

**ОАО БАЛТИКА BREWERY
AND SUBSIDIARIES**

Consolidated Financial Statements

June 30, 2003 and 2002

**OAD BALTIKA BREWERY
AND SUBSIDIARIES**

Consolidated Financial Statements

June 30, 2003 and 2002

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**OAD BALTICA BREWERY
AND SUBSIDIARIES**

Consolidated Balance Sheets
June 30, 2003 and December 31, 2002
(in thousands U.S. dollars)

Assets	June 30, 2003	December 31, 2002
Current assets:		
Cash and cash equivalents	\$ 14,934	12,844
Trade accounts receivable, net (note 2)	27,027	7,024
Loans receivable, net (note 3)	33	110
Inventories (note 4)	82,853	58,583
Prepayments and other receivables (note 5)	56,629	72,251
Total current assets	181,476	150,812
Investment securities (note 6)	322	310
Investments in affiliated companies (note 7)	9,827	8,042
Loans receivable, net (note 3)	10,388	10,408
Property, plant and equipment net (note 8)	611,167	525,688
Intangible assets	1,206	668
Total assets	\$ 814,386	695,928
Liabilities and Shareholders' Equity		
Current Liabilities:		
Trade accounts payable	\$ 55,720	33,136
Short-term debt including current installments of long-term debt (note 10)	73,711	69,766
Current installments of obligations under capital leases (note 11)	1,309	-
Accrued salaries, wages and benefits	17,866	15,914
Accrued taxes	19,328	10,768
Other liabilities	28,989	4,073
Due to related parties (note 17)	614	902
Total current liabilities	197,537	134,559
Long-term debt, excluding current installments (note 9)	8,000	10,000
Obligations under capital leases, excluding current installments (note 11)	2,618	-
Deferred income taxes	23,826	2,934
Total liabilities	34,444	147,493
Shareholders' equity (note 14):		
Preference shares	3,105	2,965
Ordinary shares	25,002	23,872
Additional paid-in capital	41,964	40,068
Retained earnings	528,128	481,151
Treasury shares	(1,320)	(759)
Other comprehensive income/(loss)	(14,474)	1,138
Total shareholders' equity	582,405	548,435
Commitments and contingencies (note 16)	-	-
Total liabilities and shareholders' equity	\$ 814,386	695,928

See accompanying notes to consolidated financial statements.

Alexander Nikonov
Vice-president on finance and economy, CFO

Sergei Alexeev
Chief accountant

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Consolidated Statements of Income For the

Six months Ended June 30, 2003 and 2002

(in thousands U.S. dollars, except per share data)

	Six months ended June 30,	
	2003	2002
Sales	\$ 368,869	384,930
Excise taxes	(32,816)	(28,558)
Net sales	336,053	356,372
Cost of goods sold	176,714	182,164
Gross profit	159,339	174,208
Selling, general and administrative expenses	74,579	64,291
Operating income	84,760	109,917
Other income (expense)		
Equity in income of affiliates	961	1,781
Interest income	498	2,729
Interest expense (note 12)	(966)	(634)
Other expense, net	(1,784)	(809)
Foreign currency income/(loss)	2,167	(2,085)
Income before income taxes and minority interest	85,636	110,899
Income taxes (note 13)	21,229	23,070
Income before minority interest	64,407	87,829
Minority interest	-	12,954
Net income before cumulative effect of a change in accounting principle	64,407	74,875
Cumulative effect on prior years of retroactive application of depreciation for kegs	-	(2,796)
Net income	\$ 64,407	72,079
Basic earnings per share before cumulative effect of accounting change	0.50	0.66
Accounting change	-	(0.03)
Basic earnings per share (note 18)	0.50	0.63
Diluted earnings per share before cumulative effect of accounting change	0.50	0.66
Accounting change	-	(0.03)
Diluted earnings per share (note 18)	0.50	0.63

See accompanying notes to consolidated financial statements.

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Consolidated Statement of Shareholders' Equity and Comprehensive Income For the
Six months Ended June 30, 2003 and Year Ended December 31, 2002
(in thousand U.S. dollars)

	Preference shares	Ordinary shares	Additional paid-in capital	Retained earnings	Treasury shares	Other comprehensive Income	Total shareholders equity
Balances at January 1, 2002	\$ 2,963	23,530	-	370,097	(463)	-	396,127
Net income				137,054			137,054
Net treasury stock acquired					(296)		(463)
Shares issued	2	342	40,068				40,412
Comprehensive income						1,138	1,138
Dividends declared							
Preference shares				(3,639)			(3,639)
Ordinary shares				(22,361)			(22,361)
Balances at December 31, 2002	\$ 2,965	23,872	40,068	481,151	(759)	1,138	548,435
Net income				64,407			64,407
Net treasury stock acquired					(561)		(561)
Cumulative translation adjustment						(16,080)	(16,080)
Comprehensive income				1,952		414	2,366
Translation difference	140	1,130	1,896	22,007		54	25,227
Dividends declared							
Preference shares				(5,409)			(5,409)
Ordinary shares				(35,980)			(35,980)
Balances at June 30, 2003	\$ 3,105	25,002	41,964	528,128	(1,320)	(14,474)	582,405

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows For the
Six months Ended June 30, 2003 and 2002

(in thousand U.S. dollars)

	June 30,	
	2003	2002
Net cash provided by operating activities (note 15)	94,790	123,132
Cash flows from investing activities:		
Capital expenditures	(84,819)	(44,719)
Acquisition of subsidiary net of cash acquired	(489)	-
Proceeds on disposal of fixed assets	5,378	315
Purchase of investment securities	-	-
Additional contribution to associate	-	-
Purchase of bank promissory notes	4,298	(22,080)
Net change in loans made to third parties	576	(825)
Net cash used in investing activities	(75,056)	(67,309)
Cash flows from financing activities:		
Bank indebtedness	808	(7,198)
Dividends paid	(15,572)	(14,168)
Dividends paid to minority	-	(3,313)
Proceeds from operations with treasury shares	(510)	463
Principal payments under capital lease obligations	(436)	-
Proceeds from long-term borrowings	-	-
Repayments of long-term borrowings	(2,000)	(2,000)
Net cash used in financing activities	(17,711)	(26,216)
Translation difference	67	-
Increase/(decrease) in cash and cash equivalents	2,090	29,607
Cash and cash equivalents, beginning of year	12,844	16,414
Cash and cash equivalents, end of year	\$ 14,934	46,021

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements For the Six months Ended
June 30, 2003 and 2002

(1) Summary of Significant Accounting Policies and Practices

(a) Description of Business

OAO Baltika Brewery (the "Company") is an open joint-stock company incorporated under Russian legislation and was registered on 21 July 1992, and through a controlling interest in three companies (referred to collectively as the "Group"), produces beer and mineral water. Other services it renders include the transport and distribution of Group products.

The Company's ordinary shares are 81% owned and controlled by Baltic Beverages Holding AB. The remainder of the ordinary shares are widely held.

The Company's preference shares are 14% owned and controlled by Baltic Beverages Holding AB. The remainder of the preference shares are widely held.

As at reporting period end the Company consists of five production plants: Baltika-Saint-Petersburg, Baltika-Tula, Baltika-Rostov, Baltika-Samara and Baltika-Khabarovsk and four subsidiaries: OOO Baltika-Moscow, OOO Leasing-Optimum, OOO Universalopttorg and Baltika Deutschland GmbH.

Most of the Group's customers are located in Russia. The Group's raw materials are readily available, and the Group is not dependent on a single supplier or only a few suppliers.

(b) Effects of the Russian business environment on activities in Russia

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 financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of Baltika Brewery and subsidiaries. The future business environment may differ from management's assessment.

(c) Convertibility of the Rouble

The Russian rouble is not a convertible currency outside the Russian Federation and, accordingly, any conversion of Russian rouble amounts to US dollars should not be construed as a representation that Russian rouble 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) Functional and reporting currency

On January 1, 2003, the economy of the Russian Federation ceased to be considered highly inflationary. The Company's balance sheet at January 1, 2003 was translated at the current exchange rate prevailing at January 1, 2003 to establish a new rouble functional currency basis. The differences between the new rouble functional currency basis and the tax basis represent temporary differences, for which deferred taxes were recognized. The effects of recognizing such deferred taxes were included as an adjustment to accumulated other comprehensive income, a component of

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June 30, 2003 and 2002

stockholders' equity (see Note (13) "Income taxes").

For the purposes of these financial statements, management has elected to use the United States dollar ("USD") as the reporting currency.

Beginning January 1, 2003, the functional currency amounts are translated into the reporting currency using the period-end rates for assets and liabilities and period weighted average rates for revenues, expenses, gains and losses. Rouble to USD exchange rates used at June 30, 2003 and December 31, 2002 were 30.35 and 31.78 roubles to 1 USD, respectively. As a result of these procedures, a cumulative translation adjustment is recorded as a component of accumulated other comprehensive income.

(e) Comparative information

Prior period amounts are presented in USD and have been translated from the Russian rouble denominated accounts in accordance with the highly inflationary economy accounting prescribed by Statement of Financial Accounting Standards No. 52 ("SFAS 52"), "Accounting for Foreign Currency Translation". Under this method, monetary assets and liabilities denominated in roubles are translated into USD at the prevailing period end exchange rate. All other assets and liabilities are translated at historic exchange rates. Revenues, expenses and cash flows have been translated, where practicable, at historic rates as of the date of the transaction. Otherwise, revenues, expenses and cash flows have been translated using reporting period average rates. Foreign currency gains and losses resulting from the use of these different rates are included in the statement of operations.

(f) Principles of Consolidation

Subsidiary companies are those companies in which the Company directly or indirectly holds more than 50% of the voting rights and is able to exercise control. Subsidiary companies have been fully consolidated from the date the Company acquired control. Minority interests in the income and assets and liabilities of the subsidiaries are disclosed separately.

As at June 30, 2003, the subsidiary companies which are included in the consolidation, consist of the following:

Name	Nature of Business	Country of Incorporation	Ownership
ООО Baltika-Moscow	Distribution of Baltika beer	Russia	100.00%
ООО Leasing-Optimum	Lessor's activity	Russia	100.00%
ООО Universaloptorg	Lessor's activity	Russia	100.00%
Baltika Deutschland GmbH	Distribution of Baltika beer	Germany	100.00%

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OOO Universaloptorg (Voronezh) is an entity that owns a warehouse and office building in Voronezh and derives its revenues from letting these premises. OOO Universaloptorg was acquired by the Group in June, 2003 for approximately \$490 th.

Associated companies are those companies over which the Group can exercise significant influence, but which it cannot control. Associated companies are accounted for by the equity method. As at June 30, 2003, the only associated company is a company founded in conjunction with the Soufflet group - ZAO Malterie Soufflet Saint-Petersburg (Soufflet). This company produces malt.

(g) Cash Equivalents

Cash equivalents of \$14,934 th. and \$12,844 th. at June 30, 2003 and December 31, 2002, respectively, consist of bank balances and short-term certificates of deposit held in local banks. For purposes of the consolidated statements of cash flows, the Group considers all short-term deposits to be cash equivalents.

(h) Loans Receivable

Loans receivable are recorded at cost, less the related allowance for impaired loans receivable. Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Group will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate. Impairment losses are included in the allowance for doubtful accounts through a charge to bad debt expense.

(i) Inventories

Inventories are stated at the lower of cost or market value. Cost is determined using the weighted average method for all inventories.

(j) Investment Securities

Investment securities at June 30, 2003 consist of equity securities. The Group classifies its equity securities as available-for-sale.

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

A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related available-for-sale security as an adjustment to yield using

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the effective interest method.

(k) Derivative Instruments and Hedging Activities

In June 1998 the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Certain Hedging Activities." In June 2000 the FASB issued SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activity, an Amendment of SFAS 133." SFAS No. 133 and SFAS No. 138 require that all derivative instruments be recorded on the balance sheet at their respective fair values. SFAS No. 133 and SFAS No. 138 are effective for all fiscal quarters of all fiscal years beginning after June 30, 2000; the Group adopted SFAS No. 133 and SFAS No. 138 on January 1, 2001. Financial assets and liabilities as at June 30, 2003 were re-measured to fair values in accordance with the provisions of SFAS No. 107 (see note (19)).

(l) Investments in Affiliated Companies

Investments in the common stock of affiliated companies are accounted for by the equity method. The Group would recognize a loss when there is a loss in value in the investment.

(m) Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation on plant and equipment is calculated on the straight-line method over the estimated useful lives of the assets as follows.

Asset	Estimated useful lives
Buildings	40 years
Construction	25-50 years
Machinery and equipment	6-10 years
Trucks	6 years
Other	5-10 years

(n) 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 the 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 and impairment losses (refer to note (1)(r)).

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.

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(o) Income Taxes

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 differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. 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.

(p) Pension and Other Postretirement Plans

The Company and its subsidiaries make contributions to the Pension Fund of the Russian Federation as required by Russian law. The contributions amount to 26% of gross salaries and are expensed as incurred. The Group has not recorded any commitments payable to management or employees on retirement.

(q) 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 financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

(r) Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

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 future cash flows, an impairment charge is recognised by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Goodwill and intangible assets not subject to amortization are tested annually for impairment. An impairment loss is recognised to the extent that the carrying amount exceeds the asset's fair value.

(s) Revenue Recognition

The Group recognizes revenue on sales when products are shipped and the customer takes ownership and assumes risk of loss. Revenues are stated net of value-added taxes charged to customers.

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June 30, 2003 and 2002

(t) *Commitments and Contingencies*

A considerable degree of uncertainty currently exists in the Russian Federation with regard to the direction of domestic economic policy, regulatory policy and political developments. Group management is unable to predict what changes in conditions may occur and what effect such changes may have on the financial statements.

As Russian commercial legislation, and tax legislation in particular, contains provisions which can be interpreted in more than one way, and due to the tax authorities' practice, as developed in a generally unstable environment, of arbitrarily judging business activities and arbitrarily classifying enterprises' activities where the regulatory basis for such a decision is insufficient, management's judgment of the Group's business activities may not coincide with the tax authorities' interpretation of these same activities.

Management is not currently aware that any situations exist which may be challenged by the tax authorities which have not already been reflected in the financial statements. However, if a particular treatment was to be challenged by the tax authorities, significant penalties may be imposed on the Group. Although the actual amount of tax due on a transaction may be minimal, penalties can be charged at 20% of the value of the outstanding tax amount and also include interest accrued thereon at 1/300 of Central Bank of Russia interest rate per day.

The Group is affected by political, legislative, fiscal and regulatory developments in Russia and also to physical risks of various kinds. The nature and frequency of the developments and risks, which are not covered by insurance, as well as their effect on the future operation and earnings are not predictable. The occurrence of significant losses and impairments associated with facilities could have a material effect on the Group's operations and no provisions for self-insurance to cover such items are incorporated into these financial statements.

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Notes to Consolidated Financial Statements For the Six months Ended
June 30, 2003 and 2002

(2) Trade Receivables

Trade receivables at June 30, 2003 and December 31, 2002 consist of the following:

	June 30, 2003	December 31, 2002
Trade receivables	\$ 27,630	7,368
Less: allowance for doubtful debts	(603)	(344)
	\$ 27,027	7,024

(3) Loans Receivable

Loans receivable at June 30, 2003 and December 31, 2002 consist of the following:

	June 30, 2003	December 31, 2002
Current:		
Other loans receivable	33	110
	\$ 33	110
Long-term:		
Loan receivable from OAO Krinitisa	\$ 10,388	10,408
	\$ 10,388	10,408

See note (16) Legal proceeding below for more details covering the OAO Krinitisa Loan.

(4) Inventories

Inventories are stated at the lower of cost or market value and are calculated using the weighted-average method. Inventory consists of the following:

	June 30, 2003	December 31, 2002
Raw materials and supplies	\$ 54,593	40,634
Work in progress	9,300	6,894
Finished goods	18,960	11,055
	\$ 82,853	58,583

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Notes to Consolidated Financial Statements For the Six months Ended
June 30, 2003 and 2002

(5) Prepayments and other receivables

Prepayments and other receivables at June 30, 2003 and December 31, 2002 consist of the following:

	<u>June 30, 2003</u>	<u>December 31, 2002</u>
VAT receivable	\$ 39,486	39,948
Profit tax receivable	339	14,044
Advances to suppliers	10,409	8,728
Bank promissory notes	-	4,228
Other	6,395	5,303
	<u>\$ 56,629</u>	<u>72,251</u>

(6) Investment Securities

Investment securities at June 30, 2003 consist of equity securities in Menatep Bank and Bin Bank. All investment securities are classified as available-for-sale.

(7) Investments in Affiliated Companies

Investments in affiliated companies consist of 30% of the common stock of Soufflet, malt producing company. This investment has been accounted for under the equity method.

(8) Property, plant and equipment

Property and equipment at June 30, 2003 and December 31, 2002 consists of the following:

	<u>June 30, 2003</u>	<u>December 31, 2002</u>
Buildings	\$ 154,708	107,300
Machinery and equipment	489,785	368,020
Kegs	16,299	12,336
Construction in progress	108,548	165,084
Less: accumulated depreciation	(158,173)	(127,052)
	<u>\$ 611,167</u>	<u>525,688</u>

Property and equipment includes production equipment amounting to \$45,295 th. and \$46,908 th. (by net book value) at June 30, 2003 and December 31, 2002 that has been pledged under a long term loan agreement with the EBRD.

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June 30, 2003 and 2002

(9) Long-Term Debt

Long-term debt at June 30, 2003 and December 31, 2002 consists of the following:

	<u>June 30, 2003</u>	<u>December 31, 2002</u>
Borrowings under financing agreement with EBRD, LIBOR interest plus margin, payable each month, principal due November 2006	\$ 12,041	14,012
Total long-term debt	12,041	14,012
Less current installments	(4,041)	(4,012)
Long-term debt, excluding current installments	\$ <u>8,000</u>	<u>10,000</u>

In 1999, the Group entered into a financial agreement with EBRD that permitted the Group to borrow up to \$40,000 th., bearing interest at LIBOR plus a margin percentage. Borrowings under the financing agreement were to be repaid in ten equal semi-annual installments commencing 28 November 2001.

Due to a change in the Group's cash flow requirement the Bank has agreed to amend the financial agreement. The long-term loan facility was changed into revolving credit facility with the loan amount not exceeding \$14,000 th. The loan amortization schedule was left unchanged. The respective agreements were signed on November 14, 2002.

Under the terms of this borrowing agreement the Group is required to follow the specified levels of cash flow in relation to the amounts borrowed in order to be able to declare or pay dividends, distribute any of its share capital, purchase, redeem or acquire any of its shares, or make any payment of principal on any subordinated debt.

(10) Short-term debt

Short-term debt at June 30, 2003 and December 31, 2002 consists of the following:

	<u>June 30, 2003</u>	<u>December 31, 2002</u>
Current portion of long-term debt	\$ 4,041	4,012
Short term loans payable	69,670	65,754
Short-term debt, including current installments of long-term debt	\$ <u>73,711</u>	<u>69,766</u>

As at June 30, 2003 an amount of \$69,670 th. has been drawn at interest rates between 3,26% and 4,43% on US dollar denominated loans and 3,5% on rouble denominated loans.

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June 30, 2003 and 2002

(11) Obligations under capital lease

The Group is obligated under capital lease covering certain machinery and equipment that expire within the next three years. At June 30, 2003 and December 31, 2002 the gross amount of plant and equipment and related accumulated amortisation recorded under capital leases were as follows:

	June 30, 2003	December 31, 2002
Machinery and equipment	\$ 3,637	-
Less accumulated amortization	-	-
	\$ 3,637	-

Amortization of assets held under capital leases is included with depreciation expense.

Future minimum capital lease payments as of June 30, 2003 are:

Year ending December 31	Capital leases
2003	\$ 772
2004	1,481
2005	1,401
2006	669
Later years	-
Total minimum lease payments	4,323
Less: amount representing interest (at rates approximating LIBOR+ 5%)	(396)
Present value of net minimum capital lease payments	3,927
Less current instalments of obligations under capital leases	1,309
Obligations under capital leases, excluding current instalments	\$ 2,618

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(12) Interest expense

The Group capitalizes interest cost as a component of the cost of construction in progress. The following is a summary of interest cost incurred during six months 2003 and 2002:

	Six months ended June 30,	
	2003	2002
Interest cost capitalized	\$ 813	-
Interest cost charged to income	966	634
Total interest cost incurred	\$ 1,779	634

(13) Income Taxes

Income tax expense attributable to income from continuing operations consists of:

	Current	Deferred	Total
Six months ended June 30, 2003	\$ 17,433	3,796	21,229
Six months ended June 30, 2002	\$ 20,561	2,509	23,070

The Group's applicable tax rate as at June 30, 2003 and 2002 is the corporate income tax rate of 24.00%. The rate used for measuring deferred tax as at June 30, 2003 and 2002 was 23,60% (6.00% for investments in Soufflet) and 17.87% (6.00% for investments in Soufflet) respectively.

Due to the fact that starting January 1, 2003, the economy of the Russian Federation ceased to be considered highly inflationary (see note (1) (d)) the differences between the new rouble functional currency basis and the tax basis represent temporary differences, for which additional deferred taxes liability of \$16,080 th. as of January 1, 2003 is recognized. The effects of recognizing such deferred taxes were included as an adjustment to accumulated other comprehensive income, a component of stockholders' equity.

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Notes to Consolidated Financial Statements For the Six months Ended
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Reconciliation of effective tax rate:

	Six months ended June 30,	
	2003	2002
Computed "expected" tax expense	\$ 20,553	26,616
Increase (reduction) in income taxes resulting from:		
Adjustment to Deferred tax assets and liabilities for enacted changes in tax laws and rates	(846)	3,668
Tax concessions granted in respect of local portion of tax	(74)	-
Tax concessions granted in respect of local portion of tax for excise payers	-	(1,200)
Tax effect of non-deductible expenditures	1,450	1,181
Other, net	146	(7,195)
	<u>\$ 21,229</u>	<u>23,070</u>

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at June 30, 2003 and December 31, 2002 are presented below.

	June 30, 2003	December 31, 2002
Deferred tax assets/(liabilities):		
Accounts receivable, principally due to allowance for doubtful accounts	\$ (54)	61
Inventories, principally due to obsolete inventory written off	84	69
Inventories, principally due to the differences in principles of overhead allocation	-	(92)
Prepayments and other receivables, principally due to allowance for doubtful accounts	130	129
Investments in affiliated companies under equity method	(369)	(297)
Unrealized inter-company gain in inventory	-	-
Fixed assets, principally due to different tax depreciation rates and different accounting basis	(23,667)	(3,859)
Effect of recoverable within 5 years transformation base	1,918	1,585
WIP and FG, principally due to different capitalisation rules for tax and accounting purposes	(1,120)	(530)
Other	(748)	-
Total gross deferred tax assets/(liabilities)	(23,826)	(2,934)
Less valuation allowance	-	-
Net deferred tax assets/(liabilities)	\$ (23,826)	(2,934)

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(14) Share capital and dividends

During 2001 and 2002 the Company was in process of reorganisation of its legal structure that was finalised on June 28, 2002 and resulted in exchange of shares held by minority shareholders in Baltika-Don and Tula Brewery into newly issued shares of Baltika.

As of June 30, 2003 the Company had authorized and issued share capital of 117,158,530 ordinary shares and 13,545,150 preference shares with a par value of 1 rouble each.

Preference shares earn dividends calculated on the basis of the nominal value multiplied by the interest rate of the Savings Bank of the Russian Federation, plus 10%. In accordance with the Company Charter, preference shares grant shareholders the following additional rights: if the Company is liquidated, the nominal value of preference shares will be returned to shareholders. Shareholders are entitled to sell their shares to the Company at their nominal value adjusted for inflation before any return is made to holders of ordinary shares.

Distributable reserves are restricted to the rouble denominated retained earnings of the Company as determined by Russian legislation.

At June 30, 2003 the dollar equivalent of the amount available for distribution for Parent company and its subsidiaries, calculated based on statutory retained earnings of consolidated financial statements of the Company in roubles with application of period end rate is \$362,316 th. (2002: \$312,464 th.).

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The following table demonstrates declared dividends for the periods ended June 30, 2003 and December 31, 2002:

	RUR per share	USD per share equivalent	Thousands USD
December 31, 2002			
Preference shares			
Final portion of dividends for 2001 (first instalment)	4.70	0.15	2,036
Final portion of dividends for 2001 (second instalment)	3.70	0.12	1,603
Total dividends declared preference shares in 2002			<u>3,639</u>
Ordinary shares			
Final portion of dividends for 2001 (first instalment)	3.65	0.12	12,556
Final portion of dividends for 2001 (second instalment)	2.85	0.09	9,805
Total dividends declared ordinary shares in 2002			<u>22,361</u>
June 30, 2003			
Preference shares			
Dividends for 2002 (first instalment)	4.91	0.16	2,191
Dividends for 2002 (second instalment)	7.21	0.23	3,218
Total dividends declared preference shares in 2003			<u>5,409</u>
Ordinary shares			
Dividends for 2002 (first instalment)	3.71	0.12	14,554
Dividends for 2002 (second instalment)	5.55	0.18	21,426
Total dividends declared ordinary shares in 2003			<u>35,980</u>

The Shareholder's meeting held on June 30, 2003 approved dividends in equivalent of \$41,389 th.

During six months 2003 the Group performed operations on repurchase and selling of ordinary and preference shares, 41,330 ordinary shares and 20,381 preference shares were purchased and 6,210 ordinary shares and 6,073 preference shares were sold. As at June 30, 2003 the balance of treasury shares amounted to 84,985 ordinary and 14,308 preference shares.

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(15) Reconciliation of Net Income to Cash Provided by Operating activities

The reconciliation of net income to net cash provided by operating activities for six months ended June 30, 2003 and 2002 follows:

	<u>Six months ended June 30,</u>	
	<u>2003</u>	<u>2002</u>
Cash flows from operating activities:		
Net income	\$ 64,407	72,079
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	26,265	21,166
Cumulative effect of prior years of retroactive application of depreciation for packaging material	-	2,796
(Gain)/loss on disposal of property and equipment	1,670	809
Undistributed income of affiliates	(961)	(1,781)
Minority interest	-	12,954
Changes in operating assets and liabilities:		
(Increase)/decrease in trade receivables	(19,092)	(427)
(Increase)/decrease in prepayments	14,185	6,634
(Increase)/decrease in inventory	(20,865)	(12,147)
Increase/(decrease) in accounts payable, accrued liabilities, taxes payable and other current liabilities	29,502	21,287
Increase/(decrease) in amount due to related parties	(321)	(238)
Net cash provided by operating activities	<u>\$ 94,790</u>	<u>123,132</u>

The Group paid \$1,420 th. and \$648 th. for interest and \$5,521 th. and \$11,894 th. for income taxes in six months 2003 and 2002, respectively.

(16) Commitments and Contingents

As at June 30, 2003, the Group had the following major capital commitments to be completed in 2003:

Project	<u>Amount in million USD</u>
St. Petersburg plant	5,4
Baltika-Rostov plant	2,5
Baltika-Tula plant	11,8
Baltika-Samara plant	0,6
Baltika-Khabarovsk plant	1,7
Total	<u>22,0</u>

Baltika-Samara started production of beer in January 2003. Its' capacity is 1,5 million HI. Baltika-Khabarovsk started production of beer in April 2003. Its' capacity is 1 million HI.

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Legal Proceedings in relation to Krinitisa

As at June 30, 2003 the Group is in process of claiming the total amount of the \$10.4 million loan (recorded under Loans receivable heading of the balance sheet) from OAO Krinitisa, a brewery located in Minsk, that was to be repaid by installments in early 2002.

The loan was provided to OAO Krinitisa in 2001 and was still outstanding as at June 30, 2003. Originally the loan was provided to OAO Krinitisa for the purpose of being used for reconstruction of Krinitisa plant and effecting the purchase of 50% plus one share in OAO Krinitisa share capital by Baltika Brewery.

As no share issue process had started at the date it was planned to, Baltika Brewery has claimed the installments not repaid on the due dates.

Baltika management evaluates the recoverability of the loan on a regular basis and is fully satisfied that the amount outstanding as at June 30, 2003 will be repaid in full; hence no provision for non-recoverability has been made as at June 30, 2003 due to the following:

- Baltika has won a range of court hearings that enable it to claim the amount of the loan from Krinitisa.
- The full amount of the loan is secured by a pledge of Krinitisa equipment.

During July, 2003 Krinitisa repaid approximately \$400 th. of the outstanding loan to Baltika Brewery.

Use of tax exemption

In 2002 the Company used a tax exemption with regard to the profits tax paid to St.Petersburg budget. The exemption was granted to companies located in St.Petersburg that produce products imposed by excise tax and have implemented capital investments program at a particular level prescribed by local legislation. The exemption was provided in the form of a 50% reduction to the tax rate for profits tax payable to the St.Petersburg budget. By applying this exemption, the Group reduced current tax expense in 2002 by approximately \$6,820 th.

As of June 30, 2003 this amount represents a contingent tax liability which may arise in any one of the following three years for the profits tax if this exemption claimed by the Company is not allowed by the Tax Authorities. This is because the Company acquired the right to a tax exemption which was subsequently curtailed by newer legislation, and the Company insists that this newer legislation cannot be 'retroactive' and take that right away. From a legal perspective it is not certain whether abolishing a previously granted exemption can be defined as being 'retroactive' and so the tax that the Company did not pay, believing itself to be exempt, may in fact fall due.

The application of this tax exemption has been challenged by the Tax Authorities and the total amount of exempted tax has been claimed. A range of court hearings took place but the disagreements on this issue have not been resolved by the date of the preparation of these financial statements.

The Company did not use the tax exemption during six months 2003 because one of conditions to be met for use of the exemption was not fulfilled (the Company paid less amount of taxes to local budget during

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six months 2003 than during the same period of 2002). The Company management believes that tax exemption will be used by September 30, 2003.

Financial Guarantees

As of June 30, 2003, the Group has issued guarantees aggregating \$3.0 million on borrowings by its affiliate Soufflet. It is expected that the Group will not be required to make payments under its guarantees. The Group monitors the financial performance of its associate. No amount has been accrued for the Group's obligation under its guarantee arrangements.

(17) Related Party Transactions

In 2003 the Group purchased raw materials (i.e. malt) from Soufflet, an associate to the group amounting to a total of \$68,756 th., (w/out VAT) or 25% of total malt purchases, and 154,142 tonns, or 30% in total malt purchases by volume. Liability to Soufflet for malt as at June 30, 2003 amounted to \$614 th.

(18) Earnings per share

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

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

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Earnings per share of common stock is as follows (in thousands U.S. dollars, except per share data):

	Six months ended June 30,			
	2003		2002	
	Income	Shares	Income	Shares
Net income before cumulative effect of a change in accounting principle	64,407		72,079	
Preferred stock dividend requirements	(5,409)		(3,639)	
Basic income and shares	58,998	117,158,530	68,440	108,193,940
Basic earnings per share before cumulative effect of accounting change	0.50		0.66	
Accounting change	-		(0.03)	
Basic earnings per share	0.50		0.63	
Basic income and shares				
Convertible preferred shares	-	-	-	-
Diluted earnings per share before cumulative effect of accounting change	0.50		0.66	
Accounting change	-		(0.03)	
Diluted earnings per share	0.50		0.63	

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(19) Fair Value of Financial Instruments

The following table presents the carrying amounts and estimated fair values of the Group's financial instruments at June 30, 2003 and December 31, 2002. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

	June 30, 2003		December 31, 2002	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets:				
Cash and cash equivalents	\$ 14,934	14,934	12,844	12,844
Trade accounts receivables	27,027	27,027	7,024	7,024
Loans receivable	10,421	10,421	10,518	9,169
Investment securities	322	322	310	310
Prepayments and other receivables	56,629	56,629	72,251	72,251
Financial liabilities:				
Trade accounts payables	\$ 55,720	55,720	33,136	33,136
Due to related company	614	614	902	902
Accrued salaries, wages and benefits	17,866	17,866	15,914	15,914
Other liabilities	28,989	28,989	4,073	4,073
Long-term debt, excluding current installments	8,000	8,000	10,000	10,000
Obligations under capital leases, excluding current installments	2,618	2,618	-	-
Short-term debt including current installments of long-term debt	73,711	73,711	69,766	69,766
Current installments of obligations under capital leases	1,309	1,309	-	-

The carrying amounts shown in the table are included in the consolidated balance sheets under the indicated captions.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, trade accounts receivable, prepayments and other receivables, trade accounts payable, due to related company, accrued salaries wages and benefits and other liabilities.

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The carrying amounts approximate fair value because of the short maturity of these instruments.

Loans receivable: The fair value of the loan is determined as the present value of expected future cash flows discounted at the originally contracted effective interest rate. See note (15) Legal proceeding above for more details covering the OAO Krinitisa loan.

Investment securities: The fair values of equity investments are based on quoted market prices at the reporting date for those or similar investments.

Long-term debt: The carrying amounts of the Group's long-term debt approximate fair value because the loan is provided to the Group at terms currently offered in the market for similar loans of comparable maturities to like borrowers, i.e. is the loan incurs LIBOR interest plus margin.