

**LLC “Investment and Industrial Group
“Hydraulic Machines and Systems”
and subsidiaries**

INDEPENDENT AUDITORS’ REPORT

**Consolidated Financial Statements
For the Year Ended 31 December 2006**

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**LLC INVESTMENT AND INDUSTRIAL GROUP
“HYDRAULIC MACHINES AND SYSTEMS” AND SUBSIDIARIES**

**STATEMENT OF MANAGEMENT’S RESPONSIBILITIES
FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006**

The following statement, which should be read in conjunction with the independent auditors’ responsibilities stated in the independent auditors’ report on pages 2-3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of the Limited Liability Company “Investment and Industrial Group “Hydraulic machines and systems” and its subsidiaries (the “Group”).

Management is responsible for the preparation of the consolidated financial statements that present fairly the consolidated financial position of the Group at 31 December 2006, the results of its operations, changes in net assets attributable to participants and cash flows for the year then ended, in accordance with International Financial Reporting Standards (“IFRS”).

In preparing the consolidated financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

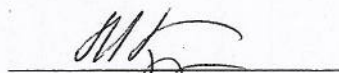
Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with local legislation and accounting standards in the respective jurisdictions in which the Group operates;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud, errors and other irregularities.

These consolidated financial statements for the year ended 31 December 2006 were approved by the management of the Group on 18 August 2008:



G.A. Tsoy
President



M.Y. Kuzmenko
Finance Director

INDEPENDENT AUDITORS' REPORT

To the participants of the Limited Liability Company "Investment and Industrial Group
"Hydraulic Machines and Systems":

We have audited the accompanying consolidated balance sheet of the Limited Liability Company "Investment and Industrial Group "Hydraulic Machines and Systems" and its subsidiaries (the "Group") as at 31 December 2006. We were engaged to audit the accompanying consolidated income statement, consolidated statements of changes in net assets attributable to participants and cash flows for the year then ended, as well as a summary of significant accounting policies and other explanatory notes to the present consolidated financial statements.

Management's responsibility for the consolidated financial statements

The Group's management is responsible for the preparation and fair presentation of these consolidated financial statements, consisting of the consolidated balance sheet, the consolidated income statement, consolidated statements of changes in net assets attributable to participants and cash flows and other explanatory notes, in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of consolidated 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

Our responsibility is to express (or to disclaim) an opinion on these consolidated financial statements based on our audit. Except as discussed in the first paragraph of the following section, 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the consolidated balance sheet of the Group as at 31 December 2006.

Basis for the disclaimer regarding the consolidated income statement, consolidated cash flow statement and for the qualifications relating to the consolidated balance sheet

Since we were engaged as auditors of the Group after 1 January 2006, we did not observe the counting of the physical inventory as of this date and we were unable to satisfy ourselves as to inventory quantities by other audit procedures. Moreover, we believe that inventory amounts materially impact on the assessment of the Group's consolidated net profit and its consolidated cash flow for 2006.

The Group did not present in the accompanying consolidated financial statements the comparative information for the year 2005 as required by International Financial Reporting Standards (the "IFRS").

The Group did not disclose in the accompanying consolidated financial statements the information on operating and geographical segments as required by International Accounting Standard 14 "Segment Reporting".

Disclaimer of the opinion in respect of the consolidated income statement and consolidated cash flow statement

Because of the significance of the matter referred to in the first paragraph of the previous section, the scope of our work was not sufficient to enable us to express an opinion, and we do not express an opinion on the consolidated income statement and consolidated cash flow statement for the year ended 31 December 2006.

Qualified opinion in respect of the consolidated balance sheet

In our opinion, except for the matters referred to in the second and third paragraphs of the section "Basis for the disclaimer regarding the consolidated income statement and consolidated cash flow statement and for qualifications on the consolidated balance sheet", the accompanying consolidated balance sheet presents fairly, in all material respects, the financial position of the Group as at 31 December 2006 in accordance with IFRS.

Deloitte & Touche

18 August 2008

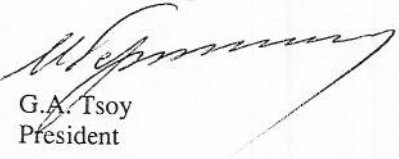
Moscow, Russia


LLC "Investment and Industrial Group "Hydraulic Machines and Systems" and Subsidiaries

Consolidated balance sheet as at 31 December 2006

(in thousands of Russian Rubles)

	Notes	31 December 2006
Assets		
Non-current assets		
Property, plant and equipment	7	1 928 832
Intangible assets	8	71 307
Goodwill	9	16 757
Deferred tax assets	22	15 473
Other non-current assets		1 005
		2 033 374
Current assets		
Cash and cash equivalents	10	142 582
Inventories	11	1 183 338
Trade accounts receivable	12	826 414
Taxes receivable	13	202 982
Other receivables	14	662 963
		3 018 279
Total assets		5 051 653
Equity and liabilities		
Minority interest	29	687 257
Net assets attributable to the participants of the Company		1 437 231
Non-current liabilities		
Long-term loans	15	947 587
Long-term finance lease liabilities	17	1 836
Deferred tax liabilities	22	224 408
Retirement benefit obligations	16	90 292
Other provisions	18	5 181
		1 269 304
Current liabilities		
Short-term borrowings	15	356 809
Finance lease liabilities	17	4 262
Trade accounts payable		582 865
Taxes payable	19	76 203
Other payables	20	637 722
		1 657 861
Total liabilities		4 364 396
Total equity and liabilities		5 051 653


G.A. Tsoy
President

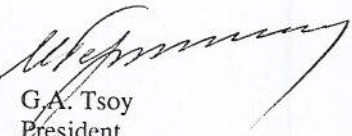

M.Y. Kuznetsov
Finance Director

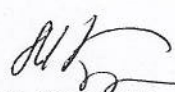
The notes on pages 9 to 42 form an integral part of these financial statements.

LLC "Investment and Industrial Group "Hydraulic Machines and Systems" and Subsidiaries

Consolidated income statement for the year ended 31 December 2006
(in thousands of Russian Rubles)

	Notes	Year ended 31 December 2006
Revenue	23	6 723 613
Cost of sales	24	(5 248 156)
		1 475 457
Selling and transportation expenses	25	(269 248)
Administrative expenses	26	(561 253)
Other operating expenses, net	27	(18 664)
		626 292
Excess of the Group's share in the fair value of acquired net assets over the purchase price	9	40 452
Interest income		2 831
Finance costs	28	(103 749)
Profit before income tax		565 826
Income tax expense	22	(166 536)
Profit for the year		399 290
Attributable to:		
Participants of the parent company		307 860
Minority shareholders		91 430


G.A. Tsoy
President

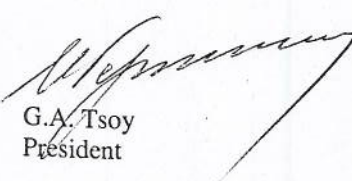

M.Y. Kuzmenko
Finance Director


The notes on pages 9 to 42 form an integral part of these financial statements.

LLC "Investment and Industrial Group "Hydraulic Machines and Systems" and Subsidiaries

Consolidated statement of changes in net assets attributable to participants as at 31 December 2006
(in thousands of Russian Rubles)

	Notes	Net assets attributable to the participants
Balance at 1 January 2006		1 674 843
Restatement of the opening balance	6	(416 336)
Balance at 1 January 2006 (restated)		1 258 507
Change in cumulative translation reserve		(20 137)
Additional issue of subsidiary's shares to the Group's beneficiaries	9	(9 682)
Acquisition of minority interest in the subsidiary	9	21 869
Acquisition of MC HMS interest by the Group's subsidiaries	9	(4 917)
Distribution to shareholders	21	(116 269)
Profit for the year		307 860
Balance at 31 December 2006		1 437 231


G.A. Tsoy
President

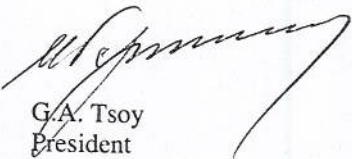

M.Y. Kuzmenko
Finance Director

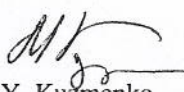
The notes on pages 9 to 42 form an integral part of these financial statements.

LLC "Investment and Industrial Group "Hydraulic Machines and Systems" and Subsidiaries

Consolidated cash flow statement for the year ended 31 December 2006
(in thousands of Russian Rubles)

	Notes	Year ended 31 December 2006
Profit before income tax		565 826
Effect of adjustments:		
Depreciation of property, plant and equipment and amortisation of intangible assets		139 305
Gain on disposal of property, plant and equipment		(22 588)
Change in retirement benefit obligations		18 159
Change in provision for doubtful receivables		11 862
Change in provision for guarantees		1 125
Interest income		(2 831)
Interest expense		114 347
Finance lease expense		2 569
Foreign exchange gain		(16 014)
Change in provision for obsolete inventory		(16 589)
Excess of the Group's share in the fair value of acquired net assets over the purchase price		(40 452)
Other		4 631
Net operating cash flow before working capital changes		759 350
Decrease in inventories		4 487
Increase in trade accounts receivable		(72 507)
Decrease in other receivables		2 978
Decrease in taxes payable		(299)
Decrease in trade and other payables		(239 455)
Income tax paid		(189 540)
Interest paid		(70 719)
Net cash inflow from operating activities		194 295
Investing activities		
Proceeds from loans given by the Group		110 517
Proceeds from disposal of property, plant and equipment		14 231
Interest received		922
Purchase of intangible assets		(7 754)
Acquisition of minority interest in the subsidiary		(10 773)
Loans given by the Group		(12 221)
Advances paid for acquisition of companies		(197 338)
Purchase of property, plant and equipment		(218 633)
Acquisition of subsidiaries, net of cash acquired		(272 365)
Net cash used in investing activities		(593 414)


G.A. Tsoy
President


M.Y. Kuzmenko
Finance Director

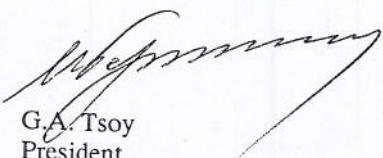
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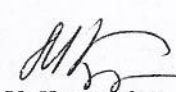
LLC "Investment and Industrial Group "Hydraulic Machines and Systems" and Subsidiaries

Consolidated cash flow statement for the year ended 31 December 2006 (continued)

(in thousands of Russian Rubles)

	Notes	Year ended 31 December 2006
Financing activities		
Proceeds from loans and borrowings		4 402 132
Repayments of loans and borrowings		(3 844 896)
Dividends paid		(161 561)
Payments to the Group's beneficiaries for the acquisition of MC HMS interest		(1 419)
Proceeds from additional issue of subsidiary's shares		2 000
Net cash from financing activities		396 256
Net decrease in cash and cash equivalents		(2 863)
Cash and cash equivalents at the beginning of the year		145 445
Cash and cash equivalents at the end of the year	10	142 582


G.A. Tsoy
President


M.Y. Kuzmenko
Finance Director

The notes on pages 9 to 42 form an integral part of these financial statements.

LLC “Investment and Industrial Group “Hydraulic Machines and Systems” and Subsidiaries

Notes to consolidated financial statements for the year ended 31 December 2006

(in thousands of Russian Rubles)

1. GENERAL

LLC “Investment and Industrial Group “Hydraulic Machines and Systems” (the “Company”) was incorporated under the laws of the Russian Federation (the “RF”) in March 2004. These consolidated financial statements include the financial statements of the Company and its subsidiaries controlled by the Company (together – the “Group”).

The Group’s principal activities are:

- Delivery of wide range of pumps and pumping units manufactured by the Group companies and other producers;
- Implementation of complex engineering and “turn-key” projects in oil extraction and transportation, heat and nuclear power engineering and hydroeconomic construction;
- Update of the current and development of innovative pumping equipment;
- Provision of services of diagnostics and complex maintenance of pumps, pumping units, power equipment, pumping plants and control systems, post-sales and warranty service.

The Group was established during 2003-2005 by three groups of people controlling various businesses as a result of business combinations and acquisitions of a number of companies engaged in production and sales of hydraulic pumps, electrotechnical equipment and spare parts for pumping equipment.

At 31 December 2006 the Company’s participants are:

Participant	Ownership, %	Value, RUR ‘000
LLC Hydroindustry	42.5	92 684
LLC Hydromashinvest	42.5	92 684
LLC Promhydroservice	15	32 712
	100	218 080

At 31 December 2006, the ultimate beneficial owners of the Group were:

- G.A. Tsoy, A.V. Molchanov, K.V. Molchanov, V.V. Khromov, A.G. Frolov, A.A. Borovko, LLC Hydromashinvest – in LLC Hydroindustry;
- V.V. Lukjanenko and Y.N. Skrynnik – in LLC Hydromashinvest;
- N.N. Yamburenko, V.N. Yamburenko, E.K. Babarykin, V.L. Strashkevich – in LLC Promhydroservice.

At 31 December 2006 the Group employed 8 412 people.

The Group's production activities are within the Russian Federation and Ukraine.

LLC “Investment and Industrial Group “Hydraulic Machines and Systems” and Subsidiaries

Notes to consolidated financial statements for the year ended 31 December 2006

(in thousands of Russian Rubles)

1. GENERAL (continued)

At 31 December 2006 information regarding the Group’s subsidiaries (principal activities, proportion of voting shares owned by the Group and the Group’s effective interest) is as follows:

Name	Principal activity	Country	Proportion of voting shares	Effective interest held by the Group
CJSC Hydromashservice	Wholesale of oil-field and pumping equipment, commission sales	Russian Federation	100%	100%
CJSC Hydromashinprom	Wholesale and retail of oil-field and pumping equipment	Russian Federation	95%	71% ⁽¹⁾
LLC Management company “Hydraulic Machines and Systems”	Services related to the management of the Group	Russian Federation	100%	82% ⁽¹⁾
LLC United Industrial Group	Information and consulting services	Russian Federation	100%	100%
OJSC Elektrodvigatel	Production and sales of pumping equipment, engines and spare parts	Russian Federation	75%	57% ⁽¹⁾
OJSC Livhydromash	Production and sales of pumping equipment and spare parts	Russian Federation	98%	96% ⁽¹⁾
OJSC Neftemash	Production and sales of oil-field equipment	Russian Federation	85%	68% ⁽¹⁾
OJSC Neftemash-Service	Oil-field equipment repair services	Russian Federation	100%	68% ⁽¹⁾
OJSC Livnynasos	Production and sales of pumping equipment and spare parts	Russian Federation	81%	68% ⁽¹⁾
OJSC Nasosenergomash	Production and sales of pumping equipment and spare parts	Ukraine	83%	83%
OJSC TH Sumskie nasosy	Commission wholesale and retail	Ukraine	83%	83%
LLC Agrofirma “Step”	Agriculture	Ukraine	99%	83% ⁽¹⁾
CJSC Nijnevartovskrem-service	Oil-field equipment repair services	Russian Federation	100%	100%
OJSC Tomskgazstroy	Construction and assembling operations	Russian Federation	23%	23%

⁽¹⁾ – Including indirect ownership.

LLC “Investment and Industrial Group “Hydraulic Machines and Systems” and Subsidiaries

Notes to consolidated financial statements for the year ended 31 December 2006

(in thousands of Russian Rubles)

2. BASIS OF PRESENTATION

These consolidated financial statements have been prepared and presented in accordance with International Financial Reporting Standards (IFRS), except for comparative information for the prior year. IFRS include standards and interpretations approved by the International Accounting Standards Board (“IASB”), including International Accounting Standards (“IAS”) and interpretations issued by the International Financial Reporting Interpretations Committee (“IFRIC”).

The Group’s companies maintain accounting records in Russian Rubles and in Ukrainian hryvnas (OJSC Nasosenergomash, OJSC TH Sumskie nasosy, LLC Agrofirma “Step”) and prepare financial statements in accordance with Russian Accounting Standards (RAS) and Ukrainian Accounting Standards (UAS), respectively. The Group’s financial statements were prepared based on accounting data of each subsidiary in compliance with the above mentioned standards amended and adjusted as required for fair data presentation in accordance with IFRS.

Functional currency and presentation currency of the Group’s consolidated financial statements is Russian Ruble (except for OJSC Nasosenergomash, OJSC TH Sumskie nasosy, LLC Agrofirma “Step” which functional currency is Ukrainian hryvna). Effect of translation of assets and liabilities denominated in Ukrainian hryvnas to Russian Rubles was recorded as a change in cumulative translation reserve with a balance of RUR 20,364 thousand at 31 December 2006.

All financial information is presented in Russian Rubles and rounded to thousands.

Exchange rates

The exchange rates of Russian Ruble and Ukrainian hryvna used by the Group in the preparation of the consolidated financial statements are as follows:

Russian Ruble/Ukrainian hryvna

At 31 December 2006	5.22
Average rate for 2006 year	5.36

These consolidated financial statements of the Group are prepared on the historical cost basis, except for:

- Property, plant and equipment as at 1 January 2004 (date of transition to IFRS) are carried at estimated value;
- Assets and liabilities of the entities acquired by the Group are carried at their fair values at the respective acquisition dates.

The accompanying consolidated financial statements were prepared by the Group’s management on a going concern basis, presumed that the Group will continue its business for the foreseeable future and has no intention or obligation to discontinue or significantly curtail operations, and therefore all its liabilities will be settled in the due course of business.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries, from the date that control effectively commenced until the date that control effectively ceased. Control is achieved where the Company has the power to govern the financial and operating policies of an entitie so as to obtain benefits from its activities.

The assets and liabilities of all subsidiaries are measured at their fair values at the date of acquisition. The minority interest is stated at the minority’s share in the fair values of the assets and liabilities recognized. Subsequently any losses applicable to the minority in excess of the minority’s interest in the subsidiary’s net assets are allocated against the interest of the Group except for extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

The financial statements of subsidiaries are prepared for the same reporting period as those of the Company; where necessary, adjustments are made to the financial statements of subsidiaries to bring accounting policies into line with those used by the Group.

Excess of the purchase consideration over the fair value of identifiable net assets acquired by the Group at the date of each transaction is recognized as goodwill. Excess of the Group’s share in the fair value of identifiable assets, liabilities and contingent liabilities over purchase consideration is recognized in the income statement in the period when the acquisition took place.

All intra-group balances, transactions, and any unrealized profits or losses arising from intra-group transactions, are eliminated on consolidation.

Accounting for acquisitions

Acquisition of subsidiaries are accounted for using the purchase method. The cost of the business combination is measured as the aggregate of the fair values at the date of exchange of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree’s identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 “Business Combination” are recognized at their fair values at the acquisition date, except for non-current assets that are classified as assets held for sale in accordance with IFRS 5 “Non-Current Assets Held for Sale and Discontinued Operations”, which are recognized and measured at fair value less costs to sell.

The results of a subsidiary acquired or disposed during the reporting year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, respectively.

When acquisition of control involves several exchange transactions, it is accounted for as step acquisition. Each exchange transaction is treated separately by the Group, using fair values of identifiable assets, liabilities and contingent liabilities at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. Minority interest is carried at fair value at the date of the acquisition of control, the minority interest is not adjusted for changes in fair value resulting from subsequent acquisitions, and the difference between the cash used to increase the ownership interest and the carrying value attributed to the assets acquired is recognized directly in the net assets attributable to participants.

For transactions under common control the Group uses the pooling of interests method. When using the pooling of interests method the financial statements of the company acquired are included into the financial statements of the Group beginning from the earliest comparative period disclosed or from the date of purchase of such company from the entity not related by means of common control, if this date occurred later. In the financial statements of the Group assets and liabilities of the acquired company are measured at their carrying values in the financial statements of the previous owner. Goodwill arising on the acquisition of the company by the previous owner from the entity not related by means of common control is also recognized in the Group’s financial statements. The difference between the purchase price from the entity under the common control and the carrying value of the net assets of the company acquired, including goodwill, is recognized in the net assets attributable to participants.

3. SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

Investments in associates

Investments in the Group’s associates are accounted for using the equity method. Investments in shares where the Group owns more than 20% of share capital, but does not have the ability or intent to control or exercise significant influence over operating and financial policies, as well as investments in shares where the Group owns less than 20% of share capital, are accounted for at cost of acquisition.

Management periodically assesses the carrying values of such investments for impairment and records valuation allowances, if required.

Goodwill

Goodwill arising on the acquisition of a subsidiary or an associate represents the excess of the cost of acquisition over the Group’s share in fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary or associate at the date of acquisition.

Goodwill on acquisition of subsidiaries is recognised within intangible assets while goodwill on acquisition of associates is included in the carrying value of investments in associates.

Goodwill is tested for impairment at least annually. The recoverable amount of goodwill is determined for cash generating unit goodwill is attributable to. When the recoverable amount of the cash generating unit is less than the carrying value of the unit, any impairment loss is allocated first to the goodwill associated with the cash-generating unit, then to other assets of the unit, pro rata on the basis of the carrying amount of each asset in the unit. If an impairment has occurred, it is recognised in the income statement during the period in which it is identified and is not subsequently reversed.

On disposal of a subsidiary or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Where an investment in a subsidiary or an associate is made, any excess of the Group’s share in the fair value of acquiree’s identifiable assets, liabilities and contingent liabilities over the purchase price at the date of acquisition is treated as negative goodwill and is recognised in the income statement for the respective period.

3.2 Foreign currency transactions

Monetary assets and liabilities of the Group denominated in foreign currencies at the balance sheet are retranslated into rubles at the exchange rates prevailing at that date. Non-monetary items denominated in foreign currency and accounted for at historical cost are retranslated at exchange rates prevailing at the date of operations. Non-monetary items carried at fair value denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Foreign currency transactions are accounted for at the exchange rate prevailing at the date of the transaction. Gains and losses arising from these translations are recognised in the consolidated income statement as foreign exchange differences.

3.3 Property, plant and equipment

Property, plant and equipment as of 1 January 2004 are recorded at revalued amount, with the valuation confirmed by an independent professionally qualified appraiser. Those values were treated as deemed cost at the date of IFRS adoption. Property, plant and equipment purchased after 1 January 2004 are carried at cost.

Subsequent additions of property, plant and equipment are carried at historical cost of acquisition or construction less accumulated depreciation and impairment. The cost of constructed assets includes the cost of material, direct labor and an appropriate portion of production overheads.

Property, plant and equipment acquired through acquisitions of subsidiaries are recorded at fair value on the date of the acquisition.

LLC “Investment and Industrial Group “Hydraulic Machines and Systems” and Subsidiaries

Notes to consolidated financial statements for the year ended 31 December 2006
(in thousands of Russian Rubles)

3. SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

Depreciation is charged so as to write off the cost or valuation of assets, other than land and construction-in-progress, over their estimated useful lives, using the straight-line method. Estimated useful lives, residual value and depreciation method are revised at the end of each reporting period and all changes in estimations are recorded without making changes in financial statements of prior periods.

Cost of material improvements in property, plant and equipment is capitalised. Major expenditures for improvements and replacements, which extend the useful lives of the assets or increase their revenue generating capacity, are capitalised.

Repairs and maintenance expenditures that do not meet the foregoing criteria for capitalisation are charged to income statement as incurred.

Estimated useful lives used by the Group for various categories of property, plant and equipment:

	<u>Years</u>
Land	Not depreciated
Buildings and constructions	3-100
Machinery and equipment	10-15
Motor vehicles	7
Other	3-5

Construction-in-progress includes expenses directly related to construction of property, plant and equipment, including appropriate overheads and expenses on acquisition of other assets required for preparation of property, plant and equipment for use, and (with regard to certain assets) also borrowing costs capitalised in accordance with the Group’s accounting policy. Depreciation of such assets commences from the date when the assets are put into operation on the same basis as for other property, plant and equipment items. Construction-in-progress is reviewed regularly to determine whether its carrying value is fairly stated and whether appropriate provision for impairment is made.

The gain or loss arising on the disposal of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income statement.

Leases

The Company accounts for the leased property in accordance with the requirements of IAS 17 “Leases”. A lease is classified as a finance lease whenever the terms of the lease transfer all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The present value of future minimum lease payments at the inception of the lease is reflected as an asset and a liability in the balance sheet. Amounts due within one year after the balance sheet date are classified as short-term liabilities and the remaining balance as long-term liabilities.

Leased assets are depreciated over their useful lives as determined in accordance with the accounting policy or over finance lease term, if shorter. If the transfer of ownership by the end of the finance lease term is reasonably certain, the period of depreciation is determined based on the useful life of the asset. If there is a reasonable probability that the assets received under finance lease agreements will be returned upon the end of the lease term, such assets are depreciated over their useful life or the finance lease term, if shorter.

Operating lease payments are recognised as an expense on a straight-line basis over the lease term.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.4 Finite-life intangible assets

Intangible assets are amortised over their useful lives and are reviewed for impairment annually whenever any impairment indicators exist. Amortisation on intangible assets are accumulated from the date they are ready for use and recognised as operating expenses for the period on a straight-line basis during their useful lives.

The Company set the following useful lives for intangible assets:

	<u>Years</u>
Operating licenses	Validity period
Software	3-5
Patents	3-7
Customer bases	2-5
Websites	2-10

Intangible assets acquired in a business combination are identified and recognised separately from goodwill where they satisfy the definition of an intangible asset and their fair values can be measured reliably. The cost of such intangible assets is their fair value at the acquisition date.

Patents and research and development costs

Development costs (for purpose of updating products and processes) are capitalised if products or processes are technically and economically justified and the Company has sufficient resources to accomplish the development. Capitalised costs include costs of raw materials, direct labor costs and appropriate portion of overheads and recognised in the Group’s financial statements at cost less accumulated depreciation and impairment losses as patents.

Research and development costs should be capitalised from the date when the company has opportunity to demonstrate:

- Technical feasibility to finish development of intangible asset and bring it to a usable or saleable condition;
- Intent to finish development of intangible asset and use or sell it;
- Possibility to use or sell the deliverables of development or research;
- Supposed way to make possible profit related to the asset;
- Availability of sufficient technical, financial and other resources necessary to finish the process of development and use or sell an intangible asset;
- Possibility to reliably estimate the costs relating to an intangible asset at the stage of its development.

Other research and development costs are recognised in consolidated income statement when incurred.

3.5 Impairment of long-term non-monetary assets, except for goodwill

At each balance sheet date the management reviews long-term non-monetary assets for indication of impairment. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Impairment loss is recorded if carrying value of asset or cash-generating unit exceeds its recoverable amount. A cash-generating unit represents the smallest group which generates a cash flow relatively independent from the other assets or cash-generating units of the Group. Impairment loss from a cash-generating unit is initially charged to goodwill allocated to this cash-generating unit and then it is allocated proportionally between other assets included in this cash-generating unit. Impairment losses are recognised directly in the consolidated income statement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value, using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which estimates of future cash flows have not been adjusted.

Impairment losses recognised in the prior periods are evaluated at each reporting date to determine any indicators of loss reduction or evidence that there is no loss.

Impairment loss is recovered in case of change in estimations used at determination of recoverable amount. Impairment losses are only recovered to the extent of amount that does not exceed the carrying amount that would have been determined, net of amortisation or depreciation, had no impairment loss been recognised.

3.6 Cash and cash equivalents

Cash and cash equivalents comprise cash balances, cash deposits and highly liquid investments with original maturities of three months or less, that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

3.7 Inventories

Inventories are accounted for at the lower of cost or net realizable value. Cost includes acquisition cost of materials and, if applicable, direct labor costs and appropriate portion of overheads incurred to deliver the inventories to their location and bring them into condition appropriate for further use. The actual cost is determined using weighted average method. Cost of finished goods and work-in-progress includes costs of raw materials, direct labor costs and other direct costs, as well as appropriate portion of production overheads, but does not include interest payable on loans. Net realizable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and transportation.

3.8 Financial assets

Financial assets are recognised and derecognised when the Group has become a party to the contractual arrangement where the acquisition or sale of a financial investment are made in accordance with the contract under which the underlying instrument should be delivered within the timelines established on the respective market and initially measured at fair value less transaction costs that are directly attributable to the deal, except for financial assets classified as financial assets at fair value through profit or loss that are initially measured at fair value.

Financial assets are classified into the following categories:

- At fair value through profit or loss;
- Held-to-maturity;
- Available-for-sale; and
- Loans and receivables.

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Loans and receivables

Trade accounts receivable, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest method less provision for doubtful debt and impairment for loans. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted. For financial assets carried at amortised cost, the amount of the impairment 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 carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of an allowance account. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss. If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

Financial liabilities and equity instruments issued by the Group

Debt and equity financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. An equity instrument is any contract that evidences a residual interest in the assets of an enterprise after deducting all of its liabilities. Equity instruments are measured at the proceeds received, net of direct issue cost.

Financial liabilities of the Group include borrowings, trade and other payables and are initially measured at fair value, net of transaction costs, and subsequently measured at amortised cost using the effective interest method.

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.9 Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax. Income taxes are computed in accordance with the laws of countries where the Group operates.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from the profit reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group’s liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred income tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the assets realised, based on tax rates that have been enacted or substantively enacted by the balance sheet date.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities.

Current and deferred tax are recognised as an expense or income in the consolidated income statement, except when they relate to items recognised directly to the net assets attributable to participants of the Group in which case the tax is also recognised directly in the net assets attributable to participants of the Group or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is taken into account in calculating goodwill or determining the excess of the acquirer’s interest in the net fair value of the acquiree’s identifiable assets, liabilities and contingent liabilities over cost of the business combination.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.10 Provisions for future expenses and payments

Provisions are recognised when the Group has legal or constructive obligations as a result of a past event for which it is highly probable that an outflow of economic benefits will be required to settle the obligation, and the amount of the obligation can be reliably estimated. Major types of provisions presented in the financial statements include provision for tax and legal claims, provision for guarantees, provision for unused vacations.

3.11 Employee benefits

3.11.1 Defined contribution plans

In accordance with current legislation the companies of the Group are legally obliged to make defined contributions to the State Pension Fund of the Russian Federation. The Group’s contributions to the State Pension Fund of the Russian Federation under the defined contribution plans are recognised in the income statement in the period they relate to.

In the Russian Federation all social contributions, including contributions to the Pension Fund, are paid in the form of a unified social tax (“UST”) calculated by the application of a regressive rate from 26% to 2% of the annual gross remuneration of each employee.

UST is allocated to three social funds, including the State Pension Fund of the Russian Federation where the contribution rate varies from 20% to 2% depending on the annual gross remuneration of each employee.

3.11.2 Defined benefit plans

A number of companies of the Group have long-term benefit plans which include payments on retirement and other benefits to their current and former employees. Accrued provisions for employee benefits are recognised in current expenses of the Group included in labour expenses.

For calculation of retirement benefits a number of assumptions are used in regard to current and former employees eligible to benefits related to employee death, turnover, disability and early retirement, as well as the following estimated assumptions: discount rate, level of payroll and other benefits in the future, expected asset profitability.

For defined benefit retirement benefit plans, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at each balance sheet date. Amount of actuarial gains and losses are recognised in total amount in the period in which they occur.

The Group determined a defined benefit plan. Under this plan the retired employees are entitled to receive a one-time allowance, for women – upon reaching 55-year age and for men – 65-year age, in the following amount depending on the length of service in the Group’s subsidiaries:

- less than 3 years – 3 minimum wages;
- 3-5 years – 5 minimum wages;
- 5-10 years – 8 minimum wages;
- 10-15 years – 10 minimum wages;
- 15-20 years – 18 minimum wages;
- 20 years or more – 20 minimum wages.

Moreover, women whose length of service in the Group is over 20 years and men – over 25 years are entitled to receive upon retirement a monthly payment of RUR 300.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.12 Revenue recognition

The Group recognises revenue at the moment when the products are delivered to customers (as property rights are transferred) and includes it in the consolidated financial statements net of VAT, excise and other similar obligatory payments.

Revenue from service rendering is recognised as the Group has rendered service and the customers have accepted the results according to the acceptance act and payment of the related receivables is substantially secured. Revenue is not recognised if there is a substantial uncertainty regarding repayment of amounts payable, related expenses or possibility of goods or services return.

The Group’s revenue consists of the following major types:

- Revenue from sales of pumps and spare parts – sales of pumping equipment used in the heat and nuclear power industry for pumping of oil and oil products, water and steam condensate, multiphase and explosive mixtures, bedded waters, etc.;
- Revenue from sales of oil-field equipment – sale of over fifty types of unit-type equipment used in oil fields;
- Revenue from repairs of oil-field equipment which includes revenue from provision of maintenance services, expert and technical diagnostics and repairs of oil-field equipment.

3.13 Finance income and expenses

Finance expenses include interest payable on loans, finance lease. All interest and other expenses related to loans are recognised as they arise as a part of finance costs.

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Interest on loans is capitalised as a part of asset cost during the period necessary for construction and preparation of asset for operation. Other expenses on loans are recognised in the consolidated income statement.

Transaction costs related to the issue of debt instruments are recognised as a decrease in liabilities and amortized over their period to maturity. Upon repayment of the liability unamortized expenses are charged to the income statement.

Financial income includes interest receivable on deposits and loans issued, dividends and income from transactions related to foreign currency exchange.

4. KEY ACCOUNTING ESTIMATES AND PROFESSIONAL JUDGEMENTS IN ACCOUNTING POLICY APPLICATION

Preparation of these consolidated financial statements in accordance with IFRS requires the Group’s management to make estimates and assumptions that affect the accounting for assets and liabilities and disclosure of contingent liabilities in the financial statements. Estimates and assumptions are subjected to constant critical analysis and are based on the management’s historical experience and other factors including expectations concerning the future, which are considered to be reasonable under the circumstances. Actual results may differ from estimates which in future may be reconsidered both to increase and to decrease. Assumptions and estimates with the most significant impact on the figures included in the financial statements comprise the following:

Income tax

The Group pays income tax in Russia or Ukraine. Determination of income and other tax amounts is subject of significant degree of judgment. There are many transactions for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final outcome of various tax disputes is different from initially reported amounts, the arising difference will have an effect on the amount of income tax and income tax provision in the period in which it is identified.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred asset to be recovered. Estimation of such probability includes judgments based on expected performance. When assessing probability of a deferred tax asset realization in the future, different factors are considered, including operating results of the Group’s activities for the prior reporting periods, the operating plan of the Group, period of possible loss carry forward for tax purposes and tax planning strategy. If actual results differ from such assessment or the assessment is subject to adjustment in future periods this may affect the Group’s financial position, performance and cash flows.

Useful economic lives of property, plant and equipment and intangible assets

Assessment of useful economic life of property, plant and equipment or intangible asset is subject to management’s judgment based on practice of operation of similar property, plant and equipment. When assessing useful life of the asset the management considers expected use, estimated technical obsolescence, physical wear and actual conditions of the asset use. Change in any of these conditions or estimates may lead to adjustment of depreciation charges in future periods.

Impairment of assets

The Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets are impaired. In making the assessment for impairment, assets that do not generate independent cash flows are allocated to an appropriate cash generating unit.

Management necessarily applies its judgment in allocating assets that do not generate independent cash flows to appropriate cash-generating units, and also in estimating the timing and value of underlying cash flows within the value in use calculation. When calculating the cost, future cash flows are estimated based on expected cash flows according to the last available budget data.

Discounted cash flows model requires quite large number of estimates and assumptions regarding the future market growth rates, market demand for products and expected profitability of sales. One of the most material assumptions within the Group’s cash flows model – the assumption that the Russian economy will continue to rapidly grow which will come to an increase in actual income and salary according to the recent years experience.

4. KEY ACCOUNTING ESTIMATES AND PROFESSIONAL JUDGEMENTS IN ACCOUNTING POLICY APPLICATION (continued)

Provision for inventory obsolescence

Provision for inventory obsolescence is calculated at each reporting date, recognised in cost of sales for the reporting period. To calculate provision for inventory obsolescence the inventory which did not move for over 12 months are analyzed by items for purpose of assessment of necessity of such inventories in production in subsequent reporting periods.

Provisions for tax and legal claims

Provisions for tax and legal claims are estimated based on expert assessment by the Group's legal department or outsourced legal companies.

The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently (see Note 31).

Provision for guarantees

The Group recognises the calculated liability amount on repairs or replacement of sold goods which guarantee period has not expired as at the reporting date. This provision is calculated based on statistical data of the Group companies about repairs and replacement of goods for the prior periods. Provision for guarantees is calculated in the end of a reporting period as simple average of actual costs of two prior reporting periods taking into account revenue growth dynamics for the reporting period and based on data on sales of goods and guarantee cases. Changes in the amount of the provision for guarantees are reported in the cost of sales of the Group.

Provision for doubtful receivables

Provision for doubtful receivables are subject to recognition in current expenses of the Group as selling expenses. To calculate the provision for doubtful receivables the probability of debt repayment by counterparty is analyzed at each reporting date based on statistics of the collection of receivables by the Group's companies from third parties and terms and conditions stipulated by delivery agreements.

Provision for doubtful receivables is calculated as follows:

- Doubtful receivables with maturity from 60 up to 180 calendar days from the day when it arose shall be provided by 25% of debt amount under particular agreement;
- Doubtful receivables with maturity from 181 up to 365 days from the day when it arose shall be provided by 50% of debt amount under particular agreement;
- Doubtful receivables with maturity of 366 days and more from the day when it arose shall be provided by 100% of debt amount under particular agreement.

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5. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Group has adopted all of the issued by the IASB and the IFRIC of the IASB new and revised Standards and Interpretations that are relevant to its financial statements for the year ended 31 December 2006.

Adoption of new Standards and Interpretations did not have material effect on the Group’s financial position and performance, however, adoption of new Standards gave rise to additional disclosures.

At the date of authorization of these financial statements, the following new and revised Standards and Interpretations were issued.

New or revised Standards and Interpretations	Effective for annual financial periods beginning on or after
IFRS 7 “Financial Instruments: Disclosures”	1 January 2007
IAS 23 (revised) “Borrowing Costs”	1 January 2009
IFRS 3 (revised) “Business Combinations”	1 January 2009
IFRS 8 “Operating Segments”	1 January 2009
Amendments to IAS 1 “Presentation of Financial Statements”	1 January 2009
Amendments to IAS 23 “Borrowing Costs”	1 January 2009
Amendments to IAS 27 “Consolidated and Separate Financial Statements”	1 July 2009
Amendments to IAS 28 “Investments in Associates”	1 July 2009
Amendments to IAS 31 “Interests in Joint Ventures”	1 July 2009
Amendment to IAS 32 “Financial Instruments: Presentation”	1 January 2009
Amendments to IAS 2 “Share-based payments”	1 January 2009
Amendments to IFRS 3 “Business Combinations”	1 July 2009
IFRIC Interpretation 11, “IFRS 2: Group and Treasury Share Transactions”	1 March 2007
IFRIC Interpretation 12, “Service Concession Arrangements”	1 January 2008
IFRIC Interpretation 13, “Customer Loyalty Programmes”	1 July 2008
IFRIC Interpretation 14 (an interpretation of IAS 19), “The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction”	1 January 2008
IFRIC Interpretation 15 “Real Estate Construction Contracts”	1 January 2009
IFRIC Interpretation 16 “Hedge of currency risk arising through investments into foreign subsidiaries, associates, branches or joint ventures”	1 October 2008

The Group did not apply these Standards and Interpretations to the consolidated financial statements for 2006. Currently the management assesses the effect of adoption of these Standards and Interpretations on the financial statements for the subsequent periods.

6. RESTATEMENT

The Group’s management decided to adjust the opening balance as at 1 January 2006 due to fundamental errors found in the prior financial statements and resulted from improper recognition of the Group establishment process and errors in accounting estimates and professional judgments used.

Correction of errors related to the formation of the Group

The following companies were not consolidated in the consolidated financial statements for the year ended 31 December 2005: LLC Management company “Hydraulic Machines and Systems”, LLC Neftemash-Service and LLC Agrofirma “Step”.

As a result of the above companies inclusion in the Group’s consolidated financial statements as at 1 January 2006, changes were made in certain items of the Group’s consolidated balance sheet, in particular:

- Cash and cash equivalents were increased by RUR 5 382 thousand;
- Trade accounts receivable were increased by RUR 12 731 thousand;
- Inventories were increased by RUR 11 945 thousand;

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- Carrying value of fixed assets was increased by RUR 8 086 thousand;
- Accounts payable and accrued liabilities were increased by RUR 27 689 thousand;
- Provision for doubtful receivables was increased by RUR 2 413 thousand.

On 29 February 2005, the Group acquired additional 1 515 000 shares (4.9%) in OJSC Nasosenergomash. This acquisition was not recorded in the consolidated financial statements for the year ended 31 December 2005.

Correction of accounting estimates and professional judgments used

Due to discrepancy of accounting estimates used for preparation of the Group’s 2005 financial statements the management had to revise and correct them properly at 1 January 2006. In particular, improperly used estimates were corrected for the following calculations:

- (1) Provision for doubtful accounts receivable;
- (2) Provision for unused vacation;
- (3) Other provisions.

As a result of this recalculation the accounts payable increased by RUR 5 840 thousand.

Provision for unused vacations was reclassified from other long-term provisions into trade accounts payable in the amount of RUR 3 312 thousand.

As a result of correction of an error with regard to accounting for finished goods in OJSC Livnynasos, the Group’s inventories increased by RUR 22 168 thousand at 1 January 2006.

At 31 December 2005 the Group used incorrect data on fair value of property, plant and equipment of OJSC Livhydomash stated in the independent appraiser’s report and used for purpose of transition to IFRS 1. As a result of correction the carrying value of property, plant and equipment decreased by RUR 92 054 thousand. Moreover, the carrying value of property, plant and equipment was decreased by RUR 32 234 thousand due to technical error made in calculation of their depreciation.

During the preparation of the 2006 financial statements there were revealed financial leases of OJSC Neftemash which were not accounted for in the 2005 financial statements. As a result of correction of this error as at 1 January 2006 the carrying value of fixed assets was increased by RUR 4 168 thousand, the carrying value of long-term financial lease liabilities was increased by RUR 1 130 thousand and the carrying value of short-term financial lease liabilities was increased by RUR 2 669 thousand.

As a result of correction of technical errors regarded to incorrectly calculated depreciation timeline the cost of intangible assets was increased by RUR 1 086 thousand as at 1 January 2006.

During the preparation of the financial statements for the year ended 31 December 2006 the Group indicated an application of defined benefit plans at OJSC Neftemash, OJSC Livnynasos, OJSC Nasosenergomash. Recognised long-term liability was reported at 1 January 2006 as a correction in the amount of RUR 72 663 thousand included in other provisions.

In the Group’s consolidated financial statements for 2005 effective ownership interests in a number of companies of the Group were calculated wrongly. Share capital of the following companies includes preferred shares: OJSC Neftemash, OJSC Electrodivigatel, OJSC Livhydomash, OJSC Livnynasos. As a result of this error following items of the Group’s consolidated financial statements were recognised mistakenly: minority interest and retained earnings. As a result of correction of errors in calculation of minority interest at 1 January 2006 it was increased by RUR 303 150 thousand.

Tax implications of correction of the above mentioned fundamental errors led to a decrease in net deferred tax liability by RUR 29 940 thousand.

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6. RESTATEMENT (continued)

Effect of restatements at 1 January 2006 is as follows:

	1 January 2006 (as previously stated)	Adjustments	1 January 2006 (restated)
Assets			
Non-current assets			
Property, plant and equipment	1 240 355	(112 034)	1 128 321
Intangible assets	19 821	1 086	20 907
Deferred tax assets	10 729	(465)	10 264
Other non-current assets	2 014	461	2 475
	1 272 919	(110 952)	1 161 967
Current assets			
Cash and cash equivalents	140 063	5 382	145 445
Inventories	1 037 519	34 113	1 071 632
Trade accounts receivables	276 438	2 457	278 895
Taxes receivable	147 761	4 428	152 189
Other receivables	462 149	8 259	470 408
Other current assets	2 904	26	2 930
	2 066 834	54 665	2 121 499
Total assets	3 339 753	(56 287)	3 283 466
Equity and liabilities			
Minority interest	136 130	281 690	417 820
Net assets attributable to the participants of the Company	1 674 843	(416 336)	1 258 507
Non-current liabilities			
Long-term borrowings	177 879	(2 924)	174 955
Long-term finance lease liabilities	-	1 130	1 130
Deferred tax liabilities	140 404	(29 475)	110 929
Retirement benefit obligations	-	72 663	72 663
Other provisions	6 836	(3 311)	3 525
	325 119	38 083	363 202
Current liabilities			
Short-term borrowings	518 178	567	518 745
Finance lease obligations	-	2 669	2 669
Trade accounts payable	631 098	33 519	664 617
Taxes payable	54 385	3 521	57 906
	1 203 661	40 276	1 243 937
Total liabilities	1 528 780	78 359	1 607 139
Total equity and liabilities	3 339 753	(56 287)	3 283 466

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7. PROPERTY, PLANT AND EQUIPMENT

	Buildings and Land constructions	Machinery and equipment	Motor vehicles	Other	Construction in progress	TOTAL	
Cost							
At 1 January 2006	75 458	601 925	409 332	68 515	91 325	26 588	1 273 143
Movement:							
Acquisition of subsidiaries	4 127	454 009	217 783	15 864	13 267	39 320	744 370
Additions	-	12 389	32 487	3 673	7 528	153 857	209 934
Transfers	3 008	33 566	53 130	15 925	17 007	(122 636)	-
Disposals	(983)	(6 884)	(8 331)	(7 936)	(3 243)	(9 663)	(37 040)
At 31 December 2006	81 610	1 095 005	704 401	96 041	125 884	87 466	2 190 407
Accumulated depreciation							
At 1 January 2006	-	(32 547)	(75 043)	(14 752)	(22 480)	-	(144 822)
Movement:							
Depreciation for the period	-	(28 331)	(73 327)	(13 587)	(17 586)	-	(132 831)
Disposals	-	6 809	4 616	3 142	1 511	-	16 078
At 31 December 2006	-	(54 069)	(143 754)	(25 197)	(38 555)	-	(261 575)
Net book value							
At 1 January 2006	75 458	569 378	334 289	53 763	68 845	26 588	1 128 321
At 31 December 2006	81 610	1 040 936	560 647	70 844	87 329	87 466	1 928 832

At 31 December 2006, the Group’s property, plant and equipment in the amount of RUR 118 838 thousand were pledged as security for the respective loan agreements (refer to Note 15).

The Group leases production equipment under finance lease agreements. At 31 December 2006, the net carrying value of leased equipment was RUR 11 080 thousand.

At 31 December 2006, construction in progress includes advances on capital expenditures in the amount of RUR 29 326 thousand.

Property, plant and equipment of the subsidiaries acquired were valued at the fair value without determination of accumulated depreciation at the date of acquisition.

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8. INTANGIBLE ASSETS

	Patents	Operating licenses	Software	Customer bases	Websites	TOTAL
Cost						
At 1 January 2006	21 870	4 710	2 310	-	9	28 899
Movement for the period:						
Acquisition of subsidiaries	-	1 435	83	52 980	26	54 524
Additions	4 120	407	2 341	-	-	6 868
Disposals	(7 436)	(855)	(484)	-	(9)	(8 784)
At 31 December 2006	18 554	5 697	4 250	52 980	26	81 507
Accumulated depreciation						
At 1 January 2006	(5 504)	(1 951)	(537)	-	-	(7 992)
Movement for the period:						
Amortisation for the period	(4 697)	(1 073)	(704)	-	-	(6 474)
Disposals	3 442	340	484	-	-	4 266
At 31 December 2006	(6 759)	(2 684)	(757)	-	-	(10 200)
Net book value						
At 1 January 2006	16 366	2 759	1 773	-	9	20 907
At 31 December 2006	11 795	3 013	3 493	52 980	26	71 307

Intangible assets of the subsidiaries acquired are carried at their fair values at the respective acquisition dates.

9. ACQUISITION OF SUBSIDIARIES

During 2006 the Group acquired shares in the following subsidiaries:

Name	Type of operation	Date of acquisition	Share of ownership
OJSC TH Sumskie nasosy	Commission wholesale and retail	30 June 2006	83%
CJSC Nizhnevartovskremsservice	Oil-field equipment repair services	1 September 2006	100%
OJSC Tomskgazstroy	Construction and assembling operations	29 December 2006	23%

In June 2006, the Group acquired 83% share of OJSC TH Sumskie nasosy. The consideration amounted to RUR 103 thousand and it was paid in cash. The principal activities of this Company include commission sale to the third parties of OJSC Nasosenergomash’s products. OJSC TH Sumskie nasosy is located in the Sumy (Ukraine).

In September 2006 the Group acquired the 100% share of CJSC Nizhnevartovskremsservice. The consideration amounted to RUR 200,110 thousand and it was paid in cash. As a result of the transaction the excess of the Group’s share in the fair value of net assets over the purchase price as at the date of acquisition was recognised in the income statement in the amount of RUR 40 452 thousand. CJSC Nizhnevartovskremsservice was acquired with the view of development and extension of the Group’s business line “Oil and gas equipment”. CJSC Nizhnevartovskremsservice specializes in providing oil-field equipment repair services. The operations are conducted in Nizhnevartovsk.

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9. ACQUISITION OF SUBSIDIARIES (continued)

During October-November 2006, the Group acquired from the third parties the stakes of OJSC Tomskgazstroy. 23% share was acquired. The total consideration amounted to RUR 87,166 thousand and it was paid in cash. For acquisition of 28% share the advance payment was made (Note 33). At 29 December 2006, the Group obtained control over the company. At 31 December 2006, this company was accounted for using the purchase method. As a result of this transaction the goodwill in the amount of RUR 16 674 thousand was recognised. OJSC Tomskgazstroy was acquired with the view of development and extension of the Group’s business line “Oil and gas engineering”. OJSC Tomskgazstroy specializes in construction and assembly works at the oil fields and conducts its operations in Tomsk and in Strezhevoy of the Tomsk region.

For the period from the date of acquisition to 31 December 2006 the revenue of acquired companies amounted to RUR 264 371 thousand and profit before tax – RUR 18 574 thousand.

The calculated amount of goodwill recognised on acquisition of subsidiaries was as follows:

At 1 January 2006	-
Recognised on acquisition of OJSC Tomskgazstroy	16 674
Recognised on acquisition of OJSC TH Sumskie nasosy	83
As at 31 December 2006	16 757

	Fair value at the date of acquisition			TOTAL
	CJSC Nizhnevartovsk remservice	OJSC Tomskgazstroy	OJSC TH Sumskie nasosy	
Assets				
Non-current assets				
Property, plant and equipment	385 182	359 163	25	744 370
Intangible assets	1 154	53 350	20	54 524
Deferred tax assets	-	-	50	50
Other non-current assets	117	292	-	409
	386 453	412 805	95	799 353
Current assets				
Cash and cash equivalents	4 558	9 431	1 026	15 015
Inventories	37 627	76 476	1	114 104
Trade accounts receivables	70 885	357 461	5 404	433 750
Taxes receivable	4 739	-	335	5 074
Other receivables	9 042	1 136	6 802	16 980
	126 851	444 504	13 568	584 923
Total assets	513 304	857 309	13 663	1 384 276

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9. ACQUISITION OF SUBSIDIARIES (continued)

	Fair value as of the date of acquisition			TOTAL
	CJSC	OJSC	OJSC TH	
	Nizhnevartovsk -remservice	Tomskgazstroy	Sumskie nasosy	
Liabilities				
Non-current liabilities				
Deferred tax liabilities	(70 561)	(58 773)	-	(129 334)
Other provisions	(4 058)	-	-	(4 058)
	(74 619)	(58 773)	-	(133 392)
Current liabilities				
Short-term borrowings	-	(34 986)	-	(34 986)
Trade accounts payable	(154 083)	(433 670)	(5 428)	(593 181)
Taxes payable	(7 700)	(11 160)	(576)	(19 436)
Other payables	(36 311)	(5 886)	(7 635)	(49 832)
	(198 094)	(485 702)	(13 639)	(697 435)
Total liabilities	(272 713)	(544 475)	(13 639)	(830 827)
Net assets	240 591	312 834	24	553 449
Goodwill	-	16 674	83	16 757
Excess of the Group’s share in the fair value of acquired net assets over the purchase price	(40 452)	-	-	(40 452)
Minority interest	(28)	(242 342)	(4)	(242 374)
Acquisition cost	200 111	87 166	103	287 380
Cash and cash equivalents acquired	4 558	9 431	1 026	15 015
Net cash outflow on acquisition	195 553	77 735	(923)	272 365

Before acquisition date the acquired companies did not prepare their financial statements in accordance with IFRS. The Group considered impracticable to determine the carrying values of the acquired assets, liabilities and contingent liabilities in accordance with IFRS immediately after their acquisition, therefore this information is not presented in these consolidated financial statements.

The increase of ownership interest in subsidiaries in 2006

In March 2006, the Group acquired from the third party 7% of shares in OJSC Nasosenergomash. The consideration amounted to RUR 10 773 thousand and it was paid in cash. As a result of this transaction the Group increased its share in OJSC Nasosenergomash’s share capital from 76% to 83%, thus having decreased the minority interest by RUR 32 642 thousand. As a result of transaction excess of the share in the acquiree net assets at the acquisition date over the purchase price was RUR 21 869 thousand. The result from transaction is recognised directly as a change in net assets attributable to the participants of the Group.

In May 2006, OJSC Electrodivigatel increased its share capital by RUR 2 000 thousand through issuing of 200 thousand of preference shares with the nominal value of RUR 10 each. Preference shares were sold to related parties (ultimate beneficiaries of the Group). As a result the effective interest owned by the Group decreased from 75% to 57% and minority interest increased for the amount of RUR 11 682 thousand.

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9. ACQUISITION OF SUBSIDIARIES (continued)

Redistribution of ownership interest in the Group subsidiary in 2006

In October 2006, the shares of LLC Management company "Hydraulic Machines and Systems" were redistributed among the companies of the Group as follows:

- CJSC Hydromashservice – 19%;
- OJSC Elektrodvigatel – 13%;
- OJSC Livhydromash – 19%;
- OJSC Neftemash – 19%;
- OJSC Livnynasos – 19%;
- CJSC Nizhnevartovskremsservice – 11%.

As a result of this redistribution of ownership interest of LLC Management company "Hydraulic Machines and Systems" among the Group subsidiaries the minority interest was increased by RUR 3 498 thousand.

10. CASH AND CASH EQUIVALENTS

	31 December 2006
Current accounts in rubles	109 770
Foreign currency accounts	17 460
Cash on hand	327
Restricted cash	200
Short-term bank deposits	14 825
	142 582

At 31 December 2006, the short-term deposit balance includes short-term deposit on demand in the amount of RUR 10,500 thousand (maturity date is 6 February 2007) opened in OJSC Etalonbank, and short-term deposit on demand in the amount RUR 4,000 thousand with a minimum balance of RUR 200 thousand placed in Orel branch of the bank OJSC MInB. The weighted average interest rate on these deposits is 3% per annum. Other deposits are RUR 325 thousand.

11. INVENTORIES

	31 December 2006
Raw materials and spare parts	549 281
Work-in-progress	268 998
Finished goods	232 423
Goods for resale	137 102
Other inventory	4 552
Obsolescence provision	(9 018)
	1 183 338

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12. TRADE ACCOUNTS RECEIVABLE

	31 December 2006
Trade accounts receivable	849 450
Provision for doubtful trade accounts receivable	(23 036)
	826 414

Current trade accounts receivable include trade receivables for the goods shipped and services rendered. These receivables are highly liquid as contractual terms of payment for completed deals are from 30 to 60 calendar days.

13. TAXES RECEIVABLE

	31 December 2006
Value added tax	173 143
Income tax	16 768
Property tax	10 165
Unified social tax	2 906
	202 982

At 31 December 2006, taxes receivable include VAT related to advances received from customers. VAT was reimbursed upon sales of goods, work and services in 2007, as well as VAT related to export contracts. VAT related to export contracts decreased VAT payable to the budget upon confirmation by tax authorities in 2007.

14. OTHER RECEIVABLES

	31 December 2006
Advances to suppliers	350 700
Other current accounts receivable	334 041
Prepaid expenses	6 906
Short-term loans given	6 681
Promissory notes receivable	1 370
Provision for doubtful other receivables	(36 735)
	662 963

Included in other current accounts receivable are advances paid for shares of OJSC Tomskgazstroy, OJSC VNIIAEN in the amount of RUR 197 338 thousand (see Note 33).

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15. LONG-TERM AND SHORT-TERM BORROWINGS

	Currency	Maturity date	31 December 2006
Long-term loan			
Bonds	Russian Ruble	November 2008	1 034 753
			1 034 753
Less: current portion of bonds			(87 166)
			947 587

Bond maturity profile

From one to two years	947 587
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Bonds are secured by the guarantees from the Group's companies (OJSC Livhydmash, OJSC Livnynasos, OJSC Neftemash, CJSC Hydromashinprom) and are stated at amortized cost using the effective interest rate of 10.13 %.

	Interest rate	Currency	31 December 2006
Short-term unsecured bank loans:			
AKIB UkrSibbank	11%	USD	65 678
CJSC NOMOS-BANK	11%	USD	47 396
CJSC NOMOS-BANK	11%	USD	22 867
AKIB UkrSibbank	15-16%	Ukrainian hryvna	20 237
Department of Science and Industrial Policy of Moscow	3%	Russian Ruble	19 848
OJSC VTB Bank, North West	11-12%	Russian Ruble	15 000
CJSC First Ukrainian International Bank	12%	USD	13 935
AKIB UkrSibbank	17%	Russian Ruble	8 265
SOD APPB AVAL	16%	Ukrainian hryvna	7 830
AKIB UkrSibbank	11%	EURO	7 042
Other	15%	Ukrainian hryvna	2 607
OJSB CB AGROIMPULSE	12%	Russian Ruble	392
			231 097
Short-term secured bank loans:			
OJSC ZapSibcombank	10-11%	Russian Ruble	37 715
			268 812
Current portion of long-term loan			87 166
Interest accrued on short-term bank loans and borrowings			831
			356 809

OJSC ZapSibcombank's loans are secured by the pledge of Group's property, plant and equipment in the amount of RUR 118 838 thousand.

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Notes to consolidated financial statements for the year ended 31 December 2006

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15. LONG-TERM AND SHORT-TERM BORROWINGS (continued)

Weighted average effective interest rates on short-term bank loans at the balance sheet date are presented below:

	Interest rate	Amount
RUR-denominated short-term loans	9%	81 221
USD-denominated short-term loans	11%	149 876
EURO-denominated short-term loans	11%	7 042
Ukrainian hryvna-denominated short-term loans	16%	30 673
		268 812

The Group has no loans that could have been converted into the Group’s equity instruments.

The Group did not hedge its currency risk or interest rate risk.

16. RETIREMENT BENEFIT OBLIGATIONS

The employees of the Group are provided with additional fixed payments upon their retirement (defined benefit plan). The last actuarial valuation of the post-retirement defined benefit plan was performed as at 31 December 2006. The current value of the defined benefit obligations and the current value of services were estimated using the projected unit credit method. This method requires the costs to be stated within the financial statements in a way that the total amount of costs for funding retirement benefits is to be distributed among all the employment periods in accordance with the payments terms. The payments are fixed or depend upon certain parameters, including the employees' salary and length of period of working for the Group.

In addition, the Group has some long-term employee benefit obligations that are close in nature to defined benefit plans, in particular a death benefit and lump sum payments upon retirement as well as benefits related to jubilee length of service or anniversaries.

The following assumptions were used in actuarial valuation as at 31 December 2006:

Discount rate	6.8%
Estimated level of the annual increase of retirement payments	5%
Estimated level of the annual increase of other benefits to employees	8%
Annual ratio of employee turnover	8%

The consolidated income statement includes the following amounts under the defined benefit plan:

	Year ended 31 December 2006
Current service cost	17 272
Interest expense	1 208
Actuarial gains recognised during the year	(321)
	18 159

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16. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

Costs recognised under the defined benefit plan were included into the cost of sales.

The present value of the defined benefit obligations as at 1 January 2006	72 663
Current service cost	17 272
Interest expense	1 208
Actuarial gains	(321)
Payment of employee benefits	(530)
The present value of the defined benefit obligations at 31 December 2006	90 292

The Group has no plan assets.

17. FINANCE LEASE

Long-term and short-term obligations under finance leases as at 31 December 2006 are stated at present value of minimum lease payments:

	Minimum lease payments	Present value of minimum lease payments
Payable under finance lease:		
Within 12 months after the balance sheet date	4 784	4 262
From two to five years	2 601	1 836
Total	7 385	6 098
Less: future interest charges	(1 287)	-
Present value of obligations under finance leases	6 098	6 098
Short-term obligations under finance leases		4 262
Long-term finance lease obligations		1 836

18. OTHER PROVISIONS

Provision for guarantees	2 839
Other provisions	2 342
	5 181

19. TAXES PAYABLE

Value added tax	24 268
Income tax	9 524
Personal income tax	14 418
Unified social tax	22 556
Property tax	421
Other taxes	5 016
	76 203

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20. OTHER PAYABLES

Advances received from customers	419 179
Wages and salaries	68 906
Provision for unused vacations	32 470
Other accounts payable	117 167
	637 722

21. CHARTER CAPITAL

As 31 December 2006, the Company’s charter capital amounted to RUR 218 080 thousand.

In accordance with the legislation of the Russian Federation a limited liability company must reimburse the stockholder having applied for leaving the Company the actual value of his stake or give him property of the same value during six months from the end of financial year during which an application on leaving the Company was filed. This leads to recognition within financial statements the Company’s obligation independently of the stakeholder’s intention to exercise his right for leaving the Company and claim his stake. In compliance with International Financial Reporting Standards (“IFRS”) the obligation is recognised within the financial statements in the amount of the Company’s net assets.

During 2006, dividends were accrued and paid to the shareholders of the Group’s subsidiaries in the amount of RUR 161 561 thousand.

22. INCOME TAX

The Group’s income tax expense in 2006 was as follows:

Current tax	187 550
Deferred tax	(21 014)
Income tax expense	166 536

The profit before income tax recognised within the financial statements is compared with the amount of income tax as follows:

Profit before income tax	565 826
Income tax expense at the statutory tax rate (24%)	(135 798)
Effect from the application of income tax rates required by the Ukrainian legislation	(357)
Tax effect of non-deductible items and other permanent differences:	
Social expenses not deductible for tax purposes	(9 765)
Depreciation of property, plant and equipment not deductible for tax purposes	(2 501)
Other expenses not deductible for tax purposes	(18 115)
Income tax expense	(166 536)

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Differences between IFRS, Russian and Ukrainian tax legislation give rise to temporary differences between the book value of certain assets and liabilities for financial reporting and tax purposes. The tax effects of temporary differences are recognised at the rates of 24% and 25% respectively.

	31 December 2006	Recognised in the income statement	Deferred income tax resulting from acquisition of subsidiaries	1 January 2006
Deferred tax liabilities				
Property, plant and equipment	(246 186)	14 217	(131 184)	(129 219)
Intangible assets	(2 249)	192	(267)	(2 174)
Other current assets	(3 660)	(3 636)	-	(24)
Long-term loan	(1 141)	(439)	-	(702)
	(253 236)	10 334	(131 451)	(132 119)
Deferred tax assets				
Inventories	8 064	(1 530)	-	9 594
Trade accounts receivable	27 493	9 302	2 118	16 073
Other current assets	2 209	1 496	-	713
Short-term borrowings	702	(471)	-	1 173
Trade accounts payable	5 301	3 162	-	2 139
Taxes payable	-	(1 018)	-	1 018
Other payables	532	(261)	49	744
	44 301	10 680	2 167	31 454
Total net deferred tax liability	(208 935)	21 014	(129 284)	(100 665)
Total deferred assets	15 473	-	-	10 264
Total deferred tax liabilities	(224 408)	-	-	(110 929)

According to the Tax Code of the Russian Federation tax losses and prepaid income tax overpayment of some companies cannot be offset against income tax payable and taxable profits of other companies. Thus, deferred tax assets and liabilities of different companies of the Group can not be offset.

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23. REVENUE

Revenue from sales of pumps and spare parts	
Export	441 286
Ukraine	13 577
Russian Federation	3 974 814
	4 429 677
Revenue from sale of oil-field equipment	
Export	64 412
Russian Federation	1 700 291
	1 764 703
Revenue from repairs of oil-field equipment	
Export	
Russian Federation	213 572
	213 572
Other sales revenue	
Export	5 387
Russian Federation	193 770
	199 157
Revenue from the provision of other services	
Export	24 566
Russian Federation	91 938
	116 504
Total	6 723 613

24. COST OF SALES

Raw materials	2 363 762
Cost of goods for resale	1 664 887
Labour expenses	810 632
Depreciation of property, plant and equipment and amortisation of intangible assets	110 136
Research and development expenses	19 861
Change in provision for obsolete inventory	(16 589)
Other expenses	295 467
Total	5 248 156

25. SELLING AND TRANSPORTATION EXPENSES

Transportation expenses	74 600
Labour expenses	56 836
Insurance	24 092
Advertising	17 098
Agency services	16 704
Rent	15 180
Change in provision for doubtful receivables	11 862
Representative and business trip expenses	8 983
Depreciation of property, plant and equipment and amortisation of intangible assets	8 439
Packaging costs	4 941
Maintenance and repair of fixed assets	2 357
Custom duties	2 337
Product Certification	1 610
Other expenses	24 209
Total	269 248

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26. ADMINISTRATIVE EXPENSES

Labour expenses	317 269
Maintenance and repair of property, plant and equipment	44 057
Taxes and duties	23 936
Material expenses	22 238
Rent	21 462
Depreciation of property, plant and equipment and intangible assets	20 730
Bank charges	16 508
Security	15 426
Professional services fees	12 565
Insurance	12 277
Representative and business trip expenses	11 922
Communication expense	4 573
Recruitment	3 152
Other expenses	35 138
Total	561 253

27. OTHER OPERATING EXPENSES, NET

Gain on sales and other disposal of property, plant and equipment and intangible assets	22 588
Income on disposal of inventory	22 430
Contractual penalties	(3 212)
Charity and social expenditures	(60 309)
Other expenses	(161)
Total	(18 664)

28. FINANCE COSTS

Foreign exchange gain	16 014
Interest expense	(114 347)
Finance lease expense	(2 569)
Other expenses	(2 847)
Total	(103 749)

29. MINORITY INTEREST

	Notes	
At 1 January 2006		136 130
Adjustments to the opening balance	6	281 690
At 1 January 2006 (restated)		417 820
Change in cumulative translation reserve		(1 613)
Additional issue of subsidiary's shares to the Group's beneficiaries	9	11 682
Acquisition of subsidiaries	9	242 374
Acquisition of minority interest in the subsidiary	9	(32 642)
Acquisition of MC HMS interest by the Group's subsidiaries	9	3 498
Distribution to shareholders	21	(45 292)
Share of profit for the year attributable to minority shareholders		91 430
At 31 December 2006		687 257

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30. 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 or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 “Related Party Disclosures”. In considering related party relationship, attention is focused on the substance of the relationship.

Related parties may enter into transactions which would not be possible between unrelated parties. Transactions between related parties may not be effected with the same terms, conditions and amounts as transactions between unrelated parties.

At 31 December 2006, the amounts of accounts receivable from and payable to related parties were RUR 1 007 thousand and RUR 10 399 thousand respectively.

There was no provision for related party doubtful receivables.

None of the parties was provided with guarantees to secure accounts receivable and payable.

Income (expense) on related party transactions:

Revenue from goods and finished goods	1 848
Revenue from services	2 638
Purchase of goods	(76 142)
Purchase of services	(5 228)

In 2006, the companies of the Group purchased spare parts for the amount of RUR 76 142 thousand and rent services for the amount of RUR 5 228 thousand from other related parties at market prices.

Remuneration paid to members of the Board of directors

For 2006, the Group paid salaries and bonuses to six Directors of the Group in the amount of RUR 61 213 thousand. Salaries and bonuses paid to the Group management are stipulated by the terms of employment contracts concluded annually.

31. COMMITMENTS, CONTINGENT LIABILITIES AND OPERATING RISKS

Terms of business activities

The Russian Federation and Ukraine are undergoing substantial political and economic changes which affected in the past and will continue to affect in the future the operations of the companies conducting their activities within these business and economic environment. Thus, business operations in Russia and the Ukraine are associated with the risks which are not typical to other markets.

These consolidated financial statements reflect the management estimates with respect to possible impact of the existing in the Russian Federation and Ukraine business environment on the Group’s results of operations and financial position. Potential impact of the future business environment may differ from the management estimates.

The operations and earnings of the Group continue, from time to time and in varying degrees, to be affected by political, legislative, fiscal and regulatory developments, including those related to environmental protection, in Russia and the Ukraine. Taking into consideration the raw material intensive industry nature the Group is exposed to different types of risks of physical damage. The nature and frequency of the events related to these risks likewise their impact upon the Group’s future operations and earnings are not predictable.

32. COMMITMENTS, CONTINGENT LIABILITIES AND OPERATING RISKS (continued)

Taxation (Tax contingencies)

Russian and Ukrainian tax, currency and customs legislation is subject to varying interpretations and frequent changes. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant state authorities. Over the recent years the tax authorities are taking a more active position in their interpretation and application of the tax legislation. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the tax authorities in respect of taxes for the three calendar years proceeding the year of tax review. Under certain circumstances fiscal periods remain open to review by the tax authorities for a longer period.

While management believes that it has adequately provided for tax liabilities based on its interpretation of current and previous legislation, the risk remains that tax authorities could take differing positions with regard to interpretive issues. This uncertainty may expose the Group to additional taxation, fines and penalties that could be significant. Management of the Group believes that the possible tax risks exposure for which the Group did not create any provisions as at the balance sheet date is not material.

Litigation

The Group is a party to a number of claims and litigations arising in the ordinary course of business. Management believes that none of these claims and litigations will have a material adverse effect on the activity or on financial position of the Group.

Insurance

The insurance industry in the Russian Federation and Ukraine is in a developing state. Part of the Group's productive fixed assets has adequate insurance coverage. The Group does not have full coverage for business interruption, or for third party liabilities in respect of property or environmental damage arising from accidents on the Group's property or relating to the Group's operations. Before the Group receives adequate insurance coverage there is a risk that the losses incurred and damage caused to property may significantly affect the Group's financial position and operations.

Environmental matters

Group's activities are governed by a number of legislative acts on environmental protection issued by different state authorities and regulating the utilization, storage and disposal of some of the Group's products.

The Group updates its estimates of liabilities with respect to environmental matters to comply with the changes in the legislation.

As soon as the Group's liabilities are determined the provision will be created during the relevant assets' remaining useful life or will be accrued immediately based on their nature. In view of the possible changes in environmental legislation, the estimates of total liabilities with respect environmental matters can not be reliably determined at the moment. Under the existing environmental legislation the management believes that the Group has no significant unrecorded liabilities in consolidated financial statements in respect of environmental protection that could have adverse effect on the Group's financial position or results of operations.

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32. FINANCIAL RISKS

As a result of its activities the Group is exposed to a number of financial risks including the risks of changes in interest rates, fluctuations in foreign currency exchange rates and capital adequacy.

Currency risk

The Group is involved in export of the pump equipment and is exposed to currency risk as a result of fluctuations in foreign currency exchange rates, mainly USD.

The change of the functional currency rate by 10% in relation to USD exchange rate may lead to the change in the Groups financial result by RUR 10 700 thousand.

The foreign exchange risk of the Group is increased resulted from the fact that all the expenses are denominated in rubles and part of income – in foreign currency. The Group did not enter any hedging agreements with the view to reduce its currency risk with respect to the Group’s transactions.

Interest rate risk

Sales revenue and cash flows from Group’s operations are mainly not dependent on the changes of the market interest rates. The Group is exposed to interest rate risk due to fluctuations of the interest rates with respect to long-term borrowings. With respect to the majority of long-term borrowings the interest rates are fixed (Note 15). The Group does not have significant interest bearing assets.

Credit risk

The major financial instrument subject to credit risk of the Group are accounts receivable. Credit risks are regularly assessed and included into calculation of provision for doubtful debt.

The total receivables with regard to ten major debtors at 31 December 2006 were 24% of the total trade accounts receivable which is an evidence of high credit risk concentration. Although the repayment of receivables may be affected by different economic factors, the management believes that the provision for doubtful debt is adequate to compensate the possible losses related to failure to repay the doubtful debt.

Fair value of financial instruments

The fair value of the Group’s bonds disclosed in Note 15 is determined on the basis of market quotes and was RUR 969 000 thousand at the balance sheet date. The fair value of the rest of financial instruments is approximately equal to their carrying value as these are short-term instruments.

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33. EVENTS AFTER THE BALANCE SHEET DATE

The Group’s management made a decision to reorganize Limited Liability Company “Investment and Industrial Group “Hydraulic Machines and Systems” into Open Joint-Stock Company with abbreviated name OJSC “HMS Group” which was recorded in the minutes #28 dated 1 July 2008 of LLC “Investment and Industrial Group “Hydraulic Machines and Systems” extraordinary participant meeting. The shares of LLC “Investment and Industrial Group “Hydraulic Machines and Systems” participants in the amount of RUR 591 180 thousand were exchanged for 1 182 361 300 ordinary shares with nominal value of RUR 0.5 each, the participants’ ownership interest have not changed.

During 2007-2008 the Group entered into a number of transactions on acquisition of ownership interest in a number of companies:

Name of the company	Ownership interest acquired, %	Consideration paid, RUR thousand	Acquisition date
OJSC Sibservice (including the interest in OJSC Trest Sibkomplektmontazhnaladka – 25%)	100%	380 227	July 2007
OJSC Trest Sibkomplektmontazhnaladka	72%	69 220	July 2007
OJSC Dimitrovgradkhimmash	30%	214 421	September 2007
OJSC Zavod Proburvod	40%	28 697	September 2007
OJSC Neftemash	16 % ⁽¹⁾	8 869	June-September 2007
OJSC Tomskgazstroy	28%	56 767	November 2007
OJSC VNIAEN	47%	155 238	November 2007
OJSC Trest Sibkomplektmontazhnaladka	1%	1 419	February 2008
OJDC IPF Sibnefteavtomatika	30%	50 850	March 2008
OJSC Hydromash Industriya	100%	10 324	March 2008
OJSC Tomskgazstroy	1%	3 832	April 2008

⁽¹⁾ In the course of acquisition 15% of ordinary shares and 1% of preference shares were acquired.

All the specified acquisitions were paid in cash.

In May 2008, OJSC Hydroindustiya, OJSC Hydromashinvest and OJSC Promhydroservice transferred their stakes in OJSC Hydromashkomplekt totalling 100% of the share capital in favour of LLC “Investment and Industrial Group “Hydraulic Machinery and Systems”. As a result of this transaction LLC Business-center Hydromash, a 100% subsidiary of LLC Hydromashkomplek, became a part of the Group.

In May 2007, the Group sold 99% interest in the capital of LLC Agrofirma “Step”. The transaction value was RUR 961 thousand and was paid in cash.

During 2007 and for the period from 1 January 2008 to 15 May 2008 CJSC NOMOS-BANK issued loans for the companies of the Group for the amount RUR 1 208 750 thousand and CJSC UniCreditBank for the amount of RUR 500 000 thousand. These loans were secured by the guarantees of the other companies of the Group.