**Hydraulic Machines and Systems Group OJSC
(previously operating as Investment and
Industrial Group Hydraulic Machines and Systems LLC)**

**International Accounting Standard No. 34
Consolidated Condensed Interim Financial Information (unaudited)
and Review Report**

**30 June 2008**

**Contents**

REPORT ON THE REVIEW OF INTERIM FINANCIAL INFORMATION

UNAUDITED CONSOLIDATED CONDENSED INTERIM FINANCIAL INFORMATION

Unaudited Consolidated Condensed Interim Balance Sheet ..... 2
Unaudited Consolidated Condensed Interim Income Statement ..... 3
Unaudited Consolidated Condensed Interim Statement of Cash Flows ..... 4
Unaudited Consolidated Condensed Interim Statement of Changes in Equity ..... 5

Notes to the Unaudited Consolidated Condensed Interim Financial Information

1. The Group and its Operations ..... 6
2. Basis of Preparation ..... 6
3. Accounting Policies ..... 6
4. Property, Plant and Equipment ..... 8
5. Other Intangible Assets ..... 9
6. Goodwill ..... 9
7. Business Combinations ..... 9
8. Investments in Associates ..... 10
9. Cash and Cash Equivalents ..... 11
10. Inventory ..... 11
11. Borrowings ..... 11
12. Retirement Benefit Obligations ..... 13
13. Construction Contracts ..... 13
14. Net Assets Attributable to Participants ..... 14
15. Income Tax ..... 15
16. Revenue ..... 15
17. Cost of Sales ..... 16
18. Distribution and Transportation Expenses ..... 16
19. General and Administrative Expenses ..... 16
20. Other Operating Expenses, Net ..... 17
21. Finance Income ..... 17
22. Finance Expense ..... 17
23. Related Parties ..... 17
24. Contingencies, Commitments and Operating Risks ..... 18
25. Operating Segments ..... 20
26. Subsequent Events ..... 23
27. Seasonality ..... 24

PRICEWATERHOUSECOOPERS

**ZAO PricewaterhouseCoopers Audit**
Kosmodamianskaya Nab. 52, Bld. 5
115054 Moscow
Russia
Telephone +7 (495) 967 6000
Facsimile +7 (495) 967 6001
www.pwc.ru

**REPORT ON THE REVIEW OF INTERIM FINANCIAL INFORMATION**

To the Shareholders and the Board of Directors of Hydraulic Machines and Systems Group OJSC:

*Introduction*
We have reviewed the accompanying consolidated condensed interim balance sheet of Hydraulic Machines and Systems Group OJSC (formerly operating as Investment and Industrial Group Hydraulic Machines and Systems LLC; the "Company") and its subsidiaries (the "Group") as at 30 June 2008, and the related consolidated condensed interim statements of income, changes in equity and cash flows for the six-month period then ended. Management is responsible for the preparation and presentation of this consolidated condensed interim financial information in accordance with International Accounting Standard 34, *Interim Financial Reporting*. Our responsibility is to express a conclusion on this consolidated condensed interim financial information based on our review.

*Scope of Review*
We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

*Basis for Qualified Conclusion*
The Group has prepared consolidated condensed interim financial information for the first time for the six months ended 30 June 2008. The accompanying consolidated condensed interim statements of income, cash flow and changes in shareholders' equity do not include information for the comparative six month period ended 30 June 2007, as required by International Accounting Standard 34, *Interim Financial Reporting*.

*Qualified Conclusion*
Based on our review, with the exception of the matter described in the preceding paragraph, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial information has not been prepared, in all material respects, in accordance with International Accounting Standard 34, *Interim Financial Reporting*.

ZAO PricewaterhouseCoopers Audit

Moscow, Russian Federation
19 January 2009

(in thousands of Russian Roubles, unless otherwise stated)

| | Note | 30 June 2008 | 31 December 2007 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets:** | | | |
| Property, plant and equipment | 4 | 3,348,972 | 2,867,035 |
| Intangible assets | 5 | 37,134 | 46,589 |
| Goodwill | 6 | 211,848 | 207,329 |
| Investments in associates | 8 | 467,235 | 416,860 |
| Deferred tax assets | | 50,799 | 57,711 |
| Other long-term receivables | | 16,969 | 50,911 |
| Other non-current assets | | 15,691 | - |
| **Total non-current assets** | | **4,148,648** | **3,646,435** |
| **Current assets:** | | | |
| Inventories | 10 | 2,877,440 | 1,852,958 |
| Trade and other receivables | | 4,349,479 | 3,921,330 |
| Cash and cash equivalents | 9 | 382,378 | 377,203 |
| Restricted cash | 9 | 1,455 | 890 |
| **Total current assets** | | **7,610,752** | **6,152,381** |
| **TOTAL ASSETS** | | **11,759,400** | **9,798,816** |
| **EQUITY AND LIABILITIES** | | | |
| Minority interest | | 410,235 | 567,953 |
| **LIABILITIES** | | | |
| **Net assets attributable to the Company's participants:** | | | |
| Paid-in capital | 14 | 591,180 | 218,080 |
| Cumulative surplus of net assets | 14 | 1,740,661 | 1,538,482 |
| **Total net assets attributable to participants** | | **2,331,841** | **1,756,562** |
| **Non-current liabilities:** | | | |
| Long-term borrowings | 11 | 230,493 | 52,631 |
| Finance lease liability | | 30,293 | 41,388 |
| Deferred tax liability | | 273,592 | 237,553 |
| Pension liability | 12 | 133,266 | 118,276 |
| Other provisions for liabilities and charges | | 8,941 | 29,594 |
| **Total non-current liabilities, excluding net assets attributable to participants** | | **676,585** | **479,442** |
| **Total non-current liabilities** | | **3,008,426** | **2,236,004** |
| **Current liabilities:** | | | |
| Trade and other payable | | 4,975,940 | 3,856,253 |
| Short-term borrowings | 11 | 3,079,955 | 2,898,852 |
| Finance lease liability | | 22,134 | 22,816 |
| Pension liability | 12 | 8,953 | 11,676 |
| Current income tax payable | | 29,289 | 23,593 |
| Other taxes payable | | 200,324 | 181,669 |
| Other provisions | | 24,144 | - |
| **Total current liabilities** | | **8,340,739** | **6,994,859** |
| **TOTAL EQUITY AND LIABILITIES** | | **11,759,400** | **9,798,816** |

Approved for issue and signed on behalf of the Board of Directors on 19 January 2009.

K.V. Molchanov
Vice-president HMS Group OJSC

M.Y. Kuzmenko
Finance Director HMS Group OJSC

*(in thousands of Russian Roubles, unless otherwise stated)*

| | Note | Six months ended 30 June 2008 |
|---|---|---|
| Revenue | 16 | 7,783,295 |
| Cost of sales | 17 | (5,994,558) |
| **Gross profit** | | **1,788,737** |
| Distribution and transportation expenses | 18 | (222,524) |
| General and administrative expenses | 19 | (788,039) |
| Other operating expenses – net | 20 | (95,890) |
| **Operating profit** | | **682,284** |
| Finance income | 21 | 14,709 |
| Finance costs | 22 | (180,640) |
| Share of results of associates | 8 | 9,542 |
| **Profit before income tax** | | **525,895** |
| Income tax charge | 15 | (172,041) |
| **Profit after tax** | | **353,854** |
| Other changes in net assets attributable to participants | 14 | (18,076) |
| **Increase in net assets** | | **335,778** |
| **Increase in net assets attributable to:** | | |
| Participants of the Company | | 202,179 |
| Minority interest | | 133,599 |
| **Increase in net assets** | | **335,778** |

*(in thousands of Russian Roubles, unless otherwise stated)*

| | Note | Six months ended 30 June 2008 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Profit before income tax | | 525,895 |
| Adjustments for: | | |
| Deprecation and amortization | 4,5 | 159,285 |
| Loss on disposal of property, plant and equipment and intangible assets | | 25,569 |
| Interest income | | (13,210) |
| Interest expense | 22 | 176,077 |
| Pension expenses | 12 | 15,339 |
| Provision for warranty | | 16,400 |
| Provision for impairment of accounts receivable | | 18,117 |
| Provision for obsolete inventories | | 14,430 |
| Foreign exchange loss | 22 | 4,563 |
| Share of result of associates | 8 | (9,542) |
| **Operating cash flows before working capital changes** | | **932,923** |
| Increase in inventories | | (1,034,518) |
| Increase in trade receivables | | (86,789) |
| Increase in taxes and levies payable | | 18,655 |
| Increase in accounts payable and accrued liabilities | | 758,915 |
| Benefits paid | 12 | (3,072) |
| Restricted cash | 9 | (565) |
| **Cash generated from operations** | | **585,549** |
| Income tax paid | | (203,869) |
| Interest paid | | (176,792) |
| **Net cash from operating activities** | | **204,888** |
| **Cash flows from investing activities:** | | |
| Repayment of loans advanced | | 25,622 |
| Loans advanced | | (179,264) |
| Proceeds from the sale of property, plant and equipment | | 2,744 |
| Interest received | | 1,586 |
| Acquisition of intangible assets | | (3,785) |
| Prepayments for business combinations | | (101,356) |
| Acquisition of property, plant and equipment | | (195,014) |
| Acquisition of associates | 8 | (50,605) |
| Acquisitions of subsidiaries, net of cash acquired | 7 | (9,690) |
| **Net cash used in investing activities** | | **(509,762)** |
| **Cash flows from financing activities:** | | |
| Repayment of borrowings | | (4,258,694) |
| Proceeds from borrowings | | 4,556,985 |
| Payment for finance lease | | (11,789) |
| Capital contribution | 14 | 23,548 |
| Acquisition of minority interest in subsidiaries | 7 | (1,419) |
| **Net cash from financing activities** | | **310,049** |
| **Net increase in cash and cash equivalents** | | **5,175** |
| **Cash and cash equivalents at the beginning of the period, net of restricted cash of RR 890** | 9 | **377,203** |
| **Cash and cash equivalents at the end of the period, net of restricted cash of RR 1,455** | 9 | **382,378** |

*(in thousands of Russian Roubles, unless otherwise stated)*

| | Note | Minority interest |
|---|---|---|
| **Balance as of 1 January 2008** | | **567,953** |
| Profit for the year attributable to minority interest | | 133,599 |
| Acquisition of minority interest in subsidiaries | | (242,967) |
| Distribution to minority holders of the Group's subsidiaries | 14 | (249,986) |
| Re-distribution of net assets to minority holders of the Group's subsidiaries | 14 | 201,637 |
| **Balance as of 30 June 2008** | | **410,235** |

## 1. The Group and its Operations

This condensed consolidated interim financial information has been prepared in accordance with International Financial Reporting Standards as at and for the six months period ended 30 June 2008 for Hydraulic Machines and Systems Group OJSC (formerly operating as Investment and Industrial Group Hydraulic Machines and Systems LLC; the "Company") and its subsidiaries ("the Group"). The Group's principal business activities are manufacturing of a wide range of pumps and pumping units, manufacturing and repairing of oil and gas equipment, engineering and construction services mainly for oil and gas companies. These products and services are sold both in the Russian Federation and abroad. The Company is incorporated and domiciled in the Russian Federation. The address of its registered office is Olkhovskaya St. 45, bld. 1, office 4, 105066 Moscow. The Group's manufacturing facilities are primarily located in Orel, Vladimir, Tomsk and Tumen regions of the Russian Federation and Sumy in Ukraine.

## 2. Basis of Preparation

***Basis of preparation.*** This condensed consolidated interim financial information for the six months ended 30 June 2008 has been prepared in accordance with IAS 34, *Interim financial reporting*. The condensed consolidated interim financial information should be read in conjunction with the annual consolidated financial statements for the year ended 31 December 2007.

## 3. Accounting Policies

***Accounting policies.*** The accounting policies applied are consistent with those of the annual consolidated financial statements for the ended 31 December 2007, as described in those annual consolidated financial statements.

Certain reclassifications have been made to prior year balances in the consolidated condensed interim balance sheet, cash flows and notes to conform to the current period presentation.

***Standards and amendments early adopted by the Group.*** IFRS 8, *Operating Segments* (effective for annual periods beginning on or after 1 January 2009) was early adopted in 2007. IFRS 8 replaces IAS 14, *Segment reporting*, and aligns segment reporting with the requirements of the US standard SFAS 131, Disclosure about segments of and enterprise and related information. The new standard requires a 'management approach', under which segment information is presented on the same basis as that used for internal reporting purposes.

The following new standards, amendments to standards, interpretations are mandatory for the first time for the financial year beginning 1 January 2008, but are not currently relevant for the Group:

- IFRIC 11, IFRS 2 – *Group and Treasury Share Transactions* (effective for annual periods beginning on or after 1 March 2007);
- IFRIC 12, *Service Concession Arrangements* (effective for annual periods beginning on or after 1 January 2008);
- IFRIC 14, IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (effective for annual periods beginning on or after 1 January 2008).

The following new standards, amendments to standards and interpretations have been issued but are not effective for the financial year beginning 1 January 2008 and have not been early adopted.

***Puttable financial instruments and obligations arising on liquidation – IAS 32 and IAS 1 Amendment (effective from 1 January 2009).*** The amendment requires classification as equity of some financial instruments that meet the definition of a financial liability. The Group is currently assessing the impact of the amendment on its consolidated financial statements.

***IAS 23, Borrowing Costs (revised March 2007; effective for annual periods beginning on or after 1 January 2009).*** The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. The Group is currently assessing the impact of the amended standard on its financial statements.

***IAS 1, Presentation of Financial Statements (revised September 2007; effective for annual periods beginning on or after 1 January 2009).*** The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in net assets attributable to participants, such as the revaluation of available-for-sale financial assets. The Group expects the revised IAS 1 to affect the presentation of its financial statements but to have no impact on the recognition or measurement of specific transactions and balances.

**3. Accounting Policies (continued)**

***IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009).*** The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

***IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009).*** The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or on the same basis as US GAAP (at fair value). The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

***Vesting Conditions and Cancellations – Amendment to IFRS 2, Share-based Payment (issued in January 2008; effective for annual periods beginning on or after 1 January 2009).*** The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The amendment is not relevant to the Group.

***Improvements to International Financial Reporting Standards (issued in May 2008).*** In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments issued in May 2008 consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Group does not expect the amendments to have any material effect on its consolidated financial statements.

***Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate – IFRS 1 and IAS 27 Amendment (revised May 2008; effective for annual periods beginning on or after 1 January 2009).*** The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendments will not have an impact on the Group's consolidated financial statements.

***Eligible Hedged Items – Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009, with earlier application permitted).*** The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not expected to have an impact on the Group's consolidated financial statements.

***Reclassification of Financial Assets (Amendments to IAS 39 Financial Assets: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures).*** The amendment to the standard permits an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of fair value through profit or loss category in particular circumstances. The amendment also permits the entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available-for-sale), if the entity has an intention and ability to hold that financial asset for the foreseeable future. The amendments will not have an impact on the Group's consolidated financial statements.

*(in thousands of Russian Roubles, unless otherwise stated)*

**3. Accounting Policies (continued)**

***New interpretations.*** The Group has not early adopted the following new interpretations:

- IFRIC 13, Customer Loyalty Programmes (issued in June 2007; effective for annual periods beginning on or after 1 July 2008);
- IFRIC 15, Agreements for construction of real estates (effective from 1 January 2009);
- IFRIC 16, Hedges of a net investment in a foreign operation (effective from 1 October 2008).

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

**4. Property, Plant and Equipment**

| | Land | Buildings | Plant and equipment | Transport | Other | Construction in progress | Total |
|---|---|---|---|---|---|---|---|
| **Cost at 1 January 2008** | **118,460** | **1,593,816** | **1,170,499** | **142,415** | **153,101** | **175,168** | **3,353,459** |
| **Accumulated depreciation** | **-** | **(95,934)** | **(291,181)** | **(46,595)** | **(52,714)** | **-** | **(486,424)** |
| **Carrying amount at 1 January 2008** | **118,460** | **1,497,882** | **879,318** | **95,820** | **100,387** | **175,168** | **2,867,035** |
| Additions through contribution to charter capital (note 14) | | 371,733 | 45,928 | - | 576 | 21,558 | **439,795** |
| Additions | 857 | 49,507 | 90,254 | 10,545 | 12,393 | 103,720 | **267,276** |
| Transfers | - | 4,632 | 19,052 | 1,106 | 825 | (25,615) | - |
| Disposals | | (481) | (3,437) | (2,053) | (1,714) | (76,653) | **(84,338)** |
| Depreciation for the period | - | (27,702) | (86,163) | (13,999) | (12,932) | - | **(140,796)** |
| **Carrying amount at 30 June 2008** | **119,317** | **1,895,571** | **944,952** | **91,419** | **99,535** | **198,281** | **3,348,972** |
| **Cost at 30 June 2008** | **119,317** | **2,019,099** | **1,317,914** | **147,553** | **162,110** | **198,281** | **3,964,171** |
| **Accumulated depreciation** | **-** | **(123,528)** | **(372,962)** | **(56,134)** | **(62,575)** | **-** | **(615,199)** |
| **Carrying amount at 30 June 2008** | **119,317** | **1,895,571** | **944,952** | **91,419** | **99,535** | **198,281** | **3,348,972** |

As of 30 June 2008, the Group's property, plant and equipment for a total of RR 166,219 had been pledged as security for loan (31 December 2007: RR 192,522) (Note 11).

The Group leases plant and equipment under a finance lease arrangements. As of 30 June 2008, the gross book value of the leased equipment was RR 100,357, accumulated depreciation was RR 15,274 (31 December 2007: RR 102,537 and RR 9,557 respectively).

Construction-in-progress includes advances for capital expenditures for a total of RR 46,332 as of 30 June 2008 (31 December 2007: RR 68,008).

*(in thousands of Russian Roubles, unless otherwise stated)*

## 5. Other Intangible Assets

| | Patents | Licensed technology | Acquired software license | Customer relationships | Websites | Total |
|---|---|---|---|---|---|---|
| **Cost at 1 January 2008** | **7,405** | **9,282** | **13,587** | **52,980** | **26** | **83,280** |
| **Accumulated amortization and impairment** | **(3,598)** | **(3,084)** | **(3,514)** | **(26,490)** | **(5)** | **(36,691)** |
| **Carrying amount at 1 January 2008** | **3,807** | **6,198** | **10,073** | **26,490** | **21** | **46,589** |
| Acquisitions through business combinations (Note 7) | - | 1 | 10 | 4,892 | - | 4,903 |
| Additions | - | 2,134 | 3,608 | - | - | 5,742 |
| Disposals | (83) | (49) | (1,479) | - | - | (1,611) |
| Amortization for the year | (1,922) | (1,394) | (1,313) | (13,857) | (3) | (18,489) |
| **Carrying amount at 30 June 2008** | **1,802** | **6,890** | **10,899** | **17,525** | **18** | **37,134** |
| **Cost at 30 June 2008** | **4,307** | **10,895** | **15,242** | **57,872** | **26** | **88,342** |
| **Accumulated amortization and impairment** | **(2,505)** | **(4,005)** | **(4,343)** | **(40,347)** | **(8)** | **(51,208)** |
| **Carrying amount at 30 June 2008** | **1,802** | **6,890** | **10,899** | **17,525** | **18** | **37,134** |

## 6. Goodwill

| | Note | 30 June 2008 |
|---|---|---|
| Gross book value as of 1 January | | 207,329 |
| Accumulated impairment as of 1 January | | - |
| **Carrying amount as of 1 January** | | **207,329** |
| Acquisitions of subsidiaries | 7 | 4,519 |
| **Carrying amount as of 30 June** | | **211,848** |
| Gross book value as of 30 June | | **211,848** |
| Accumulated impairment losses as of 30 June | | - |
| **Carrying amount as of 30 June** | | **211,848** |

Goodwill is allocated to cash generating units (CGU), which represent the lowest level within the Group at which the goodwill is monitored by management and which are not larger than a segment for segment reporting purposes as follows:

| | 30 June 2008 | 2007 |
|---|---|---|
| Tomskgazstroy OJSC | 16,757 | 16,757 |
| Trest Sibkomplektmontazhnaladka OJSC | 190,572 | 190,572 |
| Hydromash-Industria LLC | 4,519 | - |
| **Total carrying amount of goodwill** | **211,848** | **207,329** |

## 7. Business Combinations

In March 2008 the Group acquired a 100% interest in Hydromash-Industria LLC for RR 10,324 paid in cash.

The acquired subsidiary is engaged in the design of pumping equipment and spare parts. The cost of acquisition was allocated to the assets acquired and liabilities assumed. The acquired company contributed revenue of RR 6,832 and loss of RR 483 to the Group for the period from the date of acquisition to 30 June 2008. If the acquisition had occurred on 1 January 2008, the revenue from the acquired business would have been RR 9,480, and loss would have been RR 931 for the six months ended 30 June 2008.

*(in thousands of Russian Roubles, unless otherwise stated)*

## 7. Business Combinations (continued)

The summary of assets acquired and liabilities assumed are as follows:

| | Attributed fair value |
|---|---|
| Cash and cash equivalents | 634 |
| Property, plant and equipment | 141 |
| Intangible assets | 4,893 |
| Trade and other receivables | 2,934 |
| Inventories | 3,124 |
| Other assets | - |
| Borrowings | (500) |
| Trade and other payables | (3,769) |
| Other taxes payable | (169) |
| Finance lease liability | - |
| Deferred tax liability | (1,483) |
| **Other liabilities** | - |
| **Fair value of net assets** | **5,805** |
| Less: Minority interest | - |
| **Fair value of acquired interest in net assets** | **5,805** |
| Goodwill | **4,519** |
| **Total purchase consideration** | **10,324** |
| Less: cash and cash equivalents of subsidiary acquired | (634) |
| **Outflow of cash and cash equivalents on acquisition** | **9,690** |

The goodwill is primarily attributable to the profitability of the acquired business, the significant synergies and combined costs savings expected to arise.

The valuation of identifiable tangible and intangible assets was performed by an independent professional appraiser.

The acquired entity did not prepare IFRS financial statements prior to the acquisition. Management believes that determination of IFRS carrying amounts immediately before the acquisition is impractical.

***Acquisition of minority interest in subsidiaries***

In June 2008, Tomskgazstroy OJSC increased its share capital by RR 20,000 through issuing of 100 thousand of preference shares with the nominal value of RR 200 each. Preference shares were sold to HYDROMASHSERVICE CJSC, subsidiary of the Group. As a result the effective interest in the subsidiary owned by the Group increased from 50.7% to 99.9% and minority interest decreased by RR 222,566.

In February 2008, the Group acquired an additional 1.4% interest in Trest Sibkomplektmontazhnaladka OJSC for RR 1,419, respectively, paid in cash. As a result of this transaction, the Group increased its ownership interest in Trest Sibkomplektmontazhnaladka OJSC from 97.0% to 98.4% decreasing the minority interest by RR 4,788.

## 8. Investments in Associates

In April 2008 the Group acquired 30% interest in Sibnfteavtomatika OJSC for RR 50,605 paid in cash. The Group's share within associated net assets as at acquisition date was RR 59,760. The excess of fair value of the net assets acquired over the cost of acquisition of RR 9,155 was recorded in the income statement and included in the share of results of associates.

Investments in associates at 30 June 2008 included goodwill of RR 156,387 (31 December 2007: RR 156,387).

The Group's investments in associates are as follows:

| | 2008 | 2007 |
|---|---|---|
| **Carrying amount at 1 January 2008 / 1 January 2007** | **416,860** | - |
| Cost of acquisition of associates | 50,605 | 398,731 |
| The excess of fair value of the net assets acquired over the cost of acquisition | 9,155 | 9,680 |
| Dividends | (9,772) | - |
| Share of after tax results of associates | 387 | 8,449 |
| **Carrying amount at 30 June 2008 / 31 December 2007** | **467,235** | **416,860** |

*(in thousands of Russian Roubles, unless otherwise stated)*

## 9. Cash and Cash Equivalents

| | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Cash on hand | 674 | 2,392 |
| RR denominated balances with banks | 202,268 | 271,796 |
| Foreign currency denominated balances with banks | 3,791 | 22,625 |
| RR denominated bank deposits | 50,768 | 4,653 |
| Promissory notes receivable on demand | 114,120 | 72,633 |
| Other cash equivalents | 10,757 | 3,104 |
| | **382,378** | **377,203** |

*Restricted cash*

Restricted cash of RR 1,455 represents minimum balances for settlement and deposit accounts and corporate plastic cards balances (2007: RR 890).

## 10. Inventory

| | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Materials and components | 769,407 | 601,388 |
| Inventory for implementation of construction contracts | 939,489 | 398,386 |
| Work in progress | 559,063 | 364,542 |
| Finished goods | 348,632 | 280,095 |
| Goods for resale | 255,606 | 225,464 |
| Other inventories | 98,810 | 51,309 |
| Provision for obsolete inventories | (93,567) | (68,226) |
| | **2,877,440** | **1,852,958** |

At 30 June 2008 the inventories of RR 206,003 were pledged as collateral for borrowings (2007: 204,823) (Note 11).

## 11. Borrowings

| | Interest rate | Denominated in | Maturity | 30 June 2008 | 31 December 2007 |
|---|---|---|---|---|---|
| **Long-term loan:** | | | | | |
| Bonds | 9,9% | RR | November 2009 | 153,211 | 1,009,221 |
| Long-term loan 1 | 10.8% | US dollar | September 2009 | 65,311 | 50,901 |
| Long-term loan 2 | 10.3% | EURO | September 2009 | 6,184 | - |
| Long-term loan 3 | 16% | RR | September 2009 | 5,787 | 1,730 |
| | | | | **230,493** | **1,061,852** |
| Less: short-term portion of bond | | | | - | (1,009,221) |
| | | | | **230,493** | **52,631** |

In October 2006 one the Group subsidiaries, Hydromashservice CJSC, issued 1,000 thousand non-convertible three-year Russian Rouble denominated bonds (at par value 1,000 roubles each) for RR 1,000,000. The bonds bear interest rate of 9.9% per annum. The interest is payable every six months. In May 2008 the bond holders claimed redemption of bonds for RR 846,955. The fair value of the bonds, which is based on market quotations, approximates RR 153,211.

As of 30 June 2008 and 31 December 2007 the fair value of long-term borrowings approximates their carrying amount.

*(in thousands of Russian Roubles, unless otherwise stated)*

**11 Borrowings (continued)**

The bonds are secured by guarantees issued by the Group companies (Livgidromash OJSC, Livnynasos OJSC, Neftemash OJSC, Gidromashinprom CJSC).

| | Interest rate | Denominated in | 30 June 2008 |
|---|---|---|---|
| **Short-term unsecured bank loans and borrowings** | | | |
| Unsecured bank loan 1 | 10-12% | RR | 2,472,600 |
| Unsecured bank loan 2 | 7-9% | RR | 500,000 |
| Unsecured bank loan 3 | 10% | RR | 20,000 |
| Unsecured bank loan 4 | 14% | RR | 6,903 |
| | | | **2,999,503** |
| **Short-term secured bank loans** | | | |
| Secured bank loan 1 | 11% | US dollars | 56,439 |
| Secured bank loan 2 | 16% | RR | 11,476 |
| Secured bank loan 3 | 15-16% | UAH | 7,435 |
| Secured bank loan 4 | 25% | UAH | 4,467 |
| Secured bank loan 5 | 10% | EURO | 78 |
| | | | **79,895** |
| Interest on short-term borrowings | | | 557 |
| | | | **3,079,955** |

| | Interest rate | Denominated in | 31 December 2007 |
|---|---|---|---|
| **Short-term unsecured bank loans and borrowings** | | | |
| Unsecured bank loan 1 | 11% | RR | 1,703,300 |
| Unsecured bank loan 2 | 11% | US dollars | 47,070 |
| Unsecured bank loan 3 | 15-16% | UAH | 32,970 |
| Unsecured bank loan 4 | 3% | RR | - |
| Unsecured bank loan 5 | 11-12% | RR | - |
| Unsecured bank loan 6 | 12% | US dollars | - |
| Unsecured bank loan 7 | 17% | RR | - |
| Unsecured bank loan 8 | 11% | EURO | - |
| Unsecured bank loan 9 | 15% | UAH | - |
| Unsecured bank loan 11 | 12% | RR | - |
| | | | **1,783,340** |
| **Short-term secured bank loans** | | | |
| Secured bank loan 1 | 10-11% | RR | 95,000 |
| Secured bank loan 2 | 10% | RR | 9,737 |
| | | | **1,888,077** |
| Current portion of long-term borrowings | | | 1,009,221 |
| Interest on short-term borrowings | | | 1,554 |
| | | | **2,898,852** |

The Group's borrowings are denominated in the following currencies:

| | 30 June 2008 | 31 December 2007 |
|---|---|---|
| RR | 3,170,534 | 2,820,542 |
| US Dollar | 121,750 | 97,971 |
| EURO | 6,262 | - |
| UAH | 11,901 | 32,970 |
| | **3,310,447** | **2,951,483** |

As at 30 June 2008 the Group pledged property, plant and equipment and inventories in total amounts of RR 166,219 and 206,003, respectively, as a security for borrowings (2007: RR 192,522; RR 204,823).

As of 30 June 2008 and 31 December 2007 the fair value of short-term borrowings approximates their carrying amount.

The Group has not entered into any hedging agreements in respect of its foreign currency obligations or interest rate exposures.

*(in thousands of Russian Roubles, unless otherwise stated)*

## 12. Retirement Benefit Obligations

The following amounts were recognized within administrative expenses in the consolidated condensed interim income statement:

| | Six months ended 30 June 2008 |
|---|---|
| Current service cost | 8,453 |
| Interest cost | 5,236 |
| Past service cost recognised during the period | - |
| Foreign currency exchange rate changes | 1,486 |
| Actuarial loss recognised during the period | 164 |
| **Net periodic benefit cost** | **15,339** |

The amounts recognized in the consolidated balance sheet were determined as follows:

| | Six months ended 30 June 2008 |
|---|---|
| Present value of defined benefit obligations | 142,219 |
| Unrecognised actuarial gains/(losses) | - |
| Past service cost recognised during the period | - |
| **Liability in the balance sheet** | **142,219** |

Changes in the present value of the Group's pension benefit obligation are as follows:

| | Six months ended 30 June 2008 |
|---|---|
| Present value of defined benefit obligations at the beginning of the period | 129,952 |
| Current service cost | 9,939 |
| Interest expense | 5,236 |
| Actuarial losses | 164 |
| Benefits paid | (3,072) |
| Past service cost recognised during the period | - |
| **Present value of defined benefit obligations as at the end of the period** | **142,219** |

Short-term and long-term classification was determined based on discounted value of future obligation which is payable within 12 months from the balance sheet date:

| | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Short-term | 8,953 | 11,676 |
| Long-term | 133,266 | 118,276 |
| **Present value of defined benefit obligations as at the end of year** | **142,219** | **129,952** |

## 13. Construction Contracts

During six months of the 2008 the construction contracts revenue was recognized in relation to stage of completion for each contract. The stage of completion of a contract was determined based on the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs.

| | Six months ended 30 June 2008 |
|---|---|
| Construction contracts revenue | 2,672,778 |
| Contract cost expensed | (2,287,160) |
| **Gross margin** | **385,618** |

| | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Advances, received for construction contracts | 1,155,026 | 326,640 |
| Retentions | 1,396 | 61,739 |

*(in thousands of Russian Roubles, unless otherwise stated)*

### 13. Construction Contracts (continued)

The Group's financial position with respect to construction constructs in progress is as follows:

| | 30 June 2008 |
|---|---|
| Aggregate amount of contract cost incurred | 1,846,609 |
| Aggregate amount of recognized profits | 341,029 |
| Aggregate amount of recognized losses | (2,138) |
| Less: Progress billings | (2,036,558) |
| **Gross amount due from customers for contract work** | **148,942** |

| | 30 June 2008 |
|---|---|
| Aggregate amount of contract cost incurred | 3,745,126 |
| Aggregate amount of recognized profits | 501,425 |
| Aggregate amount of recognized losses | (10,060) |
| Less: Progress billings | (4,413,310) |
| **Gross amount due to customers for contract work** | **(176,819)** |

### 14. Net Assets Attributable to Participants

As at 30 June 2008 and 31 December 2007 there were three participants in the Company:

| | | 30 June 2008 | 31 December 2007 |
|---|---|---|---|
| **Participant** | **Ownership, %** | **Amount, RR'000** | **Amount, RR'000** |
| Hydroindustry LLC | 42.5 | 251,252 | 92,684 |
| Hydromashinvest LLC | 42.5 | 251,252 | 92,684 |
| Promhydroservice LLC | 15 | 88,676 | 32,712 |
| | **100** | **591,180** | **218.080** |

| | | Attributable to participants of the Company | |
|---|---|---|---|
| | **Note** | **Paid-in capital** | **Cumulative surplus of net assets** |
| **Balance as of 1 January 2008** | | **218,080** | **1,538,482** |
| Profit after tax attributable to participants | | - | 220,255 |
| Other changes in net assets attributable to participants | | - | - |
| - Change in cumulative translation reserve | | - | 4,463 |
| - Additional contribution | | 373,100 | (63,869) |
| - Acquisition of minority interest in subsidiaries | 7 | - | 242,967 |
| - Re-distribution of net assets to minority holders of the Group's subsidiaries | | - | (201,637) |
| **Balance as of 30 June 2008** | | **591,180** | **1,740,661** |

*(in thousands of Russian Roubles, unless otherwise stated)*

## 14. Net Assets Attributable to Participants (continued)

In May 2008 the participants of the Company increased the charter capital from RR 218,080 to RR 591,180 through making capital contribution of 100% of shares of Hydromashkomplekt LLC with its 100% subsidiary Business-Centre Hydromash LLC to the Group.

The summary of assets and liabilities contributed are as follows:

| | Hydromashkomplekt LLC | Business-Centre Hydromash LLC | Total |
|---|---|---|---|
| | Attributed fair value | Attributed fair value | Attributed fair value |
| Cash and cash equivalents | 23,355 | 193 | 23,548 |
| Property, plant and equipment | 86,558 | 353,237 | 439,795 |
| Intangible assets | 10 | - | 10 |
| Deferred tax assets | - | - | - |
| Other non-current assets | 39 | - | 39 |
| Trade and other receivables | 23,176 | 29,080 | 52,256 |
| Inventories | 108 | 55 | 163 |
| Borrowings | - | (55,621) | (55,621) |
| Trade and other payables | (76,431) | (1,163) | (77,594) |
| Other taxes payable | (346) | (69) | (415) |
| Deferred tax liability | (19,736) | (53,214) | (72,950) |
| **Fair value of net assets** | **36,733** | **272,498** | **309,231** |

As at 30 June 2008 the Company was a limited liability company. For such companies, voting rights of participants are determined by their percentage participation in the registered charter capital. Each participant has a right to request that the Company redeems his interest. In accordance with the Company's Charter a participant's share upon withdrawing his interest shall be assessed as a share of the Company's net assets calculated based on the statutory accounting reports for the year in which a participant withdraws his interest. As at 30 June 2008, the net assets of the Company under Russian statutory accounting reports were of RR 641,701 and no participants asked the Company for redemption. The Company's Charter establishes annual profit distribution pro rata participant's interest based on the statutory accounting reports of the Company.

During six months 2008, dividends were accrued only to the holders of preference shares reflected as minority interest in the amount of RR 249,986 (2007: RR 221,689 for the whole year), but no dividends were paid to participants or minority holders of common shares. As a result, redistribution of net assets to minority holders of preference shares and common shares was reflected in the consolidated condensed interim statement of changes in equity.

## 15. Income Tax

The Group income tax charges were as follows:

| | 30 June 2008 |
|---|---|
| Current tax | 203,525 |
| Deferred tax benefit | (31,484) |
| **Total income tax charge** | **172, 041** |

Most companies of the Group were subject to tax rate of 24% on taxable profits in the Russian Federation for six months period ended 30 June 2008.

## 16. Revenue

| | Six months ended 30 June 2008 |
|---|---|
| Sales of pumps and spare parts | 2,222,959 |
| Revenue from construction contracts | 2,672,778 |
| Sales of oilfield equipment | 1,925,572 |
| Sales of repair services for oil-field equipment | 394,428 |
| Sales of engines | 174,729 |
| Sales of products, work and services of auxiliary units | 117,652 |
| Sales of other services and goods | 275,177 |
| | **7,783,295** |

*(in thousands of Russian Roubles, unless otherwise stated)*

## 17. Cost of Sales

| | **Six months ended 30 June 2008** |
|---|---|
| Supplies and raw materials | 2,880,506 |
| Cost of goods sold | 1,075,858 |
| Labour costs | 1,005,182 |
| Construction and installation works of subcontractors | 734,854 |
| Deprecation and amortization | 117,014 |
| Utilities | 44,445 |
| Inventory impairment provision | 14,430 |
| Research and development costs | 8,065 |
| Change in work in progress and finished goods | (269,010) |
| Other expenses | 383,214 |
| | **5,994,558** |

## 18. Distribution and Transportation Expenses

| | **Six months ended 30 June 2008** |
|---|---|
| Transportation expenses | 67,258 |
| Labour costs | 66,133 |
| Entertaining costs and business trip expenses | 13,624 |
| Insurance | 11,248 |
| Advertising | 9,844 |
| Lease | 8,779 |
| Packaging expenses | 8,426 |
| Customs duties | 4,183 |
| Depreciation and amortization | 3,895 |
| Capital assets repair and maintenance | 3,253 |
| Agency services | 939 |
| Products certification | 833 |
| Other expenses | 24,109 |
| | **222,524** |

## 19. General and Administrative Expenses

| | **Six months ended 30 June 2008** |
|---|---|
| Labour costs | 451,060 |
| Taxes and duties | 59,991 |
| Audit and consultancy services | 57,537 |
| Depreciation and amortization | 36,556 |
| Stationary and office maintenance | 33,603 |
| Entertaining costs and business trip expenses | 19,457 |
| Provision for impairment of accounts receivable | 18,117 |
| Defined benefits scheme expenses | 13,853 |
| Rent | 12,987 |
| Security | 12,095 |
| Telecommunications services | 11,528 |
| Insurance | 11,431 |
| Bank services | 10,959 |
| Property, plant and equipment repair and maintenance | 9,951 |
| Training and recruitment | 5,969 |
| Other expenses | 22,945 |
| | **788,039** |

*(in thousands of Russian Roubles, unless otherwise stated)*

## 20. Other Operating Expenses, Net

| | Six months ended 30 June 2008 |
|---|---|
| Charity, social expenditures | 55,874 |
| Gains (losses) on sales and other disposal of property, plant and equipment and intangible assets | 25,914 |
| Fines and late payment interest under contracts | 3,967 |
| Gain on disposal of subsidiaries | (6,208) |
| Gain from transactions with securities | (561) |
| Depreciation of social assets | 1,820 |
| Investments impairment provision | - |
| Gain on sales of inventories | (7,060) |
| Foreign exchange losses, (net) | 3,487 |
| Other expenses | 18,657 |
| | **95,890** |

## 21. Finance Income

| | Six months ended 30 June 2008 |
|---|---|
| Interest income | 13,210 |
| Other income | 1,499 |
| | **14,709** |

## 22. Finance Expense

| | Six months ended 30 June 2008 |
|---|---|
| Interest expenses | 168,842 |
| Foreign exchange losses (net) | 4,563 |
| Finance lease expenses | 7,235 |
| | **180,640** |

## 23. Related Parties

Parties are generally 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 each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

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

The table below contains the disclosure by group of related parties with which the Company entered into significant transactions or has significant balances outstanding. Other category comprises the parties indirectly controlled by the Group through one or more intermediaries:

| **Balances with related parties** | | | **30 June 2008** |
|---|---|---|---|
| | **Participants** | **Associates** | **Other** |
| Loans issued | 77,321 | - | - |
| Accounts receivable | - | 7,580 | 3,218 |
| Accounts payable | - | 5,292 | 1,393 |

| **Balances with related parties** | | | **31 December 2007** |
|---|---|---|---|
| | **Participants** | **Associates** | **Other** |
| Loans issued | | - | 30,220 |
| Accounts receivable | - | 5,672 | 10,502 |
| Accounts payable | - | 4,379 | 34,407 |

No provision was made for accounts receivable due from related parties.

*(in thousands of Russian Roubles, unless otherwise stated)*

**23. Related Parties (continued)**

Neither party issued guarantees to secure accounts receivable or payable.

| **Income /expenses on transactions with related parties** | | | **Six months ended 30 June 2008** |
|---|---|---|---|
| | **Participants** | **Associates** | **Other** |
| Sales of services | - | 960 | - |
| Payment for research and development | | 19,039 | - |
| Purchase of services | - | 1,403 | 156 |
| Purchase of goods | - | 2,717 | - |
| Purchase of materials and components | - | 20,160 | 19,232 |

For the six months ended 30 June 2008, the Group issued loans to related parties for a total of RR 77,321 with a weighted average interest rate of 12.3%.

***Key management compensation***

Key management compensation amounted to RR 34,722 for the six months ended 30 June 2008 and includes short-term benefits such as salaries and bonuses paid to management as set forth in labour contracts concluded annually.

**24. Contingencies, Commitments and Operating Risks**

*(i) Legal proceeding*

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

*(ii) Tax legislation*

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

The Russian and Ukrainian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. In October 2006, the Supreme Arbitration Court of the Russian Federation issued guidance to lower courts on reviewing tax cases providing a systemic roadmap for anti-avoidance claims, and it is possible that this will significantly increase the level and frequency of tax authorities' scrutiny.

As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

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

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

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

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

*(ii) Tax legislation (continued)*

The Group includes companies incorporated outside of Russia. Tax liabilities of the Group are determined on the assumptions that these companies are not subject to Russian profits tax because they do not have a permanent establishment in Russia. Russian tax laws do not provide detailed rules on taxation of foreign companies. It is possible that with the evolution of the interpretation of these rules and the changes in the approach of the Russian tax authorities, the non-taxable status of some or all of the foreign companies of the Group in Russia may be challenged. The impact of any such challenge cannot be reliably estimated; however, it may be significant to the financial condition and/or the overall operations of the entity.

Russian tax legislation does not provide definitive guidance in certain areas. From time to time, the Group adopts interpretations of such uncertain areas that reduce the overall tax rate of the Group. As noted above, such tax positions may come under heightened scrutiny as a result of recent developments in administrative and court practices; the impact of any challenge by the tax authorities cannot be reliably estimated; however, it may be significant to the financial condition and/or the overall operations of the entity.

In addition to the above transfer pricing matters and possible attribution of additional taxes to the Group's foreign companies, Management estimates that the Group has no other possible obligations from exposure to other than remote tax risks.

*(iii) Environmental matters*

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

*(iv) Operating environment of the Group*

The Group, through its operations, has a significant exposure to the economy and financial markets of the Russian Federation and Ukraine.

The Russian Federation and Ukraine display certain characteristics of an emerging market, including relatively high inflation and strong economic growth. The banking sector in the Russian Federation is sensitive to adverse fluctuations in confidence and economic conditions and may occasionally experience reductions in liquidity and increased levels of volatility in market prices as witnessed during 2008. Management is unable to predict all developments which could have an impact on the banking sector and consequently what effect, if any, they could have on the financial position of the Group.

The tax, currency and customs legislation within the Russian Federation and Ukraine is subject to varying interpretations and frequent changes, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Russian Federation and Ukraine. The future economic direction of the Russian Federation and Ukraine is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Governments of the states, together with tax, legal, regulatory, and political developments.

*(v) Insurance policies*

The Russian and Ukrainian insurance services market is evolving. Part of the Group's production facilities are adequately covered by insurance. The Group has not adequately insured business interruption, third party liability for damage to property and environment resulting from accidents involving the Group's property or connected with its operations. Until the Group ensures adequate insurance coverage there is a risk that losses incurred or property damage inflicted by the Group may have a significant effect on the Group's financial position and operations.

*(vi) Contractual commitments*

As at 30 June 2008 the Group had contractual commitments for the purchase of components for construction of property, plant and equipment for RR 96,469 (31 December 2007: RR 85,162).

*(in thousands of Russian Roubles, unless otherwise stated)*

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

*(vii) Recent volatility in global and Russian financial markets*

The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the Russian banking sector, and higher interbank lending rates. The uncertainties in the global financial market, has also led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. The borrowers of the Group may also be affected by the lower liquidity situation which could in turn impact their ability to repay their outstanding loans. Deteriorating operating conditions for borrowers may also have an impact on cash flow forecasts and assessment of the impairment of financial and non-financial assets by management. To the extent that information is available, management has reflected revised estimates of expected future cash flows in their impairment assessments.

The uncertainty in the global markets combined with other local factors has during 2008 led to very high volatility in the Russian stock markets and at times much higher than normal interbank lending rates.

Management is unable to reliably estimate the effects on the Group's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Group's business in the current circumstances.

**25. Operating Segments**

The Group early adopted IFRS 8, *Operating Segments,* for the year ended 31 December 2007. Operating segments information for the six months ended 30 June 2008 is presented without comparative figures. Management has determined the operating segments based on the management reports, which are primarily derived from statutory records and regularly reconciled to IFRS financial statements. The management reports are reviewed by the chief operating decision-maker that are used to make strategic decisions. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the President of the Company. The following criteria have been used for determining the operating segments and assigning the Group subsidiaries to particular segment:

I. Business activities of companies;
II. Organizational structure of companies;
III. Nature of production processes;
IV. Manufactured and sold products;
V. Specific characteristics of buyers/customers.

Management considers the business from both a geographical and product perspective.

The **first** operating segment "**Industrial pumps**" includes:

| | 30 June 2008 | 2007 |
|---|---|---|
| 1 | Livhydromash OJSC | Livhydromash OJSC |
| 2 | LPKC LLC | LPKC LLC |
| 3 | Electrodvigatel OJSC | Electrodvigatel OJSC |
| 4 | Livnynasos OJSC | Livnynasos OJSC |
| 5 | HYDROMASHINPROM CJSC | HYDROMASHINPROM CJSC |
| 6 | Nasosenergomash OJSC | Nasosenergomash OJSC |
| 7 | TH Sumskie Nasosy LLC | TH Sumskie Nasosy LLC |
| 8 | HYDROMASHSERVICE CJSC | HYDROMASHSERVICE CJSC |
| 9 | Hydromash-Industry LLC | |

The **second** operating segment "**Oil and gas equipment**" includes:

| | 30 June 2008 | 2007 |
|---|---|---|
| 1 | Neftemash OJSC | Neftemash OJSC |
| 2 | Nizhnevartovskremservis CJSC | Nizhnevartovskremservis CJSC |
| 3 | HYDROMASHSERVICE CJSC | HYDROMASHSERVICE CJSC |
| 4 | HYDROMASHINPROM CJSC | |

*(in thousands of Russian Roubles, unless otherwise stated)*

## 25 Operating Segments (continued)

The **third** operating segment "**Oil and gas construction**" includes:

| | 30 June 2008 | 2007 |
|---|---|---|
| 1 | Trest Sibkomplektmontaghnaladka OJSC | Trest Sibkomplektmontaghnaladka OJSC |
| 2 | Tomskgazstroy OJSC | Tomskgazstroy OJSC |
| 3 | | Otdelochnik Tomskgazstroy LLC |

The table below lists **other** companies that did not fall under the above listed operating segments:

| | 30 June 2008 | 2007 |
|---|---|---|
| 1 | Hydraulic Machines and Systems Management LLC | Hydraulic Machines and Systems Management LLC |
| 2 | Hydraulic Machines and Systems Group LLC | Hydraulic Machines and Systems Group LLC |
| 3 | HYDROMASHSERVICE CJSC | HYDROMASHSERVICE CJSC |
| 4 | Hydromashkomplekt LLC | |
| 5 | Business Center HYDROMASH LLC | |
| 6 | United Industrial Group LLC (no business) | United Industrial Group LLC (no business) |
| 7 | Sibservice LLC (no business) | Sibservice LLC (no business) |

**List of associates with the breakdown by operating segments:**

The first operating segment "Industrial pumps" includes:

| | 30 June 2008 | 2007 |
|---|---|---|
| 1 | Promburvod Plant OJSC | Promburvod Plant OJSC |
| 2 | Promburvod Trade House LLC | Promburvod Trade House LLC |
| 3 | VNIIAEN OJSC | VNIIAEN OJSC |

The second operating segment "Oil and Gas equipment" includes:

| | 30 June 2008 | 2007 |
|---|---|---|
| 1 | Dimitrovgradhimmash OJSC | Dimitrovgradhimmash OJSC |
| 2 | Sibnfteavtomatika OJSC | |

Geographically, management considers the performance of their subsidiaries in Russia, Ukraine, Belorussia and location of the customers where the Group performs its trade and commercial activities.

The reportable operating segments derive their revenue primarily from the manufacture and sale of industrial pumps, oil and gas equipment, oil and gas construction and the other products and services.

Sales between segments are carried out at arm's length. The revenue from external parties reported to management is measured in a manner consistent with that in income statement.

Management assesses the performance of operating segments based on certain measures, which are presented to chief operating decision maker. This includes the financial information on the group operating reportable segments presented in accordance with Russian Statutory Accounting regulations (RSA). The information comprises measures of revenues, depreciation and amortization, interest income, interest expense, income tax expense and total assets. The other measures used by chief operating decision maker include income tax charge and aggregate share in net profit of associates recorded based on equity method, which are calculated and presented in accordance with International Financial Reporting Standards. Besides, management uses Earnings Before Interest Tax Depreciation and Amortization, which is derived from consolidated financial statements prepared in accordance with International Financial Reporting Standards.

The RSA segment reporting information and EBITDA are reconciled to the amounts reported in the Group's consolidated financial statements prepared in accordance with International Financial Reporting Standards.

The measurement basis excludes the effects on non-recurring expenditure from the operating segments, such as restructuring costs, legal expenses and goodwill impairments, when the impairment is a result of an isolated, non-recurring event.

*(in thousands of Russian Roubles, unless otherwise stated)*

**25 Operating Segments (continued)**

The Group's financial performance by operating segments for the six months ended 30 June 2008:

| Disclosures by segments | Industrial pumps | Oil and gas equipment | Oil and gas construction | All other segments | Total | Interseg-ment elimination | Consolidated for the six months ended 30 June 2008 |
|---|---|---|---|---|---|---|---|
| Revenue, RSA | 3,409,585 | 2,783,340 | 3,010,845 | 263,701 | 9,467,471 | - | 9,467,471 |
| Revenue, IFRS | 2,395,294 | 2,455,737 | 2,872,637 | 219,268 | 7,942,936 | (159,641) | 7,783,295 |
| EBITDA, IFRS | 320,706 | 432,118 | 275,441 | 10,700 | 1,038,965 | 5,373 | 1,044,338 |
| Total assets, RSA | 6,291,265 | 2,763,691 | 2,927,019 | 1,627,524 | 13,609,499 | - | 13,609,499 |

Reconciliation of EBITDA derived from IFRS accounting records to profit before income tax as per consolidated condensed interim income statement:

| Description | Industrial pumps | Oil and gas equipment | Oil and gas construction | All other segments | Total | Interseg-ment elimination | Consolidated for the six months ended 30 June 2008 |
|---|---|---|---|---|---|---|---|
| **EBITDA, IFRS** | 320,706 | 432,118 | 275,441 | 10,700 | **1,038,965** | 5,373 | **1,044,338** |
| Depreciation and amortization | (40,352) | (32,200) | (83,466) | (3,267) | **(159,285)** | - | **(159,285)** |
| Non-monetary items* | (36,597) | (51,406) | (26,616) | (12,179) | **(126,798)** | - | **(126,798)** |
| Other income and expense | (31,636) | (6,201) | (25,512) | (12,622) | **(75,971)** | - | **(75,971)** |
| **Operating profit/loss** | **212,121** | **342,311** | **139,847** | **(17,368)** | **676,911** | **5,373** | **682,284** |
| Interest income | 13,877 | 6,388 | (444) | 862 | **20,683** | (7,473) | **13,210** |
| Interest expense | (70,840) | (49,606) | (53,200) | (2,669) | **(176,315)** | 7,473 | **(168,842)** |
| Interest expense on leasing liabilities | (129) | (541) | (6,565) | - | **(7,235)** | - | **(7,235)** |
| Other finance income and expense | - | (32) | 1,531 | - | **1,499** | - | **1,499** |
| Exchange gains and losses, net | (5,284) | 8 | - | 713 | **(4,563)** | - | **(4,563)** |
| Share of results associates | (1,036) | 10,578 | - | - | **9,542** | - | 9,542 |
| **Profit/(loss) before income tax, IFRS** | **148,709** | **309,106** | **81,169** | **(18,462)** | **520,522** | **5,373** | **525,895** |

*Non-monetary items consists of: inventory impairment provision, provision for impairment of accounts receivable, unused vacation allowance, etc.

*(in thousands of Russian Roubles, unless otherwise stated)*

## 26. Subsequent Events

In November 2008 the Group acquired a 100% interest in SPA Gidromash CJSC, for a consideration of RR 129,290, paid in cash. The company's activity is production and selling of pumps and related equipment. Management has commenced assessment of the fair values of the assets and liabilities acquired. The assessment was not completed at the time of finalising this consolidated condensed interim financial information.

| | **Attributed fair value determined provisionally** |
|---|---|
| Cash and cash equivalents | 1,351 |
| Trading securities | 12,704 |
| Loans and advances to customers | 40,284 |
| Property, plant and equipment | 55,310 |
| Intangible assets | 22 |
| Inventory | 60,831 |
| Other assets | 1,748 |
| Borrowings | (6,423) |
| Trade and other payables | (79,318) |
| Other liabilities | (30) |
| **Net assets acquired** | **86,479** |
| Goodwill and other intangible assets | 42,811 |
| **Total purchase consideration** | **129,290** |
| Less: cash and cash equivalents of subsidiary acquired | (1,351) |
| **Cash outflow on acquisition** | **127,939** |

In December 2008 the Group acquired a 86% interest in Institute Rostovskiy Vodokanalproekt OJSC, for a consideration of RR 163,032, paid in cash. The company's activity is design of water-supply systems, sewage systems and related equipment. Management has commenced assessment of the fair values of the assets and liabilities acquired. The assessment was not completed at the time of finalising this consolidated condensed interim financial information.

| | **Attributed fair value determined provisionally** |
|---|---|
| Cash and cash equivalents | 7,063 |
| Trading securities | 12,609 |
| Loans and advances to customers | 27,730 |
| Property, plant and equipment | 3,277 |
| Deferred tax assets | 511 |
| Inventory | 36,817 |
| Other assets | 172 |
| Borrowings | (2,500) |
| Trade and other payables | (45,977) |
| Deferred tax liability | (1,672) |
| **Net assets acquired** | **38,030** |
| Goodwill and other intangible assets | 130,444 |
| Minority interest | **(5,442)** |
| **Total purchase consideration** | **163,032** |
| Less: cash and cash equivalents of subsidiary acquired | (7,063) |
| **Cash outflow on acquisition** | **155,969** |

In July 2008 the Group contributed RR 966 to a newly formed HMS-Promburvod CJSC in exchange for 51% interest. This entity will be a trading company for the Group's pumping equipment and spare parts.

In December 2008 the Group acquired control over Promburvod Plant OJSC by increasing its share from 39,99% to 51.38% for purchase consideration of RR 5,078, paid in cash. Management has commenced assessment of the fair values of the assets and liabilities acquired. The assessment was not completed at the time of finalising this consolidated condensed interim financial information.

*(in thousands of Russian Roubles, unless otherwise stated)*

## 26. Subsequent Events (continued)

### *Acquisitions of non-controlling interest in subsidiaries*

Subsequent to the balance sheet date the Group acquired non-controlling interest in the following subsidiaries:

| Company name | Interest acquired, % | Cost, RR | Date of acquisition | Notes |
|---|---|---|---|---|
| Sibkomplektmontazhnaladka Trust OJSC | 0.14% | 160 | August 2008 | Paid in cash |
| Tomskgazstroy OJSC | 2% | 4,273 | August 2008 | Paid in cash |

***Reorganization of the Company.*** In 2008 the Company's participants decided to reorganize the Company into an open joint-stock company named Hydraulic Machines and Systems Group OJSC. The interests held by the Company's participants of RR 591,180 shall be exchanged to 1,182,361,300 ordinary shares of RR 0.5 par value each, and the ownership ratios of the participants will remain intact. On 29 August 2008 the Company completed the reorganization.

***Borrowings.*** Subsequent to the balance sheet date the Group's subsidiaries received short-term loans in the amount of RR 1,829,463 and long-term loans in the amount of RR 87,925 from three banks. These loans are secured by the Group guarantees. The short-term loans mature in April-August 2009 and bear the interest rates of 14%. Long-term loan bears interest rate of 10.75% and payable in September 2009.

***Dividends.*** During July-December 2008 the Group subsidiaries declared dividends to minority holders in the amount of RR 40,213.

***Change in income tax rate.*** An income tax rate of 20% has been enacted in November 2008 which becomes effective starting from 1 January 2009. If the rate of 20% was applied to calculation of tax effect of temporary differences that are expected to reverse in periods subsequent to 1 January 2009 the deferred tax liability as at 30 June 2008 would have been lower by RR 37,150.

***Impact of world liquidity crisis on Group's activity.*** As a result of world liquidity crisis several companies of the Group changed payment period from customers from 30 to 60 days. The contractual relationship with customers remained stable to 31 December 2008, except for Trest Sibkomplektmontaghnaladka OJSC. Certain customers of Trest Sibkomplektmontaghnaladka OJSC have cancelled seven contracts in the amount of RR 2,471,714. Management believes that this impact is of temporary nature and plans to compensate this drop through participation in new tenders and increase the number of contracts during the first half of 2009.

## 27. Seasonality

The sales of pumps and engineering services are subject to seasonal fluctuations, with the peak demand in the second quarter of the year. This is due to growth business activity of the customers in the second quarter of the year. For the six months ended 30 June 2008, the level of sales of pumps and engineering services represented 58% of the annual level of sales of pumps and engineering services for the year ended 31 December 2007.