

**JOINT STOCK COMPANY  
“DOROGOBUZH”**

**International Financial Reporting Standards  
Consolidated Financial Statements and  
Auditor’s Report**

**31 December 2005**

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## AUDITORS' REPORT

To the Shareholders of Joint Stock Company "Dorogobuzh"

1. We have audited the accompanying consolidated balance sheet of Joint Stock Company "Dorogobuzh" and its subsidiaries (the "Group") at 31 December 2005 and the related consolidated statements of income, of cash flow and of changes in shareholders' equity for the year then ended. These financial statements (as set out on pages 2 to 28) are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.
2. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
3. The ultimate controlling party of the Dorogobuzh Group is not disclosed in these consolidated financial statements which in our opinion is not in compliance with IAS 24 "Related party disclosures" (Revised).
4. In our opinion, except for the omission of information discussed in paragraph 3 above, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group at 31 December 2005 and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Moscow, Russian Federation

03 July 2006

**Joint Stock Company "Dorogobuzh"**  
**Consolidated Balance Sheet at 31 December 2005**  
*(in thousands of Russian Roubles unless otherwise stated)*



	Note	2005	2004
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	13	2,453,823	2,462,005
Investments at fair value through profit or loss	14, 26	2,548,887	989,277
Long-term loans receivable	11	57,500	-
<b>Total non-current assets</b>		<b>5,060,210</b>	<b>3,451,282</b>
<b>Current assets</b>			
Inventories	12	758,696	661,549
Other current assets		21,232	18,257
Short-term loans receivable	11	25,000	38,176
Accounts receivable	10	713,253	514,226
Cash and cash equivalents	9	347,032	255,201
<b>Total current assets</b>		<b>1,865,213</b>	<b>1,487,409</b>
<b>Total assets</b>		<b>6,925,423</b>	<b>4,938,691</b>
<b>SHAREHOLDERS' EQUITY</b>			
<b>Shareholders' equity</b>			
Share capital	18	1,735,359	1,735,359
Share premium	18	93,794	93,794
Retained earnings		2,534,199	998,608
<b>Total shareholders' equity</b>		<b>4,363,352</b>	<b>2,827,761</b>
<b>LIABILITIES</b>			
<b>Non-current liabilities</b>			
Long-term borrowings	17	100,739	60,000
Other long-term liabilities		59,160	44,886
Deferred tax liability	22	860,888	541,558
<b>Total non-current liabilities</b>		<b>1,020,787</b>	<b>646,444</b>
<b>Current liabilities</b>			
Accounts payable	15	259,554	127,247
Current income tax payable		9,057	8,537
Other taxes payable	16	100,963	57,268
Short-term borrowings	17	904,255	866,571
Advances received	15	267,455	404,863
<b>Total current liabilities</b>		<b>1,541,284</b>	<b>1,464,486</b>
<b>Total liabilities</b>		<b>2,562,071</b>	<b>2,110,930</b>
<b>Total liabilities and shareholders' equity</b>		<b>6,925,423</b>	<b>4,938,691</b>

Approved for issue and signed on behalf of the Board of Directors on 26 June 2006.

\_\_\_\_\_  
I.N. Antonov  
President

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N. I. Sluzhenikina  
Chief Accountant

The accompanying notes on pages 6 to 28 are an integral part of the consolidated financial statements.

**Joint Stock Company "Dorogobuzh"**  
**Consolidated Income Statement for the year ended 31 December 2005**  
*(in thousands of Russian Roubles unless otherwise stated)*



	Note	2005	2004
Revenue	7	5,823,920	4,366,573
Cost of sales	19	(3,533,085)	(3,107,143)
<b>Gross profit</b>		<b>2,290,835</b>	<b>1,259,430</b>
Transportation services		(510,031)	(421,671)
Selling, general and administrative expenses	20	(580,796)	(393,472)
Taxes other than income tax		(26,878)	(28,871)
Loss on disposal of property, plant and equipment, net		(20,272)	(8,879)
Other operating expenses		(16,999)	(2,858)
Other income		118,631	9,360
Fair value gain on investments	14, 26	1,559,819	321,480
Finance expense	21	(112,573)	(79,397)
<b>Profit before taxation</b>		<b>2,701,736</b>	<b>655,122</b>
Income tax expense	22	(644,006)	(199,724)
<b>Profit for the year</b>		<b>2,057,730</b>	<b>455,398</b>
Weighted average number of ordinary shares outstanding during the period		721,182,860	721,182,860
Weighted average number of preference shares outstanding during the period		154,256,400	154,256,400
<b>Basic and diluted earnings per ordinary share (in Russian Roubles per share)</b>	23	<b>1,90</b>	<b>0,50</b>
<b>Basic and diluted earnings per preference share (in Russian Roubles per share)</b>	23	<b>4,41</b>	<b>0,58</b>

The accompanying notes on pages 6 to 28 are an integral part of the consolidated financial statements.

**Joint Stock Company "Dorogobuzh"**  
**Consolidated Statement of Cash Flows for the year ended 31 December 2005**  
*(in thousands of Russian Roubles unless otherwise stated)*



	Note	2005	2004
<b>Cash flows from operating activities</b>			
Profit before taxation		2,701,736	655,122
Adjustments for:			
Depreciation	13	181,308	173,678
Provision / (reversal of provision) for bad debts		34,719	(26,752)
(Release of) / increase in provision for write-down on inventory		(16,725)	32,773
Loss on disposal of property, plant and equipment		20,272	8,879
Finance expense		112,573	116,868
Fair value gain on investments	14,26	(1,559,819)	(321,480)
Other income		(118,631)	(9,360)
Foreign exchange effect on non-operating items		18,004	12,577
<b>Operating cash flows before working capital changes</b>		<b>1,373,437</b>	<b>642,305</b>
(Increase) / decrease in trade receivables		(64,297)	9,843
Increase in advances to suppliers		(81,392)	(37,369)
(Increase) / decrease in other receivables		(75,158)	59,356
Increase in inventories		(80,423)	(84,090)
Decrease in accounts payable		(7,349)	(23,691)
(Decrease) / increase in advances from customers		(137,405)	191,565
(Decrease) / increase in other payables		(9,876)	53,287
Increase in other current assets		(2,975)	(33,992)
Increase in other current liabilities		-	(19,355)
Increase in employee benefits obligation		14,273	44,886
<b>Cash provided from operations:</b>		<b>928,835</b>	<b>802,745</b>
Income taxes paid		(290,504)	(135,170)
Interest paid		(95,828)	(117,324)
<b>Net cash provided from operating activities:</b>		<b>542,503</b>	<b>550,251</b>
<b>Cash flows from investing activities:</b>			
Purchase of property, plant and equipment		(193,648)	(149,292)
Proceeds from sale of property, plant and equipment		252	5,693
Loans provided, net	11	(44,324)	-
Interest received		22,521	-
Dividends received		79,436	-
Purchase of investments		-	(15,411)
Proceeds from sales of investments		-	3,119
<b>Net cash received from / (used in) investing activities:</b>		<b>(135,763)</b>	<b>(155,891)</b>
<b>Cash flows from financing activities:</b>			
Dividends paid		(375,537)	(22,136)
Additions to short-term debt	17	1,192,503	1,197,505
Repayment of short-term debt	17	(1,430,319)	(1,540,624)
Additions to long-term debt	17	440,909	160,000
Repayment of long-term debt	17	(142,465)	-
<b>Net cash used in financing activities</b>		<b>(314,909)</b>	<b>(205,255)</b>
<b>Net increase in cash and cash equivalents</b>		<b>91,831</b>	<b>189,105</b>
<b>Cash and cash equivalents at the beginning of the year</b>		<b>255,201</b>	<b>66,096</b>
<b>Cash and cash equivalents at the end of the year</b>		<b>347,032</b>	<b>255,201</b>

The accompanying notes on pages 6 to 28 are an integral part of the consolidated financial statements.

**Joint Stock Company "Dorogobuzh"**  
**Consolidated Statement of Changes in Shareholders' Equity for the year ended**  
**31 December 2005**

(in thousands of Russian Roubles unless otherwise stated)



	Note	Share capital	Share premium	Retained earnings	Total shareholders' equity
<b>Balance at 31 December 2003</b>		<b>1,735,359</b>	<b>93,794</b>	<b>565,344</b>	<b>2,394,497</b>
Profit for the year	26	-	-	455,398	455,398
Dividends		-	-	(22,134)	(22,134)
<b>Balance at 31 December 2004</b>		<b>1,735,359</b>	<b>93,794</b>	<b>998,608</b>	<b>2,827,761</b>
Profit for the year		-	-	2,057,730	2,057,730
Dividends		-	-	(522,139)	(522,139)
<b>Balance at 31 December 2005</b>		<b>1,735,359</b>	<b>93,794</b>	<b>2,534,199</b>	<b>4,363,352</b>

The accompanying notes on pages 6 to 28 are an integral part of the consolidated financial statements.



## 1 Dorogobuzh Group and Its Operations

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2005 for Joint Stock Company "Dorogobuzh" (the "Company" or "Dorogobuzh") and its subsidiaries (together referred to as the "Group" or "Dorogobuzh Group").

The Group's principal activities include the manufacture, distribution and sales of chemical fertilisers and related by-products. The Group's manufacturing facilities are primarily based in the Smolenskaya oblast of Russia. Dorogobuzh was incorporated as a joint stock company on 27 July 1994. On that date the majority of assets and liabilities previously managed by the state were transferred to the Company. The transfer of assets and liabilities was made in accordance with Decree No. 721 on the privatisation of state companies approved on 1 July 1992.

The Group's immediate major shareholders at 31 December 2005 are Joint Stock Company "Acron" (further referred to as Parent company), ZAO "Nordic Rus Holding", Refco Holdings Limited and ZAO "Granit", holding 59,79%, 14,28%, 6,62% and 10,86% of voting share capital, respectively. The remaining 8,45% belong to shareholders each holding less than 5% of the Group's shares.

The Company's registered office is Verkhnedneprovsky, Smolenskaya oblast, Russia. In 2005 the Group had an average of 3,661 employees (2004: 3,760).

## 2 Basis of Preparation of the Financial Statements

**Basis of preparation.** These consolidated financial statements have been prepared in accordance with, and comply with, International Financial Reporting Standards ("IFRS") under the historical cost convention except as modified by the revaluation of investments carried at fair value through profit or loss. 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 (refer to Note 5, Adoption of New or Revised Standards and Interpretations).

**Presentation currency.** All amounts in these financial statements are presented in thousands of Russian Roubles ("RR thousands"), unless otherwise stated. The financial statements are based on the statutory records, with adjustments and reclassifications recorded for the purpose of fair presentation in accordance with IFRS.

**Accounting for the effect of inflation.** Prior to 1 January 2003 the adjustments and reclassifications made to the statutory records for the purpose of IFRS presentation included the restatement of balances and transactions for the changes in the general purchasing power of the RR in accordance with IAS 29, Financial Reporting in Hyperinflationary Economies. 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 hyperinflationary 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.

## 3 Summary of Significant Accounting Policies

### 3.1 Group accounting

**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.





### **3 Summary of Significant Accounting Policies (continued)**

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 group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all of its subsidiaries use uniform accounting policies consistent with the Group's policies. Minority interest is that part of the net results and of the net assets of a subsidiary, including the fair value adjustments, which is attributable to interests which are not owned, directly or indirectly, by the Company. Minority interest forms a separate component of the Group's equity.

**Investments in associates.** Associates are entities over which the Group has significant influence, but not control, generally accompanying a shareholding of between 20 and 50 percent of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The carrying amount of associates includes goodwill identified on acquisition less accumulated impairment losses, if any. The Group's share of the post-acquisition profits or losses of associates is recorded in the consolidated income statement, and its share of post-acquisition movements in reserves is recognised in reserves. When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

#### **3.2 Cash and cash equivalents.**

Cash and cash equivalents includes 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. 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.

#### **3.3 Trade and other receivables**

Trade and other receivables are carried at amortised cost using the effective interest method. 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 carrying amount and the recoverable amount, being the present value of estimated future cash flows, discounted at the original effective rate of interest. The amount of the provision is recognised in the income statement.

#### **3.4 Value added tax**

Value added taxes related to sales is payable to tax authorities upon collection of receivables from customers. Input VAT is a generally reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis [except for export sales related input VAT which is reclaimable upon confirmation of export and input VAT on construction in progress which can be reclaimed only upon transfer of a constructed asset into operation]. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) 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. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

#### **3.5 Inventories**

Inventories are recorded at the lower of cost and net realisable value. Cost of inventory is determined on the weighted average basis. The cost of finished goods and work in progress comprises raw material, direct labour, other direct costs and related production overhead (based on normal operating capacity) but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.



### **3 Summary of Significant Accounting Policies (continued)**

#### **3.6 Property, plant and equipment**

Property, plant and equipment are recorded at cost, restated where applicable to the equivalent purchasing power of the Russian Rouble at 31 December 2002 for assets acquired prior to 1 January 2003, less accumulated depreciation and provision for impairment, where required.

At each reporting date the management assess 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 cost to sell and its value in use. The carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) 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 assets recoverable amount. Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in the profit or loss.

Depreciation is calculated to allocate cost of property, plant and equipment to their residual values on a straight-line basis. The depreciation periods, which approximate the estimated useful economic lives of the respective assets, are as follows:

	<u>Number of years</u>
Buildings	40 to 50
Plant and machinery	10 to 20
Equipment and motor vehicles	5 to 10

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.

Repair and maintenance expenditure is expensed as incurred. Major renewals and improvements are capitalised and the assets replaced are retired. Gains and losses arising from the retirement or disposal of property, plant and equipment are included in the statement of income as incurred.

Borrowing costs on specific or general funds borrowed to finance the construction of qualifying asset are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

#### **3.7 Intangible assets**

**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.

The Group applies the transitional rules of IFRS 3 "Business combinations" in respect of goodwill and negative goodwill arising from business combinations for which the agreement date was before 31 March 2004. Consequently, beginning 1 January 2005, previously recognized goodwill is no longer amortized and is to be tested for impairment in accordance with IAS 36 "Impairment of assets"; previously recognized negative goodwill was derecognized, with a corresponding adjustment to the opening balance of retained earnings on that date. Goodwill arising from business combinations for which the agreement date is on or after 31 March 2004 is tested annually for impairment and carried at cost less accumulated impairment losses. If the cost of the acquisition is less than the acquired interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary acquired, the difference is recognized directly in the income statement.



### **3 Summary of Significant Accounting Policies (continued)**

**Research and development.** Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and costs can be measured reliably. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs with a finite useful life that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit, on average over a period not exceeding 5 years.

**Other intangible assets.** All of the Group's other intangible assets have definite useful lives and primarily include capitalised computer software, patents, trademarks and licences. Acquired computer software licenses, patents and trademarks are capitalised on the basis of the costs incurred to acquire and bring them to use.

Intangible assets are amortised using the straight-line method over their useful lives, but not exceeding 20 years.

#### **3.8 Borrowings**

Borrowings are stated at amortised cost using the effective yield method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised as interest expense over the period of the borrowings. Borrowing costs on specific or general funds borrowed to finance the construction of qualifying asset are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

#### **3.9 Income taxes**

Income taxes have been provided for in the consolidated financial statements in accordance with Russian legislation enacted or substantively enacted by the balance sheet date. The income tax charge/[credit] 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.

#### **3.10 Foreign currency transactions**

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



### **3 Summary of Significant Accounting Policies (continued)**

Monetary assets and liabilities are translated into each entity's functional currency at the official exchange rate of the CBRF 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 each entity's functional currency at year-end official exchange rates of the CBRF are recognised in profit or loss. Translation at year-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.

#### **3.11 Provisions for liabilities and charges**

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

Provisions are evaluated and re-estimated annually, and are included in the financial statements at their expected net present values using discount rates appropriate to the Company in the economic environment in the Russian Federation at each balance sheet date.

#### **3.12 Shareholders' equity**

**Share capital.** Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction in equity from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recognised as a share premium.

**Treasury shares.** Where the Company or its subsidiaries purchases the Company's equity share capital, the consideration paid including any attributable transaction costs net of income taxes is deducted from total shareholders' equity as treasury shares until they are cancelled, sold or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity. Treasury shares are stated at weighted average cost.

**Dividends.** Dividends are recognised 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 authorised for issue.

#### **3.13 Revenue recognition**

Revenues on sales of chemical fertilisers and related by-products are recognised when title transfers to the customer. Sales are shown net of VAT, custom duties and discounts, and after eliminating sales within the Group.

Revenues are measured at the fair value of the consideration received or receivable. When the fair value of consideration received cannot be measured reliably, the revenue is measured at the fair value of the goods or service given up.

#### **3.14 Mutual cancellations**

A portion of sales and purchases are settled by mutual settlements or non-cash settlements. These transactions are generally in the form of direct settlements through cancellation of mutual trade receivables and payables balances within the operational contracts. Non-cash settlements include 'veksels' or 'bills of exchange', which are negotiable debt obligations. Sales and purchases that are expected to be settled by mutual settlements or other non-cash settlements are recognised based on the estimate of the fair value to be received or given up in non-cash settlements. The fair value is determined with reference to various market information. Non-cash transactions have been excluded from the cash flow statement, so investing activities, financing activities and the total of operating activities represent actual cash transactions.



### **3 Summary of Significant Accounting Policies (continued)**

The Group also accepts bills of exchange from its customers (both issued by customers and third parties) as a settlement of receivables. Bills of exchange issued by customers or issued by third parties are carried at amortised cost using the effective interest method. A provision for impairment of bills of exchange is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms.

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.

A provision for impairment of bills of exchange is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms. 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.

#### **3.15 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 year in which the associated services are rendered by the employees of the Group.

Social costs. The Group incurs significant costs on social activities. These costs include the provision of health services, kindergartens, and the subsidy of worker holidays. These amounts represent an implicit cost of employing principally production workers and, accordingly, have been charged to cost of sales.

Pension costs In the normal course of business the Group contributes to state pension schemes on behalf of its employees. Mandatory contributions to the governmental pension scheme are accrued in the year in which the associated services are rendered by the employees of the Group.

#### **3.16 Financial assets and liabilities.**

**Classification of financial assets.** The Group classifies its financial assets into the following measurement categories: at fair value through profit or loss, held to maturity and loans and receivables.

Financial assets at fair value through profit or loss include financial assets that are either classified as held for trading or upon initial recognition are designated by the entity as at fair value through profit or loss.

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 the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at each balance sheet date.

**Initial recognition of financial instruments.** Financial assets at fair value through profit or loss 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 investments at fair value through profit or loss.



### **3 Summary of Significant Accounting Policies (continued)**

**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.

**Financial assets at fair value through profit or loss.** A financial asset is included in this category if acquired principally for the purpose of selling in the short-term or if so designated by management. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within twelve months of the balance sheet date.

#### **3.17 Earnings per share**

An earnings per share is determined by dividing the net profit attributable to shareholders by the weighted average number of shares outstanding during the reporting year. Preference shares are not redeemable and are considered to be participating shares. 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 period. Preference shares participate in the calculation because dividends attributable to preference shares cannot be less than dividends on ordinary shares.

#### **3.18 Reclassifications**

Certain amounts in previously issued financial statements have been reclassified to conform to the current year presentation.

### **4 Critical Accounting Estimates, and Judgements 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 judgements 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 judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements 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:

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

**Related party transactions.** In the normal course of business the Group enters into transactions with its related parties. These transactions are priced predominantly at market rates. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analyses. Refer to Note 8.

**Useful lives of property, plants and equipment.** Management assesses the remaining useful life of property, plant and equipment in accordance with current technical condition of assets and estimated period during which these assets will bring economic value of the Group.

**Valuation of investment carried at fair value through profit or loss.** Management uses information available from market analysts on fertiliser industry in applying valuation techniques to estimate fair value of respective investments (for further details refer to Note 14). It is reasonably possible based on existing knowledge that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments at fair value through profit or loss.





## 5 Adoption of New or Revised Standards and Interpretations

Certain new IFRSs became effective for the Group from 1 January 2005. 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. All changes in accounting policies were applied retrospectively with adjustments made to retained earnings at 1 January 2004, unless otherwise described below.

**IAS 1 (revised 2003), Presentation of Financial Statements.** The Group now classifies as current all financial liabilities for which the Group does not have an unconditional right to defer their settlement for at least twelve months after the balance sheet date. Minority interest is now presented as equity and the Group discloses on the face of the income statement profit or loss for the period and the allocation of that amount between 'profit or loss attributable to minority interest' and 'profit or loss attributable to equity holders of the parent'. Certain new disclosures and changes in presentation required by the revised standard were made in these financial statements.

**IAS 8 (revised 2003) Accounting Policies, Changes in Accounting Estimates and Errors.** The Group now applies all voluntary changes in accounting policies retrospectively. Comparatives are amended in accordance with the new policies. All material errors are now corrected retrospectively in the first set of financial statements after their discovery. The Group has not discovered any material error in its prior period financial statements.

**IAS 16 (revised 2003) Property, Plant and Equipment.** The residual value is now defined as the amount that the Group estimates it would receive currently for the asset if the asset were already of the age and in the condition expected at the end of its useful life. The Group now derecognises the carrying amount of a component of property, plant and equipment which has been replaced and capitalises the cost of the replacement. The previous version of IAS 16 did not extend its derecognition principle to components; rather, its recognition principle for subsequent expenditures effectively precluded the cost of a replacement from being capitalised. All changes to accounting policies as a result of the revised IAS 16 were accounted for retrospectively and did not result in a significant effect on the carrying amount of the Group's assets.

**IAS 17 (revised 2003) Leases.** Initial direct costs incurred in negotiating a finance lease are now deferred as part of the net investment in the lease. Finance leases are now recognised at commencement based on values measured at inception. Commencement is when the lessee can start using the leased asset. Inception is the earlier of the date of the lease agreement and the date of commitment to the principal provisions of the lease. The revised IAS 17 is applied retrospectively to all leases in accordance with the transitional provisions of the standard.

**IAS 21 (revised 2003) The Effects of Changes in Foreign Exchange Rates.** The term 'functional currency' replaced 'measurement currency', but has essentially the same meaning. Only one translation method is now applied to all foreign operations - namely that described in the previous version of IAS 21 as applying to foreign entities. Goodwill and fair value adjustments to assets and liabilities that arise on the acquisitions are now treated as part of the assets and liabilities of the acquired entity and translated at the closing rate. Accounting for goodwill and fair value adjustments of foreign operations is applied prospectively from 1 January 2005 in accordance with the transitional provisions of the standard. All other effects of the revised IAS 21 are applied retrospectively.

**IAS 24 (revised 2003) Related Party Disclosures.** The definition of related parties was extended and additional disclosures required by the revised standard were made in these financial statements.

**IAS 27 (revised 2003) Consolidated and Separate Financial Statements.** The Group's policies were changed to remove limited exceptions from consolidation. IAS 27 now requires consolidation of all subsidiaries of the parent.

**IAS 28 (revised 2003) Investments in Associates.** An investor must now consider the carrying amount of its investment in the equity of the associate and its other long-term interests in the associate when recognising its share of losses of the associate. Previously, SIC-20 limited the recognition of the investor's share of losses to the carrying amount of its investment in the equity of the associate. Additional disclosures required by the revised standards were made in these financial statements.

**IAS 32 (revised 2003) Financial Instruments: Disclosure and Presentation.** The Group amended its policies to classify as liabilities puttable shares and similar instruments previously classified as equity or compound instruments. Additional disclosures required by the revised Standard were made in these financial statements.

**IAS 33 (revised 2003) Earnings per Share.** IAS 33 was revised to provide additional guidance and illustrative examples on selected complex matters. The additional guidance did not affect the Group's accounting policies.



## **5 Adoption of New or Revised Standards and Interpretations (continued)**

**IAS 36 (revised 2004) Impairment of Assets.** The Group now performs impairment tests of goodwill, intangible asset not yet available for use and intangible assets with indefinite useful life at least annually. The 'bottom-up/top-down' approach to testing goodwill was replaced by a simpler method.

The goodwill is, from the acquisition date, allocated to each of the acquirer's cash-generating units ("CGU"), or groups of CGUs, that are expected to benefit from the synergies of the business combination. Each unit or group of units to which the goodwill is allocated represents the lowest level at which the goodwill is monitored and is not larger than a segment. Reversals of impairment losses of goodwill are now prohibited. The clarifications of certain elements of value in use calculations in the revised IAS 36 did not have an impact on these financial statements. Management now assesses reasonableness of the assumptions on which the Group's current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. The revised IAS 36 is applied in accordance with the standard's transitional provisions to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004 and to all other assets prospectively from 1 January 2005.

**IAS 38 (revised 2004) Intangible Assets.** The revised IAS 38 is applied prospectively in accordance with its transitional provisions. The amended accounting policies apply to intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004 and to all other intangible assets acquired on or after 1 January 2005. Intangible assets now include assets that arise from contractual or other legal rights, regardless of whether those rights are transferable or separable. The probability of inflow of economic benefits recognition criterion is now deemed to be always met for intangibles that are acquired separately or in a business combination. The Group's policies were amended to introduce the concept of indefinite life intangible assets which exist when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows. Such intangibles are not amortised but tested for impairment at least annually. The Group has reassessed the useful lives of its intangible assets in accordance with the transitional provisions of IAS 38. No adjustment resulted from this reassessment.

**IAS 39 (revised 2003) Financial Instruments: Recognition and Measurement.** The definition of 'originated loans and receivables' was amended to become 'loans and receivables'. This category now comprises originated or purchased loans, and receivables or bills of exchange that are not quoted in an active market. The Group has designated qualifying financial instrument as ones to be measured at fair value, with changes in fair value recognised in profit or loss. Subsequent reclassifications into or out of the 'at fair value through profit or loss' category are prohibited.

The Group amended its policies for derecognition of financial assets. Under the original IAS 39, several concepts governed derecognition. The revised IAS 39 retains the two main concepts of risks and rewards and control, but clarifies that the evaluation of the transfer of risks and rewards precedes the evaluation of the transfer of control. The Group now applies the guidance added to IAS 39 on how to determine fair values using valuation techniques and how to evaluate impairment in a group of loans, receivables or held-to-maturity investments which cannot yet be identified with any individual asset in the group. In accordance with the standard's transitional provisions the revised accounting policies are applied retrospectively except for the clarified derecognition rules which are applied prospectively from 1 January 2004. The Group has redesignated classified under "old" IAS 39 available for sale financial assets into 'at fair value through profit or loss' category as a result of application of the revised IAS 39. Please refer to Note 14.

**IFRS 3 (issued 2004) Business Combinations.** The Group applies transitional provisions of IFRS 3 and accounts for all business combinations for which the agreement date is on or after 31 March 2004 and which are within the scope of IFRS 3 by applying the purchase method. For these transactions, the Group amended its policies for the application of the purchase method: (i) the Group now separately recognises, at the acquisition date, the acquiree's contingent liabilities if their fair values can be measured reliably; and (ii) the identifiable assets, liabilities and contingent liabilities are now measured at their fair values irrespective of the extent of any minority interest. The Group ceased amortising goodwill on 1 January 2005. Accumulated amortisation was eliminated with a corresponding decrease in the cost of goodwill on 1 January 2005. Goodwill is now tested for impairment annually, or when there are indications of impairment also at interim balance sheet dates. The excess of acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost ("negative goodwill") is now recognised immediately in profit or loss.





## **5 Adoption of New or Revised Standards and Interpretations (continued)**

The Group previously amortised negative goodwill over the remaining weighted average useful life of the identifiable depreciable assets acquired. Negative goodwill that existed at 1 January 2005 was offset against retained earnings on that date. Transitional provisions of IFRS 3 require prospective application of changes in accounting policies for equity method investments acquired before 31 March 2004. From 1 January 2005, the Group discontinued including the amortisation of deemed goodwill in the determination of its share of the profits or losses of associates. Negative goodwill included in the carrying amount of associates was derecognised against retained earnings on 1 January 2005.

**IFRIC 2 (issued 2004) Members' Shares in Co-operative Entities and Similar Instruments.** Shares are now equity only if the Group has an unconditional right to refuse their redemption.

## **6 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 2006 or later periods and which the entity has not early adopted:

**IAS 39 (Amendment) – The Fair Value Option (effective from 1 January 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 recognised 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 will reclassify certain financial assets from fair value through profit and loss into the available for sale category as the result of this amendment.

**IAS 39 (Amendment) – Financial Guarantee Contracts (effective from 1 January 2006).** Issued financial guarantees, other than those previously asserted by the entity 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. The Group is in process of assessing the effect of this amendment.

**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. Specifically, it requires disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk including sensitivity analysis to market risk. It replaces 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.

**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.

**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).** The Interpretation clarifies application of IAS 29 in the reporting period in which hyperinflation is first identified. It states that IAS 29 should initially be applied as if the economy has always been hyperinflationary. It further clarifies calculation of deferred income taxes in the opening balance sheet restated for hyperinflation in accordance with IAS 29.

**IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007).** The interpretation states that IFRS 2 also applies to transactions in which the entity receives unidentifiable goods or services and that such items should be measured as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received).

**IAS 21 (Amendment) - Net Investment in a Foreign Operation (effective from 1 January 2006).** This amendment requires foreign exchange gains and losses on 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. Currently, such exchange differences are required to be recognised in consolidated profit or loss. It also extends the definition of 'net investment in a foreign operation' to include loans between sister companies.



## 7 Segment Information

The Group has one reportable segment, which is manufacturing and sale of chemical fertilizers which have similar risks and rewards.. The Group evaluates performance and makes investment and strategic decisions based upon review of profitability for the Group as a whole. Its secondary reporting format is determined to be the geographical segments: Russia and CIS countries, and other counties.

Sales are based on the geographical area in which the customer is located. There are no sales or other transactions between the segments. Production and all assets and liabilities of the Group are located in the Russian Federation.

Revenue	2005	2004
Overseas	3,672,324	2,819,939
Russia and CIS countries	2,151,596	1,546,634
	<b>5,823,920</b>	<b>4,366,573</b>

In 2005 60% of Groups export sales were made to two international trading entities, registered in Belize and British Virgin Islands accordingly. In 2004 68% of Groups export sales were made to two international trading entities, registered in Panama. The sales to them are included in the overseas segment as risks and returns on them are similar to other overseas sales.

## 8 Balances and Transactions with Related Parties

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party, is under common control or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions, which unrelated parties might 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 or had significant balances outstanding at 31 December 2005 and 2004 are detailed below. Transactions were entered into with related parties during the ordinary course of business on normal commercial terms.

### i Balances with related parties:

Balance sheet caption	Notes	Relationship	2005	2004
Trade receivables, gross	10	Parent company Parties under common control	2,040 137,581	3,329 92,917
Provision for impairment of trade receivables:	10	Parties under common control	(92,136)	(35,718)
Prepayments:	10	Parties under common control	50,057	1,615
Loans provided:	11	Parties under common control	67,500	38,176
Trade payables:	15	Parties under common control Parent company	5,692 109	5,343 855
Advances from customers:		Party under common control	2,702	9,358



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

### ii Transactions with related parties:

Statement of income caption	Notes	Relationship	2005	2004
Sales:	7	Parent company	28,980	62,185
		Parties under common control	936,818	683,715
Purchases:	19	Parent company	(18,807)	(26,471)
		Parties under common control	(17,780)	(17,906)
Transportation expenses:		Parties under common control	(377,909)	(101,291)
Commission expenses		Parent company	-	(11,188)
Security services		Parties under common control	(76,385)	(59,722)

### iii Loans issued to related parties

At 31 December 2005 and 2004 all short-term loans were denominated in RR totalled RR 10,000 and RR 38,176, respectively, at interest rates in the range of 10 % to 17%. The loans are unsecured.

In 2005 the Group accrued interest income of RR 11,570 thousand (2004: RR 3,104 thousand).

At 31 December 2005 long-term loan denominated in RR totalled RR 57,500 (2004: nil). Interest rate was fixed at 10.5 % The loan is unsecured.

## 9 Cash and Cash Equivalents

Cash and cash equivalents comprise the following:

	2005	2004
RR denominated cash on hand and balances with banks	131,278	219,222
Foreign currency denominated balances with bank	215,754	35,979
	<b>347,032</b>	<b>255,201</b>

## 10 Accounts Receivable

	2005	2004
Trade accounts receivable (refer to Note 8)	233,529	169,232
Value-added tax recoverable	302,665	141,742
Notes receivable	1,452	20,000
Income tax prepayments	3,715	23,078
Advances given	250,884	169,492
Other taxes receivable	1,223	3,024
Receivables for securities	11,021	46,784
Other accounts receivable	27,624	33,237
	832,113	606,589
Less impairment provision for trade and other receivables	(118,860)	(92,363)
	<b>713,253</b>	<b>514,226</b>

RR 39,866 and RR 2,977 of trade receivables are denominated in USD at 31 December 2005 and 2004 respectively.

RR 88,778 and RR 409 of advances given are denominated in Euro at 31 December 2005 and 2004 respectively.



## 11 Loans Receivable

	2005	2004
<b>Current loans receivable</b>		
Loans issued to third-parties	15,000	-
Loans issued to related parties (Note 8)	10,000	38,176
	<b>25,000</b>	<b>38,176</b>
<b>Non-current loans receivable</b>		
Loans issued to related parties (Note 8)	57,500	-
	<b>57,500</b>	<b>-</b>

At 31 December 2005 and 2004 all short-term loans were denominated in RR totalled RR 25,000 and RR 38,176, respectively, at interest rates in the range of 10 % to 17%. The loans are unsecured.

In 2005 the Group accrued interest income of RR 11,570 thousand (2004: RR 9,360 thousand).

At 31 December 2005 long-term loan denominated in RR totalled RR 57,500 (2004: nil). Interest rate was fixed at 10,5 % The loan is unsecured.

## 12 Inventories

	2005	2004
Raw materials and spare parts	590,510	545,568
Work in progress	18,670	24,766
Finished products	149,516	91,215
	<b>758,696</b>	<b>661,549</b>

Raw materials and spare parts inventories of RR 590,510 (2004: RR 545,568) are recorded net of obsolescence provision of RR 37,266 at the year ended 31 December 2005 (2004: RR 53,991). Inventories of RR Nil and 33,592 have been pledged as security for short-term borrowings at 31 December 2005 and 2004, respectively (Note 17).

## 13 Property, Plant and Equipment

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

	Buildings and constructions	Plant and equipment	Other	Assets under construction	Total
<b>Cost</b>					
<b>Balance at 1 January 2004</b>	5,729,438	4,143,098	69,179	54,279	<b>9,995,994</b>
Additions				140,384	<b>140,384</b>
Transfers	6,364	82,865		(89,229)	<b>0</b>
Disposals	(42,398)	(55,410)	(6,286)		<b>(104,094)</b>
<b>Balance at 31 December 2004</b>	<b>5,693,404</b>	<b>4,170,553</b>	<b>62,893</b>	<b>105,434</b>	<b>10,032,284</b>
<b>Accumulated Depreciation</b>					
Balance at 1 January 2004	3,424,775	4,017,474	42,426	-	<b>7,484,675</b>
Depreciation charge	100,341	72,703	634	-	<b>173,678</b>
Disposals	(29,370)	(53,716)	(4,988)	-	<b>(88,074)</b>
<b>Balance at 31 December 2004</b>	<b>3,495,746</b>	<b>4,036,461</b>	<b>38,072</b>	<b>-</b>	<b>7,570,279</b>
<b>Net Book Value</b>					
<b>Balance at 1 January 2004</b>	<b>2,304,663</b>	<b>125,624</b>	<b>26,753</b>	<b>54,279</b>	<b>2,511,319</b>
<b>Balance at 31 December 2004</b>	<b>2,197,658</b>	<b>134,092</b>	<b>24,821</b>	<b>105,434</b>	<b>2,462,005</b>



### 13 Property, Plant and Equipment (continued)

	Buildings and constructions	Plant and equipment	Other	Assets under construction	Total
<b>Cost</b>					
<b>Balance at 1 January 2005</b>	5,693,404	4,170,553	62,893	105,434	<b>10,032,284</b>
Additions	-	-	-	200,335	<b>200,335</b>
Transfers	34,144	78,749	13,284	(126 177)	-
Disposals	(48,271)	(21,324)	(12,910)	-	<b>(82,505)</b>
<b>Balance at 31 December 2005</b>	<b>5,679,277</b>	<b>4,227,978</b>	<b>63,267</b>	<b>179,592</b>	<b>10,150,114</b>
<b>Accumulated Depreciation</b>					
Balance at 1 January 2005	3,495,746	4,036,461	38,072	-	<b>7,570,279</b>
Depreciation charge	109,247	57,809	14,252	-	<b>181,308</b>
Disposals	(24,236)	(20,487)	(10,573)	-	<b>(55,296)</b>
<b>Balance at 31 December 2005</b>	<b>3,580,757</b>	<b>4,073,783</b>	<b>41,751</b>		<b>7,696,291</b>
<b>Net Book Value</b>					
<b>Balance at 1 January 2005</b>	<b>2,197,658</b>	<b>134,092</b>	<b>24,821</b>	<b>105,434</b>	<b>2,462,005</b>
<b>Balance at 31 December 2005</b>	<b>2,098,520</b>	<b>154,195</b>	<b>21,516</b>	<b>179,592</b>	<b>2,453,823</b>

At 31 December 2005 and 31 December 2004 the gross carrying value of fully depreciated property, plant and equipment was RR 4,912,516 and RR 4,635,288 respectively.

In 2004 the Group adjusted the gross book values and accumulated depreciation of property, plant and equipment which were purchased and/or constructed over a long period of time (up to 8 years) for the amount of inflation. The inflation was calculated in accordance with IAS 29, Financial Reporting in Hyperinflationary Economies, for each respective part of cost of the property, plant and equipment items from the dates of their origination. The adjustment did not affect the net book values of property, plant and equipment.

### 14 Investments at Fair Value Through Profit or Loss

	2005	2004
<b>Balance at 1 January</b>	989,277	655,506
Additions	106	15,410
Fair value gain	1,559,819	321,480
Disposals	(315)	(3,119)
<b>Balance at 31 December</b>	<b>2,548,887</b>	<b>989,277</b>

Investments previously classified as available-for-sale investments were designated by the Group as at fair value through profit or loss in line with requirements of IAS 39 (revised) effective from 01 January 2005. These investments comprise principally equity securities, which are listed on the RTS but which are not actively traded and hence are not considered to be quoted in an active market in line with requirements of IAS 39. For these investments, fair value is estimated by using valuation techniques based on application guidance of IAS 39 (revised). Applied multiples of enterprise value to sales and EBIT were 2,5 and 9,7 respectively. Applied discounts for lack of control and lack of marketability were 15% and 35% respectively. For other investments traded in active markets, fair value is determined by reference to the current market value at the close of business on 31 December.



## 15 Accounts Payable and Advances Received

### Accounts payable

	2005	2004
Trade accounts payable (refer Note 8)	65,499	72,848
Payables to employees	87,619	39,848
Dividends payable	97,744	333
Accrued liabilities and other creditors	8,692	14,218
	<b>259,554</b>	<b>127,247</b>

RR 970 and RR 2,427 of trade payables are denominated in foreign currency, mainly US dollars, at 31 December 2005 and 31 December 2004, respectively.

### Advances received

RR 204,174 and RR 180,696 of advances received are denominated in foreign currency, mainly US dollars, at 31 December 2005 and 31 December 2004, respectively.

## 16 Other Taxes Payable

	2005	2004
Value-added tax payable	76,103	52,534
Payroll taxes	22,788	4,235
Property and other taxes	2,072	499
	<b>100,963</b>	<b>57,268</b>

## 17 Borrowings

Borrowings consist of the following:

	2005	2004
Bonds issued	904,255	-
Term loans	100,739	926,571
	<b>1,004,994</b>	<b>926,571</b>

In June 2005 the Group issued 900 thousand non-convertible three year Russian rouble denominated bonds (at par value 1,000 rubles each) totaling 900 thousand Russian roubles with quarterly coupon payments of 9,9% per annum with an early redemption option subject to approval of Board of directors. In June 2005 Board of Directors approved the decision to grant to the holders of the bonds an option to redeem the bonds starting from December 2006. Accordingly these bonds are classified as short-term in present financial statements. The whole amount of issue was guaranteed by the Parent company.

The Group's borrowings mature as follows:

	2005	2004
Borrowings due:		
- within 1 year	904,255	866,571
- between 2 and 5 years	100,739	60,000
	<b>1,004,994</b>	<b>926,571</b>



## 17 Borrowings (continued)

The Group's borrowings are denominated in currencies as follows:

	2005	2004
Borrowings denominated in:		
- Russian Roubles	904,255	305,000
- US Dollars	100,739	621,571
	<b>1,004,994</b>	<b>926,571</b>

The effective interest rates at the balance sheet date were as follows:

<i>In % per annum</i>	31 December 2005		31 December 2004	
	Russian Roubles	US Dollars	Russian Roubles	US Dollars
Bonds issued	9.9%	-	-	-
Term loans	-	7.5%	11.5% - 12.5%	6.56% - 10.9%

The details of the significant short-term loan balances are summarized below (amounts denominated in US\$ are presented in US\$ dollars):

Short-term loan from Promstroibank-Smolensk denominated in foreign currency totaled US\$ 3,400,000 as at 31 December 2004 (2005: US\$ Nil) at interest rate 10,9% and was secured by promissory notes of the Company in the amount of 157,681 thousand roubles. The loan was repaid in 2005.

Short-term loans from Promstroibank-Smolensk denominated in Russian rubles totaled RR 30,000 as of 31 December 2004 (2005: RR Nil), at fixed interest rate of 12,5%. The loan was repaid in 2005.

Short-term loans from Moskovskiy Narodniy Bank denominated in foreign currency totaled US\$ 4,000,000 at 31 December 2004 (2005: US\$ Nil) at interest rates 7,26%. The loan was repaid in 2005.

Short-term loans from Sberbank-Moscow denominated in Russian roubles totaled RR 215,000 as of 31 December 2004 (2005: RR Nil) at interest rates of 11,5%. Loans were secured by promissory notes of the Company in the amount of 314,919 thousand roubles. The loan was repaid in 2005.

Short-term loan from Commerzbank denominated in foreign currency totaled US\$ 10,000,000 as at 31 December 2004 (2005: US\$ Nil) at interest rates ranging from 5,68% to 6,11% was secured by sales revenue of the Company. The loan was repaid in 2005.

Short-term loan from Moscow International Bank denominated in foreign currency totaled US\$ 5,000,000 as at 31 December 2004 (2005: Nil) at interest rate LIBOR+4%.

The details of the significant long-term loan balances are summarized below (amounts denominated in US\$ are presented in US\$ dollars):

Long-term loan from Moscow International Bank denominated in foreign currency totaled US\$ 3,500,000 as at 31 December 2005 (2004: Nil) at interest rate LIBOR+4%. Under the terms of the agreement there were a number of covenants including cross-default provisions. The significant covenants relate to the level of revenue and the level of encumbrance over assets .

The long-term debt from Sberbank Moscow at 31 December 2004 denominated in Russian Roubles at interest rate of 11,5% was secured by promissory notes of the Company in amount of 87,891 thousand roubles (2005: Nil). The loan was repaid in 2005.





## 18 Shareholders' Equity

Total number of outstanding shares comprises:

	Ordinary shares			Preferred shares	
	Number of shares authorised and paid	Share Capital	Share premium	Number of shares authorised and paid	Share Capital
Balance at 31 December 2003	721,182,860	1,379,569	93,794	154,256,400	355,790
Balance at 31 December 2004	721,182,860	1,379,569	93,794	154,256,400	355,790
<b>Balance at 31 December 2005</b>	<b>721,182,860</b>	<b>1,379,569</b>	<b>93,794</b>	<b>154,256,400</b>	<b>355,790</b>

The Company has two classes of shares, Class A preferred and ordinary. The nominal value for both classes of share capital is RR 0.25 per share. The Company's Board of Directors is authorised to issue both classes of share capital at their discretion.

Class A preferred shares carry no voting rights and are entitled to a minimum annual dividend of 10% of the Company's net statutory profit after taxes. Preferred shares have priority over ordinary shares in the event of liquidation but carry no voting rights except on resolutions regarding liquidation or reorganisation of the Company, changes to dividend levels of preferred shares, or the issuance of additional preferred shares. Such resolutions require approval by two thirds of preferred shareholders. The preferred shares have no rights of redemption or conversion. The share capital is shown in the amount of the historical contribution adjusted for inflation since the date of privatisation until 31 December 2002.

Russian legislation identifies the basis of distribution as the current year net profit. For 2005, the Company recorded a statutory profit as reported in the published annual statutory reporting forms of RR 1,050,718 (2004: profit of RR 339,962).

However, the 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.

A dividend was declared in 2005 in respect of 2004 to holders of ordinary and preferred shares of RR 0.23 per ordinary share and RR 0.18 per preferred share (2004: RR 0.02 per ordinary share and RR 0.05 per preferred share in respect of 2003). During 2005 the Company declared interim dividends in the amounts of RR 0.26 per ordinary share and RR 0.32 per preferred share for six months 2005 and in the amounts of RR 0.13 per ordinary share and RR 0.17 per preferred share for nine months 2005.

## 19 Cost of Sales

The components of cost of sales were as follows:

	2005	2004
Change in inventories of finished goods and work in progress	(36,534)	(3,516)
Staff costs	486,628	398,978
Materials and components used	1,280,004	1,118,975
Fuel and energy	332,928	346,148
Natural gas	927,538	712,619
Depreciation	181,308	173,678
Production overheads	57,057	65,572
Overhaul costs	222,662	224,182
Social expenditure	81,494	70,507
	<b>3,533,085</b>	<b>3,107,143</b>





## 20 Selling, General and Administrative Expenses

	2005	2004
Staff costs	355,697	246,435
Bad debts expense / (reversal)	34,719	(26,752)
Business trips expenses	1,268	710
Legal and consultancy costs	46,912	33,607
Bank services	12,505	11,641
Insurance	1,410	1,192
Buildings maintenance and rent	20,213	28,890
Commission fees	-	11,044
Security	71,667	64,735
Telecommunication costs	9,057	7,628
Representation expenses	4,707	1,447
Other expenses	22,641	12,895
	<b>580,796</b>	<b>393,472</b>

## 21 Finance Expense

	2005	2004
Interest expense	100,577	116,868
Foreign exchange losses / (gains)	11,996	(37,471)
	<b>112,573</b>	<b>79,397</b>

## 22 Income Taxes

	2005	2004
Income tax expense – current	324,676	142,767
Deferred tax charge/(credit) – origination and reversal of temporary differences	319,330	56,957
<b>Income tax charge</b>	<b>644,006</b>	<b>199,724</b>

Profit before taxation for financial reporting purposes is reconciled to tax expense/(credit) as follows:

	2005	2004
<b>Profit before taxation</b>	2,701,736	655,122
Theoretical tax charge at statutory rate of 24% thereon (2004: 24%)	648,417	157,229
Tax effect of items which are not deductible or assessable for taxation purposes:		
Income not taxable	(25,695)	(9,477)
Other non-deductible expenses	21,284	51,972
<b>Income tax charge</b>	<b>644,006</b>	<b>199,724</b>

Most companies of the Group were subject to tax rates of 24% on taxable profits for 2005. Deferred tax asset/liabilities are measured at the rate of 24% as at 31 December 2005 (24% as at 31 December 2005). The net effect of the change on deferred tax balances recognised as at 31 December 2005 is reflected in the statement of income for the year ended 31 December 2005.



**22 Income Taxes (continued)**

	31 December 2003	Differences recognition and reversals	31 December 2004
<b>Tax effects of taxable temporary differences:</b>			
Investments	151,352	69,077	220,429
Property, plant and equipment	394,392	(32,895)	361,497
<b>Tax effects of deductible temporary differences:</b>			
Accounts receivable	(47,119)	37,615	(9,504)
Accounts payable	(8,483)	4,079	(4,404)
Inventories	(6,081)	(6,877)	(12,958)
Employee benefit obligation	-	(10,773)	(10,773)
Other temporary differences	540	(3,269)	(2,729)
<b>Total net deferred tax liability</b>	<b>484,601</b>	<b>56,957</b>	<b>541,558</b>
	31 December 2004	Differences recognition and reversals	31 December 2005
<b>Tax effects of taxable temporary differences:</b>			
Property, plant and equipment	361,497	(29,575)	331,922
Investments	220,429	374,357	594,786
Inventories	(12,958)	19,824	6,866
Other temporary differences	(2,729)	5,206	2,477
<b>Tax effects of deductible temporary differences:</b>			
Accounts receivable	(9,504)	(34,877)	(44,381)
Accounts payable	(4,404)	(12,180)	(16,584)
Employee benefit obligation	(10,773)	(3,425)	(14,198)
<b>Total net deferred tax liability</b>	<b>541,558</b>	<b>319,330</b>	<b>860,888</b>
<b>Including:</b>			
<b>Deferred tax liability, long-term</b>	<b>571,153</b>		<b>912,510</b>
<b>Deferred tax asset, short-term</b>	<b>(29,595)</b>		<b>(51,622)</b>

Substantially all deferred tax liabilities presented in the balance sheet are expected to be realised within a period exceeding 12 months from the balance sheet date.



## 23 Earnings Per Share

Earnings per share is calculated by dividing the net income attributable to participating shareholders by the weighted average number of ordinary and preference shares in issue during the period, excluding the average number of ordinary shares purchased by the Company or its subsidiary and held as treasury shares (see Note 18).

	<b>2005</b>	<b>2004</b>
Weighted average number of ordinary shares outstanding	721,182,860	721,182,860
Weighted average number of preference shares outstanding	154,256,400	154,256,400
Dividends to ordinary shareholders	411,074	14,421
Dividends to preference shareholders	111,065	7,713
<b>Total dividends for the year</b>	<b>522,139</b>	<b>22,134</b>
Profit attributable to ordinary shareholders	1,376,078	364,632
Profit attributable to preference shareholders	681,652	90,766
<b>Profit for the year</b>	<b>2,057,730</b>	<b>455,398</b>
<b>Basic and diluted earnings per ordinary share (in Russian roubles)</b>	<b>1.90</b>	<b>0.50</b>
<b>Basic and diluted earnings per preference share (in Russian roubles)</b>	<b>4.41</b>	<b>0.58</b>

## 24 Contingencies, Commitments and Operating Risks

### i Contractual commitments and guarantees

As at 31 December 2005 the Group had outstanding capital commitments in relation to property, plant and equipment for amount of RR 372,617 (2004: RR 4,021).

As at December 31, 2005 and 2004, the Group has issued financial guarantees to third parties in respect of borrowings from non-group companies in the amount of RR Nil and RR 1,139,943, respectively. No amount has been accrued in the consolidated financial statements for the Group's obligation under these guarantees as the projected outflows from such guarantees are immaterial.

### ii Taxation

Russian 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 calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Transfer pricing legislation, which was introduced from 1 January 1999, provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect to all controlled transactions, provided that the transaction price differs from the market price by more than 20%. Controlled transactions include transactions with related parties, and transactions with unrelated parties if the price differs on similar transactions with two different counterparties by more than 20%. There is no formal guidance as to how these rules should be applied in practice.

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 2005 no provision for potential tax liabilities had been recorded (2004: no provision).

### iii Environmental matters

The enforcement of environmental regulation in the Russian Federation 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.



## 24 Contingencies, Commitments and Operating Risks (continued)

### iv Legal proceedings

From time to time and in the normal course of business, claims against the Group are received. On the basis of its own estimates and both internal and external professional advice the Management is of the opinion that no material losses will be incurred in respect of claims in excess of provisions that have been made in these consolidated financial statements.

### v Operating environment

Whilst there have been improvements in economic trends in the country, the Russian Federation continues 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, 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. The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

## 25 Significant Non-Cash Transactions

Included in sales are non-cash transactions amounting to RR 43,146 (2004: RR 33,395), or approximately 18% and 20% of accounts receivable, and 66% and 46% of accounts payable were settled via non-cash transactions during the years ended 31 December 2005 and 2004, respectively. The transactions represent cancellation of mutual balances with customers and suppliers within the operating cycle. Non-cash transactions have been excluded from the consolidated statement of cash flows.

## 26 Correction of an Error

In 2005 Management reassessed the fair value of its investment carried at fair value through profit or loss at 31 December 2004. The effects of the adjustment are summarised below:

	As previously reported	Adjustment	Restated at 31 December 2004 and for the year then ended
Investments at fair value through profit or loss	682,592	306,685	989,277
Other long-term liabilities	-	(44,886)	(44,886)
Deferred tax liability	(478,727)	(62,831)	(541,558)
Shareholders equity at 31 December 2004	2,628,795	198,966	2,827,761
Net profit for the year ended 31 December 2004			
	256,432	198,966	455,398
Earnings per share	0.29	0.23	0.52

## 27 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. The Group has no other significant concentrations of credit risk. 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 provision already recorded.

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



## **27 Financial Risk Management (continued)**

### **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 63% (2004: 65%) of its production to overseas and attracts substantial amount of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated assets and liabilities give rise to foreign exchange exposure. Foreign currency denominated assets (see Note 9 and 10) and liabilities (see Note 15 and 17) are disclosed in respective notes. The Group does not have formal arrangements to mitigate foreign exchange risks of the Group's operations.

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

The Group's income and operating cash flows are exposed to changes in market interest rates. The Group is exposed to fair value interest rate risk through market value fluctuations of interest bearing short-term and long-term borrowings majority of which are at fixed interest rates. The Group has no significant interest-bearing assets.

## **28 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, judgement is necessarily required to interpret market data to determine the estimated fair value. The Russian Federation continues 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.** Investments at fair value through profit or loss 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 for investments carried at fair value through profit or loss were determined by using valuation techniques based on application guidance of IAS 39 (revised) on the basis of financial data of the investees and application of other valuation methodologies. It is reasonably possible based on existing knowledge that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments at fair value through profit or loss. (refer to Note 17).

**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.



## **29 Subsequent Events**

**Dividends.** In May 2006 annual shareholders meeting approved annual dividends distribution for the year ended 31 December 2005 in the amount of RR 0.55 on each ordinary share and RR 0.69 on each preferred share. Considering the interim dividends for six and nine months 2005 declared during the year the final dividends will be paid in the amount of RR 0.16 on each ordinary share and RR 0.2 on each preferred share.

**Capital expenditure.** In 2005 the Company entered into a commitment for Euro 10,900 thousands to acquire equipment for the production of ammonia and carbamide. This equipment is expected to be installed in 2008-2009 and lead to a substantial increase in production capacity of the Company.