## JSC CHELYABINSK ZINC PLANT

# International Financial Reporting Standards Consolidated Financial Statements

# For the year ended 31 December 2006

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## Statement of Management Responsibilities

To the Shareholders of JSC Chelyabinsk Zinc Plant

International convention requires that management prepare financial statements, which present fairly, in all material respects, the state of affairs of JSC "Chelyabinsk Zinc Plant" its subsidiaries (together referred to as the "Group") at the end of each financial period and of the Group's results and its cash flows for each financial period. Management is responsible for ensuring that the Group keeps accounting records, which disclose, with reasonable accuracy, the financial position and which enable them to ensure that the financial statements comply with International Financial Reporting Standards and that statutory accounting reports comply with Russian laws and regulations. They also have a general responsibility for taking such steps that are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Management considers that, in preparing the consolidated financial statements set out on pages 1 to 36, the Group has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgments and estimates, and that appropriate International Financial Reporting Standards have been followed.

The consolidated financial statements, which are based on the statutory accounting reports and restated in accordance with International Financial Reporting Standards, are hereby approved on behalf of the Board of Directors.

For and on behalf of the Board of Directors

V.V. Geykhman

General Director

11 June 2007

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of JSC Chelyabinsk Zinc Plant:

1 We have audited the accompanying consolidated financial statements of JSC Chelyabinsk Zinc Plant (the "Company") and its subsidiaries (the "Group") which comprise the consolidated balance sheet as at 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cashflows for the year then ended and a summary of significant accounting policies and other explanatory notes.

*Management's Responsibility for the Financial Statements*

2 Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditor's Responsibility*

3 Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5 We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

6 In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit

Moscow, Russian Federation
11 June 2007

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**JSC CHELYABINSK ZINC PLANT**

**Consolidated Balance Sheet**
**as of 31 December 2006**

| *In thousands of Russian Roubles* | Note | 31 December 2006 | 31 December 2005 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 8 | 7,061,332 | 3,311,755 |
| Advances for capital construction | 8 | 134,693 | 5,199 |
| Goodwill | 9 | 831,986 | - |
| Other intangible assets | 8 | 22,584 | 24,028 |
| Available-for-sale investments | | - | 2,108 |
| Other non-current assets | 12 | 603,181 | - |
| **Total non-current assets** | | **8,653,776** | **3,343,090** |
| **Current assets** | | | |
| Inventory, net | 10 | 2,252,927 | 1,478,985 |
| Trade and other receivables, net | 11 | 1,321,947 | 689,769 |
| Loans and promissory notes receivable | 12 | 589,064 | 26,000 |
| Bank deposits | 12 | 500,606 | - |
| Cash and cash equivalents | 12 | 443,553 | 131,740 |
| Restricted cash | 12 | 402,707 | 4,073 |
| **Total current assets** | | **5,510,804** | **2,330,567** |
| **TOTAL ASSETS** | | **14,164,580** | **5,673,657** |
| **Equity** | | | |
| Share capital | 13 | 78,860 | 74,077 |
| Share premium | 13 | 1,375,231 | 48,192 |
| Legal reserve | 13 | 572 | 397 |
| Cumulative translation reserve | | (189,515) | - |
| Retained earnings | | 7,102,628 | 4,235,524 |
| **TOTAL EQUITY** | | **8,367,776** | **4,358,190** |
| **LIABILITIES** | | | |
| **Non-current liabilities** | | | |
| Borrowings | 14 | 2,767,959 | - |
| Provision for asset retirement obligations and site restoration | 17 | 38,386 | - |
| Deferred income tax liability | 21 | 1,350,619 | 181,264 |
| Other non-current liabilities | | 4,122 | - |
| **Total non-current liabilities** | | **4,161,086** | **181,264** |
| **Current liabilities** | | | |
| Borrowings | 14 | 702,312 | 269,836 |
| Accounts payable, accrued expenses and advances from customers | 15 | 729,761 | 808,933 |
| Current income tax payable | | 131,846 | 38,444 |
| Other taxes payable | 16 | 71,799 | 16,990 |
| **Total current liabilities** | | **1,635,718** | **1,134,203** |
| **TOTAL LIABILITIES** | | **5,796,804** | **1,315,467** |
| **TOTAL LIABILITIES AND EQUITY** | | **14,164,580** | **5,673,657** |

Approved for issue and signed on behalf of the Board of Directors 11 June 2007

V.V. Geykhman
General Director

B.D. Birman
Finance Director

| *In thousands of Russian Roubles* | Note | Year ended 31 December 2006 | Year ended 31 December 2005 |
|---|---|---|---|
| Revenue | 18 | 14,985,390 | 4,791,159 |
| Cost of goods sold | 19 | (10,126,195) | (4,044,103) |
| **Gross profit** | | **4,859,195** | **747,056** |
| Distribution costs | 20 | (182,922) | (113,392) |
| General and administrative expenses | 20 | (683,836) | (382,976) |
| **Operating profit** | | **3,992,437** | **250,688** |
| Finance income | | 12,559 | 25,584 |
| Finance costs | | (257,015) | (26,610) |
| Net foreign exchange gain/(loss) | | 137,927 | (8,005) |
| **Profit before income tax** | | **3,885,908** | **241,657** |
| Income tax charge | 21 | (1,014,171) | (94,432) |
| **Profit for the year** | | **2,871,737** | **147,225** |
| **Profit is attributable to:** | | | |
| Equity holders of the Company | | 2,871,737 | 147,225 |
| **Net profit for the year** | | **2,871,737** | **147,225** |
| **Earning per share - basic and diluted (in RR)** | 22 | **559** | **29** |

Approved for issue and signed on behalf of the Board of Directors 11 June 2007

V.V. Geykhman
General Director

B.D. Birman
Finance Director

## Consolidated Statement of Cash Flows for the year ended 31 December 2006

| *In thousands of Russian Roubles* | Note | 2006 | 2005 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit before income tax | | 3,885,908 | 241,657 |
| Adjustments for: | | | |
| Depreciation and amortisation | 8 | 792,134 | 415,670 |
| Net loss on disposal of property, plant and equipment | 20 | 101,607 | 7,685 |
| Impairment/(reversal of impairment) of trade and other receivables | 20 | 16,904 | (199) |
| (Reversal of write-down)/write-down of inventory to net selling price | 19 | (5,251) | 5,026 |
| Finance gains and losses, net | | 244,456 | 1,026 |
| Precious metals revaluation | 19 | (56,345) | (5,764) |
| Unrealised foreign exchange losses less gains on non-operating items | | (165,046) | 7,638 |
| Other non-monetary items | | - | (1,640) |
| **Operating cash flows before working capital changes** | | **4,814,367** | **671,099** |
| Increase in trade and other receivables | | (622,678) | (228,775) |
| Increase in inventory | | (573,473) | (939,404) |
| (Decrease)/increase in trade and other payables | | (187,990) | 669,858 |
| (Decrease)/increase in taxes payable | | (15,267) | 685 |
| Increase in bank deposits | | (500,606) | - |
| (Increase)/decrease in restricted cash balance | | (398,634) | 1,220 |
| **Cash generated from operations** | | **2,515,719** | **174,683** |
| Interest paid | | (257,405) | (29,312) |
| Income taxes paid | | (890,061) | (88,439) |
| Income tax refund | | - | 8,201 |
| **Net cash generated from operating activities** | | **1,368,253** | **65,133** |
| **Cash flows from investing activities** | | | |
| Purchase of property, plant and equipment | | (823,617) | (106,169) |
| Proceeds from sale of property, plant and equipment | | 21,698 | 2,622 |
| Loans originated and promissory notes purchased | | (649,864) | (662,000) |
| Proceeds from repayment of loans and redemption of promissory notes | | 86,800 | 805,009 |
| Interest received | | 12,028 | 24,276 |
| Net cash paid for purchase of subsidiary | 23 | (3,715,677) | - |
| Non-current deposits | 12 | (602,649) | - |
| **Net cash (used in)/provided from investing activities** | | **(5,671,281)** | **63,738** |
| **Cash flows from financing activities** | | | |
| Repayment of borrowings | | (759,119) | (278,749) |
| Proceeds from borrowings | | 4,087,187 | 90,452 |
| Proceeds from disposal of treasury shares | 13 | 25,438 | - |
| Acquisition of treasury shares, net | 13 | (21,804) | - |
| Finance lease payments | | (29,225) | - |
| Proceeds from issuance of shares | 13 | 1,323,730 | - |
| **Net cash provided from /(used in) financing activities** | | **4,626,207** | **(188,297)** |
| Effect of foreign exchange rate fluctuation on cash and cash equivalents | | (11,366) | 2,959 |
| **Net increase/(decrease) in cash and cash equivalents** | | **311,813** | **(56,467)** |
| **Cash and cash equivalents at the beginning of the period** | | **131,740** | **188,207** |
| **Cash and cash equivalents at the end of the period** | 12 | **443,553** | **131,740** |

Approved for issue and signed on behalf of the Board of Directors 11 June 2007

V.V. Geykhman
General Director

B.D. Birman
Finance Director

**JSC CHELYABINSK ZINC PLANT**

**Consolidated Statement of Changes in Equity**
**for the year ended 31 December 2006**

| *In thousands of Russian Roubles* | Share capital | Treasury shares | Share premium | Legal reserve | Cumulative translation reserve | Retained earnings | Total equity |
|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2005** | **74,077** | **-** | **48,192** | **397** | **-** | **4,088,299** | **4,210,965** |
| Net profit for the year | - | - | - | - | - | 147,225 | 147,225 |
| Total recognized income for the period | - | - | - | - | - | 147,225 | 147,225 |
| **Balance at 1 January 2006** | **74,077** | **-** | **48,192** | **397** | **-** | **4,235,524** | **4,358,190** |
| Translation movement | - | - | - | - | (189,515) | - | (189,515) |
| Net profit recognized directly in equity | - | - | - | - | (189,515) | - | (189,515) |
| Net profit for the year | - | - | - | - | - | 2,871,737 | 2,871,737 |
| Total recognized profit for the period | - | - | - | - | (189,515) | 2,871,737 | 2,682,222 |
| Acquisition of treasury shares (Note 13) | - | (21,804) | - | - | - | - | (21,804) |
| Sale of treasury shares (Note 13) | - | 21,804 | 3,634 | - | - | - | 25,438 |
| Legal reserve (Note 13) | - | - | - | 175 | - | (175) | - |
| Issue of shares (Note 13) | 325 | - | 1,323,405 | - | - | - | 1,323,730 |
| Issue of shares through profit capitalisation (Note 13) | 4,458 | - | - | - | - | (4,458) | - |
| **Balance at 31 December 2006** | **78,860** | **-** | **1,375,231** | **572** | **(189,515)** | **7,102,628** | **8,367,776** |

Approved for issue and signed on behalf of the Board of Directors 11 June 2007

V.V. Geykhman
General Director

B.D. Birman
Finance Director

## 1 JSC Chelyabinsk Zinc Plant and its operations

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2006 for JSC Chelyabinsk Zinc Plant (the "Company") and its subsidiaries (together referred to as the "Group").

The Company was incorporated in May 1993 and is domiciled in the Russian Federation. The Company is an open joint stock company set up in accordance with Russian regulations.

At 31 December 2006, the Group's immediate and ultimate parent is NF Holdings BV incorporated in the Netherlands, which owns 52.34% of the Company's shares.

The Company enters into significant transactions with related parties (Note 7).

***Principal activities.*** The Group's principal business activity is the extraction and integrated processing of ore with the purpose of producing zinc and lead concentrates, production and distribution of zinc, zinc alloys and by-products. The Group's manufacturing facilities are based in Chelyabinsk (the Russian Federation) and Akzhal (the Republic of Kazakhstan). There are a number of subsidiaries including a newly acquired subsidiary in the Group (Note 23). The companies of the Group are incorporated under the Laws of the Russian Federation, the Republic of Kazakhstan, and Switzerland. At 31 December 2006 the Group employed approximately 2,955 employees (31 December 2005: 1,799).

***Registered address and place of business.*** The Company's registered address is: Sverdlovsky trakt 24, Chelyabinsk, Russian Federation.

## 2 Basis of preparation and significant accounting policies

***Basis of preparation.*** These consolidated financial statements for the year ended 31 December 2006 have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention except for certain financial instruments that are presented at fair value. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

***Presentation currency.*** All amounts in these financial statements are presented in thousands of Russian Roubles ("RR thousands"), unless otherwise stated.

***Accounting for the effects of hyperinflation.*** The Russian Federation and the Republic of Kazakhstan have previously experienced relatively high levels of inflation and were considered to be hyperinflationary as defined by IAS 29 "Financial Reporting in Hyperinflationary Economies" ("IAS 29"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation has ceased, effective from 1 January 2003 the Group no longer applies the provisions of IAS 29. Accordingly, the amounts expressed in the measuring unit current at 31 December 2002 are treated as the basis for the carrying amounts in these financial statements for Russian companies of the Group. The characteristics of the economic environment of the Republic of Kazakhstan indicate that hyperinflation has ceased effective from 1 January 1999. Accordingly, the amounts expressed in the measuring unit current at 31 December 1998 are treated as the basis for the carrying amounts in these financial statements for Kazakh companies of the Group.

**2 Basis of preparation and significant accounting policies (continued)**

***Consolidated financial statements.*** Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain economic benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The date of exchange is the acquisition date where a business combination is achieved in a single transaction, and is the date of each share purchase where a business combination is achieved in stages by successive share purchases.

The excess of the cost of acquisition over the fair value of the net assets of the acquiree at each exchange transaction represents goodwill. The excess of the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired over cost ("negative goodwill") is recognised immediately in profit or loss.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any minority interest.

Intercompany transactions, balances and unrealised gains on transactions between the Group companies are eliminated. Unrealised losses are also eliminated unless the value of assets transferred can be recovered. The Company and all its subsidiaries use uniform accounting policies consistent with the Group's policies.

***Property, plant and equipment.*** Property, plant and equipment are stated at historic acquisition or construction cost less accumulated depreciation and provision for impairment, where required. An independent appraisal company was engaged by the Group to estimate fair value of assets under construction and property, plant and equipment as of 1 January 1998, as historic information on cost of assets under construction and property, plant and equipment was not readily available. A remaining useful economic life of 5 years was designated to this property, plant and equipment, which were fully depreciated as of 31 December 2002. Subsequent additions to property, plant and equipment are accounted for at cost, restated to the equivalent purchasing power of the Russian Rouble at 31 December 2002 for assets acquired after 1 January 1998, but prior to 1 January 2003.

An independent appraisal company was engaged to estimate fair value of assets under construction and property, plant and equipment of the acquired subsidiary (Note 23), as well as their estimated remaining useful lives, as of 10 April 2006 (the acquisition date).

Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of property, plant and equipment items are capitalised and the replaced part is retired.

Expenditure, including evaluation costs, incurred to establish or expand productive capacity, costs to conduct mining-construction and mining-capital works, as well as costs arising from mining preparation works during the development or mine reconstruction phase, are capitalised within mining assets as part of buildings and constructions.

**2 Basis of preparation and significant accounting policies (continued)**

At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, the management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the income statement. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss.

***Depreciation.*** Land is not depreciated. Assets under construction are not depreciated before transfer into operation. Depreciation on other items of property, plant and equipment is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives:

| | Useful life in years |
|---|---|
| Buildings and infrastructure | 10 to 50 |
| Plant, machinery and equipment | 5 to 30 |
| Other | 2 to 20 |

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

***Stripping costs.*** Stripping (i.e. overburden and other waste removal) costs incurred in the development of a mine before production commences are capitalised as part of the cost of constructing the mine and are subsequently amortised over the life of its operation.

Stripping costs incurred subsequently during the production stage of its operations are expensed.

***Operating leases.*** Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss on a straight-line basis over the period of the lease.

***Finance lease liabilities.*** Where the Group is a lessee in a lease which transferred substantially all the risks and rewards incidental to ownership to the Group, the assets leased are capitalised in property, plant and equipment at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of future finance charges, are included in borrowings. The interest cost is charged to the income statement over the lease period using the effective interest method. The assets acquired under finance leases are depreciated over their useful life or the shorter lease term if the Group is not reasonably certain that it will obtain ownership by the end of the lease term.

***Goodwill.*** Goodwill represents the excess of the cost of an acquisition over the fair value of the acquirer's share of the net identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of exchange. Goodwill on acquisitions of subsidiaries is presented separately in the consolidated balance sheet. Goodwill on acquisitions of associates is included in the investment in associates. Goodwill is carried at cost less accumulated impairment losses, if any.

The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is allocated to the acquirer's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination. Such units or group of units represent the lowest level at which the Group monitors goodwill and are not larger than a segment. Gains or losses on disposal of an operation within a cash generating unit to which goodwill has been allocated include the carrying amount of goodwill associated with the operation disposed of, generally measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit which is retained.

**2 Basis of preparation and significant accounting policies (continued)**

***Intangible assets.*** All of the Group's intangible assets have definite useful lives and include capitalised cost of obtaining "CZP SHG" (Chelyabinsk Zinc Plant Special High Grade) certification, computer software and licences. Cost of obtaining CZP SHG certification and acquired computer software and licences are capitalised on the basis of the costs incurred to obtain or acquire these intangible assets and bring them to use.

Intangible assets are amortized on a straight-line basis over their useful lives:

| | **Useful life in years** |
|---|---|
| Cost of obtaining CZP SHG certification | 30 |
| Computer software and licenses | 3 to 5 |

Where an indication of impairment exists, the carrying amount of any intangible asset is assessed and, when impaired, the asset is written down to the higher of value in use and fair value less costs to sell.

***Classification of financial assets.*** The Group classifies its financial assets into the following measurement categories: trading, available-for-sale, held to maturity and loans and receivables.

Trading investments are securities or other financial assets, which are either acquired for generating a profit from short-term fluctuations in price or trader's margin, or are included in a portfolio in which a pattern of short-term trading exists. The Group classifies financial assets into trading investments if it has an intention to sell them within a short period after acquisition, i.e. within 1 to 3 months. The Group did not hold any trading investments during the reported periods.

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Group intends to sell in the near term.

Held to maturity classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both intention and ability to hold to maturity. The Group did not hold any held-to-maturity investments during the reported periods.

All other financial assets are included in the available-for-sale category.

***Initial recognition of financial instruments*** Trading investments and derivatives are initially recorded at fair value. All other financial assets and liabilities are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial instruments that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Group commits to deliver a financial instrument. All other purchases and sales are recognised on the settlement date with the change in value between the commitment date and settlement date not recognised for assets carried at cost or amortised cost; recognised in profit or loss for trading investments; and recognised in equity for assets classified as available for sale.

***Derecognition of financial assets.*** The Group derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

## 2 Basis of preparation and significant accounting policies (continued)

***Available-for-sale investments.*** Available-for-sale investments are carried at fair value. Interest income on available for sale debt securities is calculated using the effective interest method and recognised in profit or loss. Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payment is established. All other elements of changes in the fair value are deferred in equity until the investment is derecognised or impaired at which time the cumulative gain or loss is removed from equity to profit or loss.

Impairment losses are recognised in the income statement when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of available-for-sale investments. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss. Impairment losses on equity instruments are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through current period's profit or loss.

***Income taxes.*** Income taxes have been provided for in the consolidated financial statements in accordance with the legislation of the Russian Federation and the Republic of Kazakhstan enacted or substantively enacted by the balance sheet date. The income tax charge comprises current tax and deferred tax and is recognised in the consolidated income statement unless it relates to transactions that are recognised, in the same or a different period, directly in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxes other than on income are recorded within operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date, which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

Deferred income tax is provided on post acquisition retained earnings of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

***Inventories.*** Inventories are measured at the lower of cost and net realizable value. Cost of inventory is determined on the weighted average basis. Zinc ore is recognised as raw materials when delivered to the surface and is valued at the average cost of extraction. The cost of finished goods and work in progress comprises raw material, direct labour, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

The precious metals are stated at net realisable value ("NRV"). NRV is determined by reference to the Central Bank of the Russian Federation quotations. The change in NRV of the precious metals balance for the period is included within cost of sales.

## 2 Basis of preparation and significant accounting policies (continued)

***Trade and other receivables.*** Trade and other receivables are carried at original invoice amount less provision made for impairment of these receivables. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognised in the income statement.

***Cash and cash equivalents.*** Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method. Restricted balances are excluded from cash and cash equivalents for the purposes of the cash flow statement. Balances restricted from being exchanged or used to settle a liability for at least twelve months after the balance sheet date are included in other non-current assets.

***Share capital.*** Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is presented in the relevant notes as a share premium.

***Treasury shares.*** Where any Group company purchases the Company's equity share capital, the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

***Dividends.*** Dividends are recognized as a liability and deducted from equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are authorized for issue.

***Value added tax.*** Output value added tax is payable to tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the balance sheet on a gross basis and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

***Borrowings.*** Borrowings are carried at amortised cost using the effective interest method. Borrowing costs are recognised as an expense on a time proportion basis using the effective interest method. The Group does not capitalise borrowing costs.

***Trade and other payables.*** Trade payables are accrued when the counterparty performed its obligations under the contract and are carried at amortised cost using the effective interest method.

***Provisions for liabilities and charges.*** Provisions for liabilities and charges are recognised when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain.

**2 Basis of preparation and significant accounting policies (continued)**

***Financial guarantees.*** Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the guarantee. At each balance sheet date, the guarantees are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the obligation at the balance sheet date.

***Asset retirement obligations.*** Asset retirement costs include landfill site restoration and closure (dismantling and demolition of infrastructure and the removal of residual materials and remediation of disturbed areas). Estimated landfill site restoration and closure costs are provided for and incurred in the cost of property, plant and equipment in the accounting period when the obligation arising from the related disturbance occurs during the mine development phase, based on the net present value of estimated future costs. Provisions for asset retirement obligations do not include any additional obligations which are expected to arise from future disturbance. The costs are estimated on the basis of a closure and restoration plan. The cost estimates are calculated annually during the life of the operation to reflect known developments, e.g. updated cost estimates and revisions to the estimated lives of operations, and are subject to formal review at regular intervals.

Landfill site restoration and closure costs are a normal consequence of mining, and the majority of landfill site restoration and closure expenditure is incurred during the life of the mine. Although the ultimate cost to be incurred is uncertain, the Group's business estimates their respective costs based on feasibility and engineering studies using current restoration standards and techniques.

The amortisation or "unwinding" of the discount applied in establishing the net present value of provisions is charged to the income statement in each accounting period. The amortisation of the discount is shown as a financing cost, rather than as an operating cost.

Movements in the provisions for asset retirement obligations, resulting from new disturbance as a result of mine development, updated cost estimates, changes to the estimated lives of operations and revisions to discount rates are capitalised within property, plant and equipment. These costs are then depreciated over the lives of the assets to which they relate. Movements in the provisions for asset retirement obligations that relate to disturbance caused by the production phase are charged to the income statement.

Where landfill site restoration is conducted systematically over the life of the operation, rather than at the time of closure, provision is made for the estimated outstanding continuous rehabilitation work at each balance sheet date and the cost is charged to the income statement.

***Foreign currency translation.*** The functional currency of each of the Group's consolidated entities is the currency of the primary economic environment in which the entity operates. The Company's functional currency and the Company's presentation currency is the national currency of the Russian Federation, Russian Roubles ("RR").

Monetary assets and liabilities are translated into functional currency at the official exchange rate of the Central Bank of the Russian Federation at the respective balance sheet dates. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into functional currency at year-end official exchange rates of the Central Bank of the Russian Federation are recognised in profit or loss. Translation at period-end rates does not apply to non-monetary items, including equity investments. Effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

At 31 December 2006 the principal rate of exchange used for translating foreign currency balances was US$ 1 = RR 26.3311 (31 December 2005: US$ 1 = RR 28.7825). The official Euro to RR exchange rate at 31 December 2006, as determined by the Central Bank of the Russian Federation, was 34.6965 (31 December 2005: 34.1850).

**2 Basis of preparation and significant accounting policies (continued)**

***Translation from functional to presentation currency.*** The results and financial position of each group entity (functional currency of none of which is a currency of a hyperinflationary economy) are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
(iii) all resulting exchange differences are recognised as a separate component of equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. When a subsidiary is disposed of through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity, the exchange differences deferred in equity are reclassified to profit or loss.

***Revenue recognition.*** Revenues from sales of goods are recognised at the point of transfer of risks and rewards of ownership of the goods, normally when the goods are shipped. If the Group agrees to transport goods to a specified location, revenue is recognised when the goods are passed to the customer at the destination point.

Revenues are measured at the fair value of the consideration received or receivable. Sales are shown net of VAT and discounts.

Mining royalties are included within cost of sales.

Interest income is recognised on a time-proportion basis using the effective interest method.

***Employee benefits.*** Wages, salaries, contributions to the Russian Federation state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and kindergarten services) are accrued in the reporting period in which the associated services are rendered by the employees of the Group. These amounts principally represent an implicit cost of employing production workers and, accordingly, have been charged to the statement of income as cost of sales.

In the normal course of business the Group contributes to the state pension scheme of the respective states (the Russian Federation and the Republic of Kazakhstan) on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred.

***Finance income and finance costs.*** Finance income and costs comprise interest expense on borrowings and loans payable, deposits, loans to own employees, interest income/expense from unwinding of discount on provision for asset retirement obligations and other financial assets and liabilities.

Interest income is recognised as it accrues, taking into account the effective yield on the asset.

***Earnings per share.*** Earnings per share is determined by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of participating shares outstanding during the reporting year.

***Segment reporting.*** A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from sales to external customers and whose revenue, result or assets are ten percent or more of all the segments are reported separately.

## 3 Critical Accounting Estimates, and Judgments in Applying Accounting Policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgments, apart from those involving estimations, in the process of applying the accounting policies. Judgments that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

***Goodwill.*** The Group will finalise the purchase price allocation of the newly acquired subsidiary (Note 23) within one year from the acquisition date. Goodwill amount will be assessed for impairment and based on the recoverable amount to be determined a significant portion or entire amount of the goodwill could be subject to impairment, which is immediately recognised in the income statement and is not subject to reversals in future periods.

***Tax legislation.*** Russian tax, currency and customs legislation is subject to varying interpretations. Refer to Note 24.

***Assumptions to determine amount of provisions.*** The Group determines recoverability of accounts receivable and advances by comparing actual cash collection to the contractual payment schedule. In the case when a risk of non-collection is assessed as probable, a provision for the doubtful accounts receivable and advances is recognised.

***Provision for asset retirement obligations.*** In accordance with the contracts on subsurface use the Group has a legal obligation to decommission its mining properties and restore a landfill site after its closure. Provision is made, based on net present values, for site restoration and rehabilitation costs as soon as the obligation arises from past mining activities. The provision for asset retirement obligation is estimated based on the current environmental legislation in the Republic of Kazakhstan. Asset retirement obligations are subject to potential changes in environmental regulatory requirements. As at 31 December 2006 the carrying amount of the provision for asset retirement obligations was RR 38 million (Note 17).

Management believes that there are no material asset retirement obligations for the assets located in Russia.

***Slow-moving and obsolete inventory.*** The Group has accumulated significant stock of zinc cakes (a by-product with approximately 20% zinc content, which requires substantial processing to extract zinc) due to the limited capacity of certain workshops. No slow-moving provision has been created against this stock, as there is a valid expectation that upon the completion of the construction of Waelz-kiln N 5 the Group will be able to begin processing the accumulated stock of zinc cakes in 2007. The Group records zinc cakes at historic production cost, which is substantially lower than its potential resale value and cost of zinc content (Note 10).

The provision for obsolete inventory is based on the Group's ability to identify obsolete inventory and assess its recoverability.

## 4 Adoption of new or revised standards and interpretations

Certain new IFRSs became effective for the Group from 1 January 2006. Listed below are those new or amended standards or interpretations which are or in the future could be relevant to the Group's operations and the nature of their impact on the Group's accounting policies.

***IFRIC 4, Determining whether an Arrangement contains a Lease (effective from 1 January 2006).*** IFRIC 4 requires that determining whether an arrangement is, or contains, a lease be based on the substance of the arrangement. It requires an assessment of whether (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset. The Group reassessed its arrangements and concluded that no adjustments are required as a result of adoption of IFRIC 4.

## 4 Adoption of new or revised standards and interpretations (continued)

***IAS 39 (Amendment) – The Fair Value Option (effective from January 1, 2006).*** IAS 39 (as revised in 2003) permitted entities to designate irrevocably on initial recognition practically any financial instrument as one to be measured at fair value with gains and losses recognized in profit or loss ('fair value through profit or loss'). The amendment changes the definition of financial instruments 'at fair value through profit or loss' and restricts the ability to designate financial instruments as part of this category. The Group's policy is not to voluntarily designate assets and liabilities as at fair value through profit or loss.

***IAS 39 (Amendment) – Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006).*** The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. This amendment is not relevant for the Group.

***IAS 39 (Amendment) – Financial Guarantee Contracts (effective from 1 January 2006).*** Issued financial guarantees, other than those previously asserted by the Croup to be insurance contracts, will have to be initially recognised at their fair value, and subsequently measured at the higher of (i) the unamortised balance of the related fees received and deferred and (ii) the expenditure required to settle the commitment at the balance sheet date. Different requirements apply for the subsequent measurement of issued financial guarantees that prevent derecognition of financial assets or result in continuing involvement accounting. This amendment did not have material impact on these consolidated financial statements.

***IAS 19 (Amendment) – Employee Benefits (effective from 1 January 2006).*** The amendment to IAS 19 introduces an additional option to recognise actuarial gains and losses arising in post-employment defined benefit plans in full directly in retained earnings in equity. It also requires new disclosures about defined benefit plans and clarifies accounting for a contractual agreement between a multi-employer plan and participating employers. This amendment has no impact on these consolidated financial statements.

***IAS 21 (Amendment) - Net Investment in a Foreign Operation (effective from 1 January 2006).*** This amendment requires foreign exchange gains and losses on monetary items that form part of net investment in a foreign operation (eg quasi-equity intercompany loans) to be reported in consolidated equity even if the loans are not in the functional currency of either the lender or the borrower. Previously, such exchange differences were required to be recognised in consolidated profit or loss. It also extended the definition of 'net investment in a foreign operation' to include loans between sister companies. This amendment is not relevant for the Group.

***IFRS 6 Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006).*** IFRS 6 allows an entity to continue using the accounting policies for exploration and evaluation assets applied immediately before adopting the IFRS, subject to certain impairment test requirements.

***IFRIC 5 - Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006).*** Subject to certain exceptions, this interpretation prohibits offsetting a liability for decommissioning costs with an asset representing an interest in a decommissioning or similar fund and clarifies measurement of the reimbursement asset.

***IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective for periods beginning on or after 1 December 2005, that is from 1 January 2006).*** The Interpretation states that a liability shared among market participants in proportion to their respective market share, in particular the liability for the decommissioning of historical waste electrical and electronic equipment in the European Union, should not be recognised because participation in the market during the measurement period is the obligating event in accordance with IAS 37. This amendment is not relevant for the Group.

***IFRS 1 (Amendment) – First-time Adoption of International Financial Reporting Standards and IFRS 6 Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006).*** This minor amendment to IFRS 1 clarifies that the IFRS 6 comparative information exemption applies to the recognition and measurement requirements of IFRS 6, as well as the disclosure requirements.

Adoption of new or revised standards and interpretations did not have a material impact on these consolidated financial statements.

## 5 New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2007 or later periods and which the entity has not early adopted:

***IFRS 7 Financial Instruments: Disclosures and a complementary Amendment to IAS 1 Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007).*** The IFRS introduces new disclosures to improve the information about financial instruments. The volume of disclosures will increase significantly with an emphasis on quantitative aspects of risk exposures and the methods of risk management. The quantitative disclosures will provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Qualitative and quantitative disclosures will cover exposure to credit risk, liquidity risk and market risk including sensitivity analysis to market risk. IFRS 7 replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and some of the requirements in IAS 32, Financial Instruments: Disclosure and Presentation. The Amendment to IAS 1 introduces disclosures about level of an entity's capital and how it manages capital. The Group is currently assessing what impact the new IFRS and the amendment to IAS 1 will have on disclosures in its financial statements.

***IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009).*** The Standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information. Management is currently assessing what impact the Standard will have on segment disclosures in the Group's financial statements.

***Other new standards or interpretations.*** The Group has not early adopted the following other new standards or interpretations:

- IFRIC 7, Applying the Restatement Approach under IAS 29 (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007).
- IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007).
- IFRIC 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006);
- IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006);
- IFRIC 11, IFRS 2—Group and Treasury Share Transactions (effective for annual periods beginning on or after 1 March 2007);
- IFRIC 12, Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008).
- IAS 23 (Amendment), Borrowing Costs (effective for annual periods beginning on or after 1 January 2009).

Unless otherwise described above, these new standards and interpretations are not expected to significantly affect the Group's consolidated financial statements.

## 6 Segment information

For the purposes of these consolidated financial statements, business segments are the primary format and geographical segments are secondary format. The Group has only one business segment – production of zinc and lead concentrate, zinc and zinc alloys. With regards to the secondary geographical segments, sales are based on the country in which the customer is located, while total assets and capital expenditures are based on where the assets are located. All of the Group's assets and capital expenditures are located in the Russian Federation and the Republic of Kazakhstan.

**6 Segment information (continued)**

The Group's assets by geographical segments had the following structure:

| *In thousands of Russian Roubles* | 31 December 2006 | 31 December 2005 |
|---|---|---|
| Russian Federation | 9,596,600 | 5,673,657 |
| Kazakhstan | 5,006,797 | - |
| Intersegment elimination | (438,817) | - |
| **Total assets** | **14,164,580** | **5,673,657** |

The Group's revenue by location of customers had the following structure:

| *In thousands of Russian Roubles* | 2006 | 2005 |
|---|---|---|
| Russian Federation | 8,451,760 | 3,756,269 |
| Europe | 5,229,901 | 915,111 |
| Other CIS countries | 719,299 | 28,747 |
| Kazakhstan | 524,489 | - |
| Asia | 59,941 | 91,032 |
| **Total revenues** | **14,985,390** | **4,791,159** |

Capital expenditure incurred in Kazakstan comprised RR 90.9 million (2005: nil). The rest of the capital expenditure incurred in Russia.

## 7 Balances and Transactions with Related Parties

For the purposes of these consolidated financial statements, parties are considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. The Company's immediate parent and ultimate controlling party are disclosed in Note 1.

Related parties of the Group are predominantly comprised of parties under the control of the Group's shareholders or acting as agents on behalf of the parties controlled by the Group's shareholders. Related parties may enter into transactions which unrelated parties may not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions in 2006 and 2005 or had significant balances outstanding at 31 December 2006 and 31 December 2005 are detailed below.

### (i) Balance sheet caption

| *In thousands of Russian Roubles* | Note | 31 December 2006 | 31 December 2005 |
|---|---|---|---|
| *Assets* | | | |
| Receivable from OJSC CTRP | | 46 | 49 |
| Receivable from OJSC PNTZ | | 135 | - |
| Receivable from CJSC Medical Centre CTRP | | 58 | - |
| Advance given to CJSC TD Uraltrubostal | | 15 | - |
| Total receivable | 11 | 254 | 49 |
| Interest receivable from CJSC GROUP CTRP | 11 | - | 2,933 |
| Loans to CJSC GROUP CTRP | 12 | - | 26,000 |
| Loans to key management | | 2,798 | - |
| **Total assets** | | **3,052** | **28,982** |
| *Liabilities* | | | |
| Payable to CJSC SKS METRIS | | - | (380) |
| Payable to LLC Arkley Capital | | (1,033) | - |
| Advances received from OJSC CTRP | | (187) | (10) |
| **Total liabilities** | 15 | **(1,220)** | **(390)** |

## 7 Balances and Transactions with Related Parties (continued)

### (ii) Income statement caption

| *In thousands of Russian Roubles* | Note | 2006 | 2005 |
|---|---|---|---|
| *Revenue* | | | |
| Sales to OJSC CTRP | | 185,034 | 86,724 |
| Sales to OJSC PNTZ | | 493 | - |
| Sales to CJSC Medical Centre CTRP | | 38 | - |
| **Total sales** | 18 | **185,565** | **86,724** |
| *Purchases* | | | |
| Purchases from CJSC SKS METRIS | | (9,291) | (4,657) |
| Purchases from CJSC CTRP-KTS | | - | (64) |
| Purchases from LLC Arkley Capital | | (10,538) | - |
| Purchases from OJSC CTRP | | (9,692) | - |
| Purchases from CJSC TD Uraltrubostal | | (3,053) | - |
| Purchases from CJSC Medical Centre CTRP | | (2,203) | - |
| **Total purchases** | | **(34,777)** | **(4,721)** |
| *Operating income and expense* | | | |
| Other income received from CJSC Meta-Chelyabinsk | | 525 | - |
| Other income received from CJSC Medical Center CTRP | | 500 | - |
| **Total operating income and expenses** | | **1,025** | **-** |
| *Finance income* | | | |
| Interest on loan provided to OJSC CTRP | | - | 1,545 |
| Interest on loan provided to CJSC SKS METRIS | | - | 3,377 |
| Interest on loan provided to CJSC GROUP CTRP | | 353 | 3,092 |
| Interest on loan provided to CJSC CTRP-META | | - | 4,493 |
| Interest on loan provided to OJSC Baza MTS | | - | 249 |
| Interest on loan provided to CJSC SOT | | - | 964 |
| Interest on loan provided to CJSC CTRP-KTS | | - | 1,477 |
| Interest on loans provided by OJSC PNTZ | | - | - |
| **Total finance income** | | **353** | **15,197** |

## 7 Balances and Transactions with Related Parties (continued)

### (iii) Cash Flow statement caption

| *In thousands of Russian Roubles* | 2006 | 2005 |
|---|---|---|
| *Operating activities* | | |
| Cash receipts from OJSC CTRP for sold goods | 218,520 | 107,211 |
| Advances received from OJSC CTRP | 446 | - |
| Advances received from CJSC Medical Centre CTRP | 557 | - |
| Advances received from CJSC Meta Chelyabinsk | 619 | - |
| Payments to CJSC SKS METRIS | (9,671) | (5,431) |
| Payments to CJSC SKS CTRP-KTS | - | (75) |
| Payments to OJSC CTRP | (11,437) | - |
| Payments to LLC Arkley Capital | (11,402) | - |
| Payments to CJSC TD Uraltrubostal | (3,587) | - |
| Payments to CJSC Medical Centre CTRP | (2,600) | - |
| **Total cash flows from operating activities** | **181,445** | **101,705** |
| *Investing activities* | | |
| Interest received from OJSC CTRP | - | 1,545 |
| Interest received from CJSC SKS METRIS | - | 3,377 |
| Interest received from CJSC GROUP CTRP | 3,286 | 159 |
| Interest received from CJSC CTRP-META | - | 6,118 |
| Interest received from OJSC Baza MTS | - | 249 |
| Interest received from CJSC SOT | - | 964 |
| Interest received from CJSC CTRP-KTS | - | 1,477 |
| **Total interest received** | **3,286** | **13,889** |
| Loan to OJSC CTRP | - | (20,000) |
| Loan to CJSC CTRP-META | - | (220,000) |
| Loan to CJSC GROUP CTRP | - | (22,000) |
| Loan to CJSC SKS METRIS | - | (230,000) |
| Loan to CJSC SOT | - | (25,000) |
| Loan to OJSC Baza MTS | - | (10,000) |
| Loan to CJSC CTRP-KTS | - | (135,000) |
| **Total loans given** | **-** | **(662,000)** |
| Loan redeemed by CJSC SKS METRIS | - | 230,000 |
| Loan redeemed by CJSC SOT | - | 25,000 |
| Loan redeemed by OJSC Baza MTS | - | 10,000 |
| Loan redeemed by CJSC CTRP-META | - | 295,009 |
| Loan redeemed by OJSC CTRP | - | 80,000 |
| Loan redeemed by CJSC GROUP CTRP | 26,000 | 30,000 |
| Loan redeemed by CJSC CTRP-KTS | - | 135,000 |
| **Total loans redeemed** | **26,000** | **805,009** |
| **Total cash flows provided from investing activities** | **29,286** | **156,898** |
| *Financing activities* | | |
| Loan from OJSC PNTZ | 300,000 | - |
| Loan repaid to OJSC PNTZ | (300,000) | - |
| **Total cash flows from financing activities** | **-** | **-** |

## 7 Balances and Transactions with Related Parties (continued)

**OJSC CTRP (CTRP), CJSC GROUP CTRP (GROUP CTRP), CJSC SKS METRIS (METRIS), CJSC CTRP-META (CTRP-META), CJSC SOT (SOT), CJSC CTRP-KTS (CTRP KTS), OJSC PNTZ (PNTZ), CJSC TD URALTRUBOSTAL (URALTRUBOSTAL), CJSC MEDICAL CENTRE CTRP (MEDICAL CENTRE), CJSC META CHELYABINSK (META CHELYABINSK)**

These companies are controlled by the Group's shareholders.

During 2006 the Group supplied 1,803 tons of zinc and zinc alloys (2005: 1,936 tons) in accordance with the agreements with CTRP and PNTZ at the price determined as the LME official quotation for a metric ton of SHG zinc averaged over the quotation period and adjusted by a coefficient of 1.15 for zinc and 1.18 for zinc alloys. As at 31 December 2006 the Group had a net payable balance of RR 6 thousand to CTRP and PNTZ (31 December 2005: a receivable balance of RR 39 thousand) .

During 2006 the Group did not provide any loans to related parties (2005: RR 20 million, RR 220 million, RR 22 million, RR 230 million, RR 25 million, RR 10 million and RR 135 million to CTRP, CTRP-META, GROUP CTRP, METRIS, SOT, Baza MTS and CTRP-KTS, respectively). During 2006 the loan amounting to RR 26 million was redeemed by Group CTRP (2005: all loans fully redeemed except for the loan to Group CTRP). At 31 December 2006 there were no outstanding balances in respect of loans provided to related parties (31 December 2005: RR 26 million due from GROUP CTRP).

The loans bore interest at 10-11% p.a. during 2006 and 2005. Management believes that the actual interest rates do not differ significantly from the market interest rates. For 2006 the interest income on the loans given amounted to RR 0.4 million (2005: RR 15.2 million). At 31 December 2006 there was no outstanding interest receivable due from related parties (31 December 2005: RR 2.9 million due from GROUP CTRP).

During 2006 the Group made purchases of inventory (pipe-bends, pipes and other) from METRIS, CTRP and URALTRUBOSTAL totalling RR 22 million. During 2005 the Group made purchases of inventory (pipe-bends, pipes) from METRIS and CTRP totalling RR 4.7 million. At 31 December 2006 the Group did not have any accounts receivable or payable (31 December 2005: accounts payable of RR 0.4 million) to METRIS and a net payable balance of RR 0.1 million (31 December 2006: nil) to CTRP.

**(iv) Directors' and key management's compensation**

Total directors' and key managements' compensation is represented by contractual salary and discretionary bonus. It is recorded in general and administrative expenses in the statement of income in the amount of RR 83 million and RR 27 million for the year ended 31 December 2006 and 2005, respectively. There were 14 members of the directors and key management group for the year ended 31 December 2006 (year ended 31 December 2005: 14 members).

## 8 Property, Plant and Equipment

Property, plant and equipment and related accumulated depreciation consist of the following:

| *In thousands of Russian Roubles* | Note | Land | Buildings and infrastructure | Plant, machinery and equipment | Other | Mineral property | Intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Cost at 1 January 2005** | | **45,419** | **1,692,627** | **2,657,245** | **227,363** | **-** | **27,508** | **295,108** | **4,945,270** |
| **Accumulated depreciation** | | **-** | **(328,945)** | **(834,945)** | **(121,795)** | **-** | **(2,700)** | **-** | **(1,288,385)** |
| **Carrying amount at 1 January 2005** | | **45,419** | **1,363,682** | **1,822,300** | **105,568** | **-** | **24,808** | **295,108** | **3,656,885** |
| Additions/Transfers | | - | 19,232 | 48,931 | 25,665 | - | - | 11,760 | 105,588 |
| Disposals | | - | - | (4,443) | (4,247) | - | - | (2,330) | (11,020) |
| Depreciation charge | | - | (89,032) | (300,731) | (25,127) | - | (780) | - | (415,670) |
| **Carrying amount at 31 December 2005** | | **45,419** | **1,293,882** | **1,566,057** | **101,859** | - | **24,028** | **304,538** | **3,335,783** |
| **Cost at 31 December 2005** | | **45,419** | **1,711,718** | **2,684,679** | **245,271** | **-** | **27,508** | **304,538** | **5,019,133** |
| **Accumulated depreciation** | | **-** | **(417,836)** | **(1,118,622)** | **(143,412)** | **-** | **(3,480)** | **-** | **(1,683,350)** |
| **Carrying amount at 31 December 2005** | | **45,419** | **1,293,882** | **1,566,057** | **101,859** | **-** | **24,028** | **304,538** | **3,335,783** |
| Acquisition through business combinations | 23 | - | 425,573 | 477,767 | 194,394 | 2,919,487 | 56 | 18,017 | 4,035,294 |
| Additions/Transfers | | - | 29,851 | 209,588 | 139,488 | 2,000 | 432 | 388,955 | 770,314 |
| Disposals | | - | (13,406) | (48,500) | (41,060) | - | - | (20,339) | (123,305) |
| Depreciation charge | | - | (129,485) | (406,730) | (53,615) | (200,391) | (1,913) | - | (792,134) |
| Changes in estimates of asset retirement obligation | 17 | - | - | 1,953 | - | - | - | - | 1,953 |
| Translation to presentation currency | | - | (15,217) | (13,827) | (6,746) | (107,334) | (19) | (846) | (143,989) |
| **Carrying amount at 31 December 2006** | | **45,419** | **1,591,198** | **1,786,308** | **334,320** | **2,613,762** | **22,584** | **690,325** | **7,083,916** |
| **Cost at 31 December 2006** | | **45,419** | **2,133,646** | **3,249,603** | **522,136** | **2,806,267** | **27,977** | **690,325** | **9,475,373** |
| **Accumulated depreciation** | | **-** | **(542,448)** | **(1,463,295)** | **(187,816)** | **(192,505)** | **(5,393)** | **-** | **(2,391,457)** |
| **Carrying amount at 31 December 2006** | | **45,419** | **1,591,198** | **1,786,308** | **334,320** | **2,613,762** | **22,584** | **690,325** | **7,083,916** |

At 31 December 2006 and 31 December 2005, the gross carrying value of fully depreciated property, plant and equipment still in use approximated RR 339 million and RR 322 million, respectively.

At 31 December 2006 the Bayerische Hypo- und Vereinsbank AG, CJSC International Moscow Bank and Banque Commerciale pour l'Europe du Nord-Eurobank held a pledge over the equipment of the Group with the total replacement value of RR 1,713 million and net book value of RR 882 million (Note 14). There was no equipment pledged at 31 December 2005.

Intangible assets include cost of obtaining "CZP SHG" (Chelyabinsk Zinc Plant Special High Grade) certification with the carrying value of RR 22.1 million (2005: RR 23.6 million). The product was officially registered at the London Metal Exchange in December 2004.

The carrying amount of property, plant and equipment held under finance lease at 31 December 2006 comprised RR 51.3 million (2005: nil).

Advances for capital construction include prepayment for the licence on the subsoil use of the Amurskoye deposit in the amount of RR 29 million. The licence was obtained in January 2007 (Note 27).

## 9 Goodwill

Goodwill is related to acquisition of 100% of shares in Nova Trading AG (previously Nova Trading and Commerce AG) (Note 23).

Movements in goodwill arising on the acquisition of subsidiaries are:

| *In thousands of Russian Roubles* | **2006** |
|---|---|
| **Carrying amount at 1 January** | - |
| Acquisition of subsidiary (Note 23) | 866,146 |
| Translation adjustment | (34,160) |
| **Carrying amount at 31 December** | **831,986** |

## 10 Inventories

| *In thousands of Russian Roubles* | **31 December 2006** | **31 December 2005** |
|---|---|---|
| Raw materials and consumables | 1,611,068 | 1,192,611 |
| Work in progress | 353,399 | 163,410 |
| Finished goods | 228,069 | 86,584 |
| Precious metals | 39,085 | 11,454 |
| Goods for resale | 43,457 | 43,095 |
| Provision for obsolete and slow-moving inventory | (22,151) | (18,169) |
| **Total inventories, net** | **2,252,927** | **1,478,985** |

At 31 December 2006 the Group has accumulated zinc cakes (a by-product with approximately 20% zinc content, which requires substantial processing to extract zinc) in excess of 127.9 thousand tons (31 December 2005: 100.8 thousand tons), which has not been processed due to the limited capacity of certain workshops.

The Group approved installation of processing equipment for zinc cakes during the period from 2003 to 2005. However, in 2005 this program was suspended due to a reduction of production output and only resumed at the end of 2005. The equipment was put into operation in the second quarter of 2007 (Note 27).

The carrying value of zinc cakes is substantially lower than its potential resale value and cost of zinc content. The carrying value of zinc cakes, induded in consumables, amounted to RR 59 million (31 December 2005: RR 36 million). At 31 December 2005 the EBRD held a pledge over the 100.8 thousand tons of zinc cakes of the Group as a guarantee over the loan facility (Note 14).

There is no inventory pledged at 31 December 2006 (31 December 2005: zinc cakes with carrying value of RR 36 million).

## 11 Accounts Receivable

| *In thousands of Russian Roubles* | Note | 31 December 2006 | 31 December 2005 |
|---|---|---|---|
| Trade receivables RR denominated – third parties | | 64,212 | 42,377 |
| Trade receivables RR denominated – related parties | 7 | 239 | 49 |
| Trade receivables US$ denominated | | 538,247 | 186,507 |
| Trade receivables KZT denominated | | 7,845 | - |
| Less provision for impairment of trade receivables | | (20,254) | (1,481) |
| VAT and other taxes recoverable | | 533,158 | 330,762 |
| Interest receivable – third parties | | 1,727 | - |
| Interest receivable – related parties | 7 | - | 2,933 |
| Property insurance prepaid | | 7,973 | 36,792 |
| Other prepayments | | 164,499 | 90,427 |
| Other prepayment – related parties | 7 | 15 | - |
| Other accounts receivable | | 24,286 | 1,403 |
| **Total trade and other receivables, net** | | **1,321,947** | **689,769** |

## 12 Cash and cash equivalents, restricted cash, loans and promissory notes receivable, bank deposits and other non-current assets

| *In thousands of Russian Roubles* | 31 December 2006 | 31 December 2005 |
|---|---|---|
| RR denominated bank balances payable on demand and cash on hand | 97,431 | 6,391 |
| US$ denominated bank balances payable on demand | 113,911 | 1,925 |
| KZT denominated bank balances payable on demand and cash on hand | 48,829 | - |
| RR term deposits | - | 50,538 |
| US$ term deposits | 181,685 | 69,078 |
| RR promissory notes | 1,697 | 3,808 |
| **Total cash and cash equivalents** | **443,553** | **131,740** |
| **Restricted cash** | **402,707** | **4,073** |

At 31 December 2005 short-term deposits denominated in Roubles include cash deposited with the Uralsky Kommerchesky Bank in the amount RR 50 million at 5% p.a. maturing in January 2006.

At 31 December 2006 short-term deposits denominated in US Dollars included: two cash deposits with International Moscow Bank in the amount of US$ 1,9 million and US$ 5 million (equivalent of RR 50 million and RR 131.7 million) at 5.15% and 4.95% p.a., respectively, maturing in January 2007.

At 31 December 2005 short-term deposits denominated in US Dollars include cash deposited with the Chelindbank in the amount RR 28.8 million (equivalent of US$ 1 million) at 1% p.a. maturing 16 January 2006 and cash deposited with the Uralvneshtorgbank in the amount RR 40.3 million (equivalent of US$ 1.4 million) at 7% p.a. maturing 15 March 2006.

The balance of restricted cash as at 31 December 2006 included:

- a promissory note of OAO Chelindbank with the book value of RR 400 million maturing in June 2007. This promissory note was purchased with discount in the amount of RR 17.1 million and pledged as a guarantee for the fulfillment of liabilities of Cadauro Limited under the loan agreement with OAO Chelindbank;
- a promissory note of OOO CB Agropromcredit with the book value of RR 2.7 million maturing in January 2007. This promissory note was purchased with discount in the amount of RR 0.2 million and pledged with issuing bank as a guarantee for payments to customs authorities.

**12 Cash and cash equivalents, restricted cash, bank deposits, loans and promissory notes receivable, and other non-current assets (continued)**

The balance of restricted cash as at 31 December 2005 included the promissory note of the Kreditny Agroprombank for RR 2.8 million pledged with this bank as a guarantee for payments to customs authorities. This promissory note is non-interest bearing. It matures in January 2007. The remaining amount of RR 1.3 million is represented by a letter of credit opened with the Chelindbank in favour of G. Diefenbach S.r.l. for supply of equipment. This letter of credit matured 11 March 2006.

Bank deposits include short-term RR denominated deposits with the Bank of Moscow in the amount of RR 500.6 million at 6.1% p.a. maturing in June 2007.

As at 31 December 2006 promissory notes of RR 580.8 million of Bank of Moscow were included in loans and promissory notes receivable caption. The promissory notes were US$ denominated, bore interest of 5% p.a. and mature in June 2007. As at 31 December 2005 loans and promissory notes receivable represented loans originated to Group CTRP of RR 26 million (Note 7).

Cash deposits with OAO Chelindbank in the amount of RR 400 million at 11.5% p.a. and cash deposits with Kreditny Agroprombank in the amount of RR 200 million at 11.5% p.a., both maturing in 2008, were included in other non-current assets. Deposit agreements with OAO Chelindbank stipulate the decrease of interest on deposits in case of early withdrawal of cash within the schedule: - from 271 to 365 days is 9% p.a., - from 181 to 270 days is 8% p.a., - from 121 to 180 days is 7% p.a., - from 91 to 120 days is 5.5% p.a., - from 61 to 90 days is 4% p.a., - from 31 to 60 days is 3.5% p.a., - less than 30 days is 0% p.a. Deposit agreements with Kreditny Agroprombank stipulate the decrease of interest on deposits in case of early withdrawal of cash to 0.5% p.a.

Bank balances payable on demand bore interest at 0.0 - 0.5% p.a.

**13 Shareholders' equity**

Total number of common shares issued comprises:

| *In thousands of Russian Roubles* | Number of ordinary shares | Book value of ordinary shares | Treasury shares | Share premium | Total |
|---|---|---|---|---|---|
| **At 1 January 2005** | **636,796** | **74,077** | **-** | **48,192** | **122,269** |
| **At 1 January 2006** | **636,796** | **74,077** | **-** | **48,192** | **122,269** |
| Treasury shares purchased | - | - | (7) | - | - |
| Treasure shares sold | - | - | 7 | 3,634 | 3,634 |
| Additional issue of shares, July 2006 | 4,457,572 | 4,458 | - | - | 4,458 |
| Additional issue of shares, November 2006 | 325,173 | 325 | - | 1,323,405 | 1,323,730 |
| **At 31 December 2006** | **5,419,541** | **78,860** | **-** | **1,375,231** | **1,454,091** |

The total nominal amount of the Company's issued share capital prior to restatement of capital contributions made before 1 January 2003 to the purchasing power of the Russian Rouble at 31 December 2002 is RR 637 thousand (2005: RR 637 thousand). At 31 December 2006 authorized, issued and fully paid share capital consists of 5,419,541 ordinary shares with a nominal value of RR 1 each (2005: 636,796 shares). Each ordinary share carries one vote.

Share premium represents the excess of contributions received over the nominal value of shares issued. In March-April 2006 the Company repurchased 7,268 of its ordinary shares at RR 3,000 per share, which represent 1.14% of the charter capital for RR 21.8 million. In June 2006 they were sold for RR 25.4 million. The gain from the operations with treasury shares was recorded as the increase in share premium.

In May 2006 the Board of Directors approved issuance of an additional 4,457,572 common shares with the par value of 1 RR per share. These shares were distributed among shareholders in July 2006 in proportion to the number of shares owned by shareholders for no additional consideration (Notes 22).

In November 2006 the Company additionally issued through a public offering 325,173 ordinary registered shares for total consideration of RR 1,324 million at approximately RR 4.1 thousand (US$ 167.5) per share, net of transaction costs of RR 126.3 million.

During October and November 2006, in the course of the initial public offering, the Company and its major shareholder, NF Holdings B.V., offered 2,257,173 shares of the Company (41,65% of the charter capital) in the Russian Federation and abroad. The Company offered 325,173 newly issued shares and NF Holdings B.V offered 1,932,000 shares from its portfolio.

## 13 Shareholders' equity (continued)

Placement on the domestic market was performed via the Russian Trading System ("RTS"). This stake of 983,581 shares (43,6% of the total share placing) represented 325,173 shares placed by the Company, and the remaining 658,408 shares offered by NF Holdings B.V. Placement of 1,273,592 shares on the London Stock Exchange was offered by NF Holdings B.V.

The Company's shares were sold at RTS at approximately RR 4.1 thousand (US$ 167.5) per share. The stock placement at LSE was done through the sale of global depositary receipts (GDR) in proportion of 10 GDR per one share, the price for 10 GDR amounted to approximately RR 4.1 thousand (US$ 167.5).

The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the net profit. For the year ended 31 December 2006, the current year net statutory profit for the Company as reported in the published annual statutory reporting forms was RR 2,140 million (for the year ended 31 December 2005: RR 268 million). However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and accordingly management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements.

The formation of the legal reserve in the statutory accounting reports is stipulated by the Law on Joint Stock Companies and equals 5% of the declared share capital. The legal reserve of RR 271 thousand recorded in the statutory financial statements at 31 December 2006 (RR 96 thousand in the statutory financial statements at 31 December 2005) is different from the respective reserve in these consolidated financial statements due to inflation effect.

In April 2006 the annual shareholders meeting decided not to accrue or pay dividends for outstanding ordinary shares. A similar decision was taken in 2005. As at 31 December 2006 and 31 December 2005 the amounts of unpaid dividends for prior periods were nil.

## 14 Borrowings

| *In thousands of Russian Roubles* | 31 December 2006 | 31 December 2005 |
|---|---|---|
| Long-term bank loans denominated in US$ | 2,744,729 | - |
| Current portion of long-term US$ loans | 688,129 | 269,836 |
| Finance lease payable | 37,413 | - |
| **Total borrowings** | **3,470,271** | **269,836** |
| 1 to 2 years | 856,092 | - |
| 2 to 3 years | 849,089 | - |
| 3 to 4 years | 841,854 | - |
| 4 to 5 years | 220,924 | - |
| **Total long-term borrowings** | **2,767,959** | **-** |

At 31 December 2006 long-term bank loans denominated in US$ were represented by two loans obtained from Bayerische Hypo- und Vereinsbank AG and consortium of CJSC International Moscow Bank and Banque Commerciale pour l'Europe du Nord-Eurobank for financing acquisition of Nova Trading & Commerce AG shares, for general working capital purposes and export financing. The total amount of these loans were US$ 70 million (RR 1,862 million) and US$ 68.5 million (RR 1,943 million), respectively. Both loans bear interest of LIBOR+3.6% p.a. and should be repaid in equal installments during 2006 – 2011. Total amount repaid by 31 December 2006 is US$ 6 million (RR 161 million).

These banks hold a pledge over the equipment of the Group with a total replacement value of RR 1,713 million and net book value of RR 882 million (Note 8).

The loans were additionally collateralized by 100% shares of Nova Trading & Commerce AG subsidiary (renamed to Nova Holding AG in November 2006) and 52,34% shares of the Company, owned by the Group's immediate parent NF Holdings BV incorporated in Netherlands (Note 1).

**14 Borrowings (continued)**

The loans contain covenants on adequacy of financial ratios, capital expenditure, dividend payments, property insurance and certain other clauses.

At 31 December 2005 the current portion of long-term borrowings was represented by a loan from the European Bank for Reconstruction and Development (EBRD) for financing the plant renovation program. The EBRD loan was denominated in US$. It bore an interest rate of LIBOR+4.25% (2004: LIBOR+4.5%) for the first two tranches of the loan in the amounts US$ 8 million (RR 222 million) and US$ 7 million (RR 194.3 million), respectively, and LIBOR+4.5% (2004: LIBOR+4.75%) for the third and fourth tranches in the amounts US$ 7 million (RR 194.3 million) and US$ 5 million (RR 138.8 million), respectively.

The EBRD held a pledge over 100.8 thousand tons of zinc cakes of the Group as a guarantee over the loan facility. The carrying value of the zinc cakes pledged as guarantee for the loan was RR 36 million (Note 10).

The EBRD loan was collateralised by the Company's shares. The EBRD loan contained covenants on adequacy of capital expenditure, dividend payments, property insurance, operations with related parties and certain other clauses. Due to a failure to comply with all of the debt covenants as of 31 December 2005 the loan was classified as current. In March 2006 the Group repaid the remaining amount of the EBRD loan ahead of schedule.

Management believes that the effective interest rates do not differ significantly from the nominal interest rates disclosed above.

Management believes that the fair value of the loans outstanding at 31 December 2006 does not differ significantly from the carrying amount.

The Group did not enter into any significant hedging arrangements in respect of its foreign currency obligations or interest rate exposures.

Minimum lease payments under finance leases and their present values are as follows:

| *In thousands of Russian Roubles* | **31 December 2006** | **31 December 2005** |
|---|---|---|
| **Finance lease liabilities – minimum lease payments** | | |
| - less than 1 year | 21,720 | - |
| - 1 to 5 years | 28,202 | - |
| - over 5 years | - | - |
| | **49,922** | **-** |
| Future finance charges on finance lease | (12,509) | - |
| **Present value of finance lease liabilities** | | |
| - less than 1 year | 14,183 | - |
| - 1 to 5 years | 23,230 | - |
| - over 5 years | - | - |
| | **37,413** | **-** |

## 15 Accounts payable, accrued expenses and advances from customers

| *In thousands of Russian Roubles* | Note | 31 December 2006 | 31 December 2005 |
|---|---|---|---|
| Trade payables RR denominated – third parties | | 350,830 | 378,125 |
| Trade payables RR denominated – related parties | 7 | 1,033 | 380 |
| Trade payables US$ denominated – third parties | | 151,270 | 313,445 |
| Trade payables KZT denominated – third parties | | 17,875 | - |
| Advances from customers RR denominated – third parties | | 52,560 | 30,462 |
| Advances from customers RR denominated – related parties | 7 | 187 | 10 |
| Advances from customers US$ denominated – third parties | | 40,199 | 43,892 |
| Payroll and social tax payable | | 71,442 | 12,759 |
| Interest payable | | - | 6,531 |
| Accrued liabilities and other payables | | 44,365 | 23,329 |
| **Accounts payable, accrued expenses and advances from customers** | | **729,761** | **808,933** |

## 16 Other taxes payable

| *In thousands of Russian Roubles* | 31 December 2006 | 31 December 2005 |
|---|---|---|
| Property tax | 13,252 | 14,304 |
| Withholding tax | 31,187 | - |
| Personal income tax | 4,838 | 1,829 |
| VAT payable | 9,365 | - |
| Other taxes | 13,157 | 857 |
| **Total other taxes payable** | **71,799** | **16,990** |

## 17 Provisions for asset retirement obligations

The Group has an obligation to landfill site restoration during the mining operations and decommissioning of its mining property after its expected closure in 2017. Movements in provisions for asset retirement obligations are as follows:

| *In thousands of Russian Roubles* | Site restoration costs |
|---|---|
| **Carrying amount at 1 January 2005** | - |
| Changes in estimates adjusted against property, plant and equipment | - |
| Discount rate amortization | - |
| **Carrying amount at 1 January 2006** | **-** |
| Acquisition of subsidiary (Note 23) | 35,279 |
| Changes in estimates adjusted against property, plant and equipment (Note 8) | 1,953 |
| Unwinding the present value discount | 2,545 |
| Translation difference | (1,391) |
| **Carrying amount at 31 December 2006** | **38,386** |

The discount rates for the calculation of the net present value of the estimated future costs for asset retirement obligations at 31 December 2006 were 7.39% p.a.

## 18 Revenues

| *In thousands of Russian Roubles* | Note | 2006 | 2005 |
|---|---|---|---|
| Zinc and zinc alloys – third parties | | 12,727,596 | 4,072,169 |
| Zinc and zinc alloys – related parties | 7 | 185,527 | 86,184 |
| Zinc concentrate – third parties | | 1,199,813 | - |
| Lead concentrate – third parties | | 208,049 | - |
| Zinc tolling – third parties | | - | 103,401 |
| Other – third parties | | 664,367 | 528,865 |
| Other – related parties | 7 | 38 | 540 |
| **Total revenues** | | **14,985,390** | **4,791,159** |

Other revenue comprised sales of zinc production process by-products including: indium, cadmium, sulphuric acid and other products.

## 19 Cost of sales

| *In thousands of Russian Roubles* | Note | 2006 | 2005 |
|---|---|---|---|
| Materials and consumables used | | 7,860,392 | 2,476,250 |
| Utilities and fuel | | 903,504 | 587,721 |
| Production overheads | | 217,021 | 144,409 |
| Repairs and maintenance | | 371,849 | 146,714 |
| Depreciation | 8 | 792,134 | 415,670 |
| Staff costs | | 152,499 | 107,414 |
| Change in work-in-progress | | (126,615) | (97,909) |
| Change in finished goods | | (110,628) | 15,429 |
| Obsolete inventory provision, net | | (5,251) | 5,026 |
| Social costs | | 33,207 | 19,147 |
| Precious metals revaluation | | (56,345) | (5,764) |
| Cost of goods and materials for resale | | 94,428 | 229,996 |
| **Total cost of sales** | | **10,126,195** | **4,044,103** |

## 20 Distribution, general and administrative expenses

| *In thousands of Russian Roubles* | 2006 | 2005 |
|---|---|---|
| Transportation and custom duties | 182,992 | 113,392 |
| **Total distribution expenses** | **182,992** | **113,392** |
| Staff costs | 183,142 | 77,339 |
| Repairs and maintenance | 26,384 | 40,893 |
| Property insurance – third parties | 38,598 | 47,629 |
| Property tax | 58,179 | 62,909 |
| Land tax | 16,741 | 20,270 |
| Other taxes | 48,482 | (1,139) |
| Impairment of trade and other receivables | 16,904 | (199) |
| Loss on disposal of property, plant and equipment | 101,607 | 7,685 |
| Expenses under surety agreement | - | 24,951 |
| Penalties | 30,976 | - |
| Other income and expenses, net | 162,823 | 102,638 |
| **Total general and administrative expenses** | **683,836** | **382,976** |

Total depreciation expense and staff costs (including social expenses) in cost of sales and general and administrative expenses amounted to RR 792,134 thousand (31 December 2005: RR 415,670 thousand) and RR 368,848 thousand (31 December 2005: RR 203,900 thousand), respectively.

CHELYABINSK ZINC PLANT

## 21 Income taxes

Income tax expense comprises the following:

| *In thousands of Russian Roubles* | **2006** | **2005** |
|---|---|---|
| Current tax charge | 942,698 | 94,323 |
| Deferred tax charge | 71,473 | 109 |
| **Income tax expenses for the year** | **1,014,171** | **94,432** |

A reconciliation between the expected and the actual taxation charge is provided below.

| *In thousands of Russian Roubles* | **2006** | **2005** |
|---|---|---|
| **IFRS profit/loss before tax** | **3,885,908** | **241,657** |
| Theoretical tax charge at effective statutory rates* | 961,399 | 57,998 |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| Non-deductible bonuses | 16,948 | - |
| Social expenses | 8,271 | 5,977 |
| Business interruption insurance expenses | 2,097 | 2,557 |
| Expenses under surety agreement | - | 5,988 |
| Other non-deductible expenses | 25,456 | 21,912 |
| **Income tax expense for the year** | **1,014,171** | **94,432** |

* Profit before taxation on operations performed in the Russian Federation is assessed based on effective rate of 24% (2005: 24%), in the Republic of Kazakhstan – 30% (2005: 30%).

Differences between IFRS and statutory taxation regulations of the countries where the Group's companies are located give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below and is recorded at effective rates stated above.

## 21 Income taxes (continued)

| *In thousands of Russian Roubles* | 31 December 2004 | (Charged)/ credited to profit or loss | 31 December 2005 | (Charged)/ credited to profit or loss | Business combinations | Translation difference | 31 December 2006 |
|---|---|---|---|---|---|---|---|
| **Tax effects of deductible temporary differences:** | | | | | | | |
| Accounts receivable | 804 | (627) | 177 | 3,435 | 879 | (115) | 4,376 |
| Accounts payable and accrued liabilities | 2,215 | 17,783 | 19,998 | (1,508) | 7,072 | (268) | 25,294 |
| Provisions for asset retirement obligations | - | - | - | 1,404 | 10,584 | (473) | 11,515 |
| Deferred tax assets | 3,019 | 17,156 | 20,175 | 3,331 | 18,535 | (856) | 41,185 |
| **Tax effects of taxable temporary differences:** | | | | | | | |
| Property, plant and equipment | (166,018) | 2,107 | (163,911) | 90,994 | (1,157,447) | 40,861 | (1,189,503) |
| Inventories | (18,156) | (19,372) | (37,528) | (133,347) | 265 | 4 | (170,606) |
| Other | - | - | - | (32,451) | - | 756 | (31,695) |
| Deferred tax liabilities | (184,174) | (17,265) | (201,439) | (74,804) | (1,157,182) | 41,621 | (1,391,804) |
| **Total net deferred tax liability** | **(181,155)** | **(109)** | **(181,264)** | **(71,473)** | **(1,138,647)** | **40,765** | **(1,350,619)** |

As at 31 December 2006 the unrecognised deferred tax liability associated with investment in subsidiaries amounted to RR 84 million (2005: nil).

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## 22 Earnings per share

Basic earnings per share were calculated by dividing the profit attributable to equity holders of the Company of RR 2,871,737 thousand (31 December 2005: RR 147,225 thousand) by the weighted average number of ordinary shares in issue during the year of 5,134,902 shares (31 December 2005: 5,094,368 shares).

The Company has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal the basic earnings per share.

## 23 Business combinations

On 10 April 2006 the Group acquired 51% of the share capital of Nova Trading and Commerce AG (In November 2006 it was renamed in Nova Holding AG), the company that holds and manages a zinc-lead mine in the Republic of Kazakhstan, for a cash consideration of US$ 86.5 million (RR 2,404 million). On 31 May 2006 the Group made a payment of US$ 50 million (RR 1,349 million) for the remaining 49% of the share capital of Nova Trading and Commerce AG. The title for these shares was transferred to the Group on 10 August 2006.

The acquired business contributed revenues of RR 1,434,004 thousand and net profit of RR 298,881 thousand to the Group for the period from acquisition date to 31 December 2006. If the acquisition had occurred on 1 January 2006, the consolidated revenue and consolidated profit for 2006 would have been RR 15,277,246 thousand and RR 2,799,608 thousand, respectively.

Details of net assets acquired and goodwill arising are as follows:

| *In thousands of Russian Roubles* | **IFRS carrying amount immediately before business combination** | **Fair value** |
|---|---|---|
| Cash and cash equivalents | 37,396 | 37,396 |
| Inventories | 73,677 | 138,872 |
| Property, plant and equipment | 700,948 | 4,035,294 |
| Trade and other receivables | 22,710 | 22,710 |
| Other assets | 973 | 973 |
| Trade and other payables | (85,731) | (85,731) |
| Taxes payable | (70,076) | (70,076) |
| Provisions for asset retirement obligations | (35,279) | (35,279) |
| Deferred tax liability | (118,785) | (1,138,647) |
| Other liabilities | (18,585) | (18,585) |
| **Fair value of acquired interest in net assets of subsidiary** | **507,248** | **2,886,927** |
| Goodwill arising from the acquisition | | 866,146 |
| **Total purchase consideration** | | **3,753,073** |
| Less: cash and cash equivalents of subsidiary acquired | | (37,396) |
| **Outflow of cash and cash equivalents on acquisition** | | **3,715,677** |

The goodwill is primarily attributable to the mine's profitability and the significant synergies expected to arise after its acquisition by the Group.

In substance upon payment of the advance the Company acquired all the risks and rewards of ownership of the remaining 49% of the subsidiary and therefore acquisition of 51% and 49% in the subsidiary was treated as one acquisition of 100% and no minority interest was recognised.

As at 31 December 2006 no impairment was recognised in relation to goodwill. The goodwill number is provisional and no impairment test is required at the acquirer's level as the management had a period to April 2007 to finalise the pruchase price allocation. Subsequent to year end the Company finalised the purchase price allocation and no significant adjustments were required (Note 27).

## 24 Contingencies, commitments and operating risks

### *i Legal proceedings*

During the year ended 31 December 2006, the Group was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of the management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated financial statements.

### *ii Tax legislation*

Both Russian and Kazakhstan tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities.

Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed.

Fiscal periods remain open to review by the authorities in respect of taxes for three and five calendar years preceding the year of review in Russia and Kazakhstan, respectively. Under certain circumstances reviews may cover longer periods.

The Russian transfer pricing legislation introduced 1 January 1999 provides the possibility for the Russian tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all controllable transactions, provided that the transaction price established by the parties differs from the market price by more than 20%.

Controllable transactions include transactions with interdependent parties, as determined under the Russian Tax Code, and all cross-border transactions (irrespective whether performed between related or unrelated parties), transactions where the price applied by a taxpayer differs by more than 20% from the price applied in similar transactions by the same taxpayer within a short period of time, and barter transactions. There is no formal guidance as to how these rules should be applied in practice. The arbitration court practice with this respect is contradictory.

Tax liabilities arising from intercompany transactions are determined using actual transaction prices. It is possible with the evolution of the interpretation of the transfer pricing rules in the Russian Federation and the changes in the approach of the Russian tax authorities, that such transfer prices could potentially be challenged in the future. Given the brief nature of the current Russian transfer pricing rules, the impact of any such challenge cannot be reliably estimated; however, it may be significant.

Additionally, where the form and the accompanying documentation of a transaction generally meet the literal requirements of the applicable tax legislation, but the substance of the transaction may bring a different result, it is possible that such transactions could be challenged in the future with the evolution of the interpretation of tax law in the Russian Federation and the changes in the approach of the Russian tax authorities.

The Group's Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained. Accordingly, at 31 December 2006 no provision for potential tax liabilities had been recorded (2005: no provision). The Group estimates that it does not have material potential obligations from exposure to other than remote tax risks.

### *iii Capital expenditure commitments*

At 31 December 2006 the Group has contractual capital expenditure commitments in respect of property, plant and equipment totalling RR 56.6 million (31 December 2005: RR 1.4 million).

The Group management has already allocated the necessary resources in respect of these commitments. The Group believes that future net income and funding will be sufficient to cover this and any similar such commitments.

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## 24 Contingencies, commitments and operating risks (continued)

### *iv Sales commitments*

At 31 December 2006 the Group has entered into a number of agreements for zinc supply in 2007 totalling approximately 70.1 thousand tons (31 December 2005: 31.6 thousand tons), with a price to be agreed on the date of sale.

At 31 December 2006 the Group has entered into a sale agreements for silver and gold supply totalling approximately 38,888 g of gold and 11,995,221 g of silver (31 December 2005: a sale agreement for silver totalling approximately 1,585,540 g), with the price to be agreed on the date of sale.

### *v Inventory purchase commitments*

At 31 December 2006 the Group has entered into a number of agreements for zinc concentrate purchase totalling approximately 89 thousand tons (31 December 2005: 30 thousand tons to be supplied in 2006), with a price to be agreed on the date of purchase.

The Group has already allocated the necessary resources in respect of these commitments. The Group believes that future net income and funding will be sufficient to cover this and any similar such commitments.

### *vi Operating lease commitments*

Where the Group is the lessee, the future minimum lease payments under non-cancellable operating leases of land are as follows:

| *In thousands of Russian Roubles* | **31 December 2006** |
|---|---|
| Less than 1 year | 285 |
| 1 to 5 years | 350 |
| Over 5 years | 1,183 |
| **Total operating lease commitments** | **1,818** |

### *vii Other obligations under Zinc-Lead Extraction Contract and Licenses*

In accordance with provisions stipulated in the License and Zinc-Lead Extraction Contract there are a number of other obligations the Nova Zinc subsidiary should comply with, such as:

- to perform the work plan and the work program in accordance with their terms;
- to employ appropriate and advance technology and business management expertise to mining operations in accordance with Good Practice in the development of the fields;
- to comply with agreed technological plans and projects for conduction of Mining Operations, which provide for safety of personnel and general public;
- to give preference to equipment, materials, and finished products manufactured in Kazakhstan, if they are competitive, in the Group's opinion, with regard to their technological properties, environmental and operational safety, prices, working parameters, and delivery terms;
- to give preference when conducting Mining Operations to local companies in Kazakhstan when procuring services, if they are competitive, in the Group's opinion, with regard to their technological properties, environmental and operational safety, prices, working parameters, and delivery terms;
- to give preference to hiring Kazakhstan citizens;
- to prepare and perform training programs for the professional training of Kazakhstan citizens and specialists engaged in operations under the Contract;
- to restore the Contract Territory which was disturbed as a consequence of the Mining Operations or other activities of the subsidiary to a condition suitable for further use in accordance with requirements of the legislation of Kazakhstan.

**24 Contingencies, commitments and operating risks (continued)**

***vii Other obligations under Zinc-Lead Extraction Contract and Licenses (continued)***

In April 2006 Committee of Geology and Subsurface Protection under the Ministry of Energy and Mineral Resources (the "Committee") and Centranedra conducted the audit of the Company's fulfilment of license conditions in regard of the Contract. According to the act of the working group of the Committee the Group should develop a plan how to reduce the lag in stripping operations.

The management of the Group does not expect any significant impacts on its operations and financial position as a result of the audit performed by the Committee.

***viii Guarantees***

Guarantees are irrevocable assurances that the Group will make payments in the event that another party cannot meet its obligations.

As at 31 December 2006 the Group issued a guarantee in the favour of Gadauro Limited secured by promissory note of Chelindbank (Note 12). The carrying amount of promissory notes is measured net of the fair value of the originated guarantee.

In June 2005 the Group entered into a suretyship agreement with the EBRD to guarantee the obligations of CTRP, a party controlled by the shareholders of the Group, in respect of a loan agreement with the EBRD dated 19 November 2004 for the amount of US$ 190 million (RR 5,468 million). As at 31 December 2005 the outstanding loan principal payable by CTRP amounted to US$ 121.7 million (RR 3,503 million). Under the suretyship agreement the obligations of the Company were up to a maximum aggregate amount of US$ 23.5 million (RR 676 million). The suretyship agreement was terminated in March 2006.

***ix Insurance***

Under the bank loan covenants (Note 14), the Group is to insure the assets of the Company during the loan period. On 15 October 2006 the Company signed a property insurance agreement totalling to RR 9,779 million. The agreement expires on 14 October 2007 (for the year ended 31 December 2006: RR 2,923 million).

As at 31 December 2006 the companies of the Group concluded civil liability insurance agreements for enterprises operating hazardous facilities, insurance agreements to cover the harm to the life, health or property of third persons as a result of an accident at a hazardous undertaking. The coverage is RR 43,375 thousand. These agreements shall expire during 2007.

***x Environmental matters***

The enforcement of environmental regulation in the Russian Federation and the Republic of Kazakhstan is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

***xi Operating environment of the Group***

Whilst there have been improvements in economic trends in the Russian Federation and the Republic of Kazakhstan, its economies continue to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation and the Republic of Kazakhstan, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

Additionally, the mining sector in Kazakhstan is impacted by political, legislative, fiscal and regulatory developments in Kazakhstan. The prospects for future economic stability in Kazakhstan are largely dependent upon the effectiveness of economic measures undertaken by the government, together with legal, regulatory and political developments, which are beyond the Group's control.

**24 Contingencies, commitments and operating risks (continued)**

***xi Operating environment of the Group (continued)***

The future economic direction of the Russian Federation and the Republic of Kazakhstan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Governments of these countries, together with tax, legal, regulatory, and political developments.

***xii Operating risks concentrations***

Significant volume of zinc and zinc alloys sales is made by the Group to four customers: Trade House NLMK LLC., OJSC MMK, Transal LLC (former CJSC Alf-Trading), and Euromin S.A. These customers account for 89% of the Group's total revenue from zinc and zinc alloys sales for the year ended 31 December 2006 (31 December 2005: 84%). All sales of zinc and lead concentrate are made by the Group to two customers: OJSC Kazzinc and Glencore International AG, which account for more than 99% of the Group's total revenue from zinc and lead concentrate sales for the year ended 31 December 2006.

The Group's management believes that exposure to the risk of total or partial loss of business relationship with these customers is not significant.

**25 Financial risk management**

**i Credit risk**

Financial assets, which potentially subject Group entities to credit risk, consist principally of trade receivables. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. At 31 December 2006 the Group had one debtor with the outstanding balance of RR 524 million, or 27% of the total trade and other receivables. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provisions already recorded.

Cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

***ii Market risk***

The Group takes on exposure to market risks. Market risks arise from commodity prices and open positions in interest rate, currency and equity financial instruments, all of which are exposed to general and specific market movements. The Board of Directors sets limits on the value of risk that may be accepted, which is monitored on a daily basis. However, the use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

***iii Foreign exchange risk***

The Group exports production to European and CIS countries and attracts a substantial amount of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated assets (Note 11, 12) and liabilities (Note 14, 15) give rise to foreign exchange exposure.

The Group does not have formal arrangements to mitigate foreign exchange risks of the Group's operations. However, management believes that the Group is secured from foreign exchange risks as foreign currency denominated sales are used to cover repayment of foreign currency denominated borrowings.

***iv Cash flow and fair value interest rate risk***

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest-bearing long-term borrowings. The interest rates on long-term borrowings are disclosed in Note 14. The Group has no significant interest-bearing assets, other than disclosed in Note 12.

***v Liquidity risk***

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities.

## 26 Fair value of financial instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price.

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. The Russian Federation and the Republic of Kazakhstan continue to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and therefore not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

***Financial instruments carried at fair value.*** Trading and available-for-sale investments are carried on the consolidated balance sheet at their fair value. Cash and cash equivalents are carried at amortised cost which approximates current fair value.

Fair values were determined based on quoted market prices except for certain investment securities available for sale for which there were no available external independent market price quotations. These securities have been fair valued by the Group on the basis of results of recent sales of equity interests in the investees between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of the investees and application of other valuation methodologies. Valuation techniques required certain assumptions that were not supported by observable market data. Changing any such used assumptions to a reasonably possible alternative would not result in a significantly different profit, income, total assets or total liabilities.

***Financial assets carried at amortised cost.*** The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty. Carrying amounts of trade receivables approximate fair values.

***Liabilities carried at amortised cost.*** The fair value is based on quoted market prices, if available. The estimated fair value of fixed interest rate instruments with stated maturity, for which a quoted market price is not available, was estimated based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity. The fair value of liabilities repayable on demand or after a notice period ("demandable liabilities") is estimated as the amount payable on demand, discounted from the first date that the amount could be required to be paid. Estimated fair values of borrowings are presented in Note 14.

## 27 Post balance sheet events

In January 2007 the Group obtained the production licence for Amur zinc ore deposits, Bredinsky district of Chelyabinsk region. The proven reserves of the deposit amount to 1,014 thousand tons of zinc. It is anticipated that this deposit production will deversify the the raw-material base of the Group. The licence was fully prepaid in 2006 (Note 8).

According to the agreement signed by the Company, the Group should spend approximately RR 180 million during 2007-2008 for the extension of this deposit.

In the second quarter 2007 the Company launched Waelz kiln No. 5. As a result, the Group will be able to reduce zinc cake reserves and to achieve a higher level of the processing of raw materials into finished products.

In March 2007 the Group cancelled its guarantee to OAO Chelindbank for Cadauro Limited and redeemed bank promissory notes of OAO Chelinbank with book value of RR 400 million pledged under this guarantee. The guarantee was renewed in the amount of RR 180.5 million and was secured by pledge of promissory notes of OAO Chelindbank of the same amount acquired by the Group. The promissory notes are interest free and mature in June 2007.

In April 2007 the Group finalised the purchase price allocation in regard to the acquisition of Nova Trading and Nova Holding AG (Note 23). No material adjustments to the amounts determined provisionally were identified.

In June 2007 the Group signed a contract for the acquisition of 100% of the voting shares of Pimco 2620 Limited, for a purchase consideration of approximately RR 419,739 thousand (UK Pounds 8,150 thousand). Pimco 2620 Limited is a zinc alloy manufacturer located in the United Kingdom. As of the date of issue of these consolidated financial statements, the Group has not finalised the purchase price allocation of the acquisition.