb/d in 2001, driven primarily by growth from Block 17 in Angola, Sincor in Venezuela, South Pars and Dorood in Iran, and various fields in the UK North Sea.

Gas production increased by 12% to 4,532 Mcf/d in 2002 from 4,061 Mcf/d in 2001, driven primarily by growth from Elgin-Franklin and Nuggets in the UK North Sea and new fields launched in Norway and Syria.

Driven by a sustained exploration and appraisal program, proved reserves continued to grow, rising 2% to 11,203 Mboe at year-end 2002 from 10,978 Mboe at year-end 2001. The 2002 proved reserves represent 12.7 years of production based on the average rate for 2002.
For consolidated subsidiaries, the 2000-2002 three-year average reserve replacement rate was very competitive at 151%.

The 2000-2002 three-year average reserve replacement cost for consolidated subsidiaries was 4.0 $/boe and finding costs were 0.7 $/boe.

The main discoveries in 2002 were made in deep-offshore West Africa (Nigeria and Angola, including Zinia in the 2002 fourth quarter), in the North Sea and in Kazakhstan (Kalamkas).

Major 2002 highlights included the build-up of production from South Pars in Iran, Girassol in Angola, Elgin-Franklin in the UK North Sea, and the Sincor upgrader in Venezuela. The Sincor upgrader is in the process of restarting operations after having been idled for 10 weeks by a strike in Venezuela.

Other highlights for the year included the approval of the Snohvit project by the Norwegian Parliament, the acquisition of 5% of the BTC pipeline project as well as the acquisition of several permits in Russia.

Gas and power activities in Argentina were the object of a 431 M€ asset impairment in 2002; however, the operational highlight of the year was launching the Taweelah power project in Abu Dhabi.

For renewable energies, new developments included a solar power project in Morocco and the start of a wind energy project at the Dunkirk refinery site in France.

**Upstream – key figures**

| | 2002 | 2001 | % |
|---|---|---|---|
| Production (kboe/d) | 2,416 | 2,197 | +10% |
| • Liquids (kb/d) | 1,589 | 1,454 | +9% |
| • Gas (Mcfd) | 4,532 | 4,061 | +12% |
| Proved reserves (Mboe) | 11,203 | 10,978 | +2% |
| • Liquids (Mb) | 7,231 | 6,961 | +4% |
| • Gas (Bcf) | 21,575 | 21,929 | –2% |
| Operating income (M€) excluding non-recurring items | 9,309 | 9,022 | +3% |
| Net operating income (M€) excluding non-recurring items | 4,648 | 4,652 | – |
| Investments (M€) | 6,122 | 7,496 | –18% |
| Divestments at selling price (M€) | 603 | 1,116 | –46% |
| Cash flow from operating activities (M€) | 7,721 | 8,085 | –5% |

## Downstream

Operating income excluding non-recurring items from the Downstream segment fell by 70% to 909 M€ in 2002 from 3,004 M€ in 2001.

Refined product demand in the OECD countries declined due to weak economic conditions and mild weather during 2002, thus creating an exceptionally poor environment for the Downstream segment: European refining margins fell by 48% and marketing margins were under pressure given the context of high crude oil prices.

Downstream results were further affected by an unusually high level of scheduled refinery turn-arounds: seven of the twelve refineries operated by TotalFinaElf in Europe were affected, mainly in the third and fourth quarters of 2002. Synergies and productivity efforts had a positive impact of about 0.2 B€ on operating income which only partially offset the negative impact of the environment and the refinery turn-arounds.

Net operating income excluding non-recurring items for the Downstream segment fell by 63% to 846 M€ in 2002 from 2,309 M€ in 2001.

Within this context, Downstream ROACE was 8% in 2002. Taking into account the refinery turn-arounds, refinery throughput fell by 5% to 2,349 kb/d in 2002 from 2,465 kb/d in 2001, and the utilization rate fell to 88% in 2002 from 96% in 2001.

Refined product sales were up slightly to 3,751 kb/d in 2002 from 3,724 kb/d in 2001.

In refining, the main highlights for 2002 concerned the major turn-arounds that improved the safety and reliability of the units as well as increased the conversion and desulphurization rates.

In marketing, a new market segmentation strategy was implemented in France in 2002, using the Total brand (focused on the service-sensitive market segment) and the redesigned Elf brand (focused on the price-sensitive market segment).
Outside of France, an agreement in principle was reached with Agip and Galp under which TotalFinaElf will dispose of its Total-brand service stations in Spain and acquire stations in Italy and Portugal.
TotalFinaElf sold its service station network in Switzerland, where its market share was less than 3%.

**Downstream – key figures**

| | 2002 | 2001 | % |
|---|---|---|---|
| Refinery throughput* (kb/d) | 2,349 | 2,465 | –5% |
| Refined product sales** (kb/d) | 3,751 | 3,724 | +1% |
| Operating income (M€) excluding non-recurring items | 909 | 3,004 | –70% |
| Net operating income (M€) excluding non-recurring items | 846 | 2,309 | –63% |
| Investments (M€) | 1,112 | 1,180 | –6% |
| Divestments at selling price (M€) | 283 | 1,079 | –74% |
| Cash flow from operating activities (M€) | 1,447 | 4,374 | –67% |

**Including share of Cepsa.*
***Including trading and share of Cepsa.*

## Chemicals

Sales for the Chemicals segment were stable at 19,317 M€ in 2002 compared to 19,560 M€ in 2001.

Operating income excluding non-recurring items fell by 29% to 777 M€ in 2002 from 1,095 M€ in 2001.

The environment for Chemicals had a negative impact of about 0.4 B€ on operating income for the year.

Operating income for the Base chemicals and polymers sector was affected by a particularly depressed environment in the ethylene/polyethylene chain as well as in the chlorine chain.

Intermediates resisted the difficult economic conditions. Specialties improved their performance.

Net operating income excluding non-recurring items fell by 38% to 374 M€ in 2002 from 603 M€ in 2001.

Chemicals ROACE was 5%(4) in 2002.

The main 2002 highlights for the Base chemicals & polymers sector were the signing of a letter of intent with Samsung for a 50% interest in its Daesan petrochemical complex in South Korea, the launching of a new polypropylene unit at Feluy in Belgium and the purchase of Enichem's interest in Qapco in Qatar.

TotalFinaElf actively managed its portfolio of Intermediates and Specialties in 2002. Telomeres fluorides were sold and the sale of the SigmaKalon paints unit was initiated with a closing expected during the first quarter 2003 after approval from the competition authorities.

*(4) Excluding amortization of goodwill in the amount of 131 M€ in 2002.*

**Chemicals – key figures** (M€)

| | 2002 | 2001 | % |
|---|---|---|---|
| Sales | 19,317 | 19,560 | –1% |
| Operating income excluding non-recurring items | 777 | 1,095 | –29% |
| Net operating income excluding non-recurring items | 374 | 603 | –38% |
| Investments | 1,237 | 1,611 | –23% |
| Divestments at selling price | 140 | 541 | –74% |
| Cash flow from operating activities | 1,053 | 1,261 | –16% |

## Parent company TOTAL FINA ELF S.A. accounts and proposed dividend

The parent company TOTAL FINA ELF reported earnings of 2,410 M€ in 2002 compared to 3,829 M€ in 2001. The Board of Directors of TotalFinaElf, after closing the accounts, decided to propose at the May 6, 2003 Annual General Meeting (AGM) a cash dividend of 4.10 euros per share, representing an 8% increase from the previous year, to which will be added the “avoir fiscal” (French tax credit) pursuant to the terms in force. The dividend will be paid May 16, 2003.

**2003 Sensitivities**

| | Variation | 2003 Sensitivities (estimated) * | | |
|---|---|---|---|---|
| | | Operating income | Net income | EPS (5) |
| €/$ | ± 0.1 $ per € | 1.10 B€ | 0.57 B€ | 0.87 € |
| Brent | ± 1 $ per barrel | 0.54 B€ | 0.26 B€ | 0.40 € |
| Refining margin (TRCV) | ± 1 $ per ton | 0.11 B€ | 0.07 B€ | 0.11 € |

** Sensitivities based on an environment of €/$ = 1, Brent = 20 $/b, TRCV = 12 $/t.*
*(5) Based on 655.0 M fully-diluted shares at December 31, 2002.*

## Outlook

Given the uncertainties related to events in the Middle East, it is difficult to predict trends for the 2003 oil market environment.

Since the start of the year, oil prices have remained at high levels. Refining margins have recently rebounded sharply. The dollar has lost ground against the euro, and petrochemicals continued to suffer low margins given the high price of naphtha feedstock.

Within this context, TotalFinaElf plans to maintain an investment program of 8.7 billion euros, with priority given to Upstream growth. The 2003 budget for investments is split 67% for Upstream, 15% for Downstream and 18% for Chemicals (including the Samsung JV project).

TotalFinaElf plans to continue to improve its performance in 2003 (assuming a constant environment):
– Upstream production is expected to grow by 5%
– Downstream projects a 300 M€ operating income improvement from ongoing synergies and productivity efforts
– Chemicals will pursue self-help programs, restructurings and active portfolio management.

The target to improve operating income by 4.8 B€ on an annual basis by the end of the 2000-2003 period is confirmed, assuming a constant environment.

Over the medium term, the target for hydrocarbon production is to average 5% growth per year through 2007.

In addition, the following 2005 targets for return on average capital employed (ROACE(6)) have been set: Upstream 16%(7), Downstream 16% and Chemicals 14%(8). For the Group as a whole, the 2005 ROACE target is 15.5%.

The net-debt-to-equity ratio is expected to be maintained at around 30%, and the buy-back program is expected to continue.

In setting demanding but realistic medium-term targets for growth and profitability, the Group mobilizes the talents and energy of its people to achieve profitable and sustainable growth.

*(6) In the reference environment: €/$ = 1 ; Brent = 17$/b, TRCV = 12$/t ; Chemicals in mid-cycle.*
*(7) This target takes into account the impact of the change in UK taxes and the situation in Argentina.*
*(8) Excluding amortization of goodwill.*