

OAO Concern “Kalina”

Independent Auditors’ Report

Consolidated Financial Statements

Years Ended December 31, 2001 and 2000

OA0 CONCERN "KALINA"

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of OAO Concern "Kalina":

We have audited the accompanying consolidated balance sheets of OAO Concern "Kalina" (the "Group") as of December 31, 2001 and 2000, and the related consolidated statement of operations, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2001 and 2000, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

June 15, 2002

OAO CONCERN "KALINA"

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2001 AND 2000 (in US Dollars and in thousands)

	Notes	2001	2000
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents		\$ 9,259	\$ 11,312
Accounts receivable, net	3	13,749	16,511
Advances to suppliers and prepaid expenses, net	4	4,034	8,964
Inventories	5, 10	37,290	28,723
Taxes recoverable	6	3,980	916
Investments	7	2,928	241
Total current assets		<u>71,240</u>	<u>66,667</u>
PROPERTY, PLANT AND EQUIPMENT, net	8, 10	25,088	16,744
INTANGIBLE ASSETS, net		227	577
DEFERRED TAX ASSET	11	<u>256</u>	<u>219</u>
TOTAL ASSETS		<u>\$ 96,811</u>	<u>\$ 84,207</u>
COMMITMENTS AND CONTINGENCIES			
	15	-	-
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Accounts payable	9	\$ 20,329	\$ 28,436
Short-term debt	10	14,875	11,329
Accrued liabilities		979	617
Deferred tax liability	11	956	1,632
Taxes payable	6	<u>10,196</u>	<u>10,035</u>
TOTAL CURRENT LIABILITIES		47,335	52,049
LONG-TERM BONDS		171	-
TOTAL LIABILITIES		<u>47,506</u>	<u>52,049</u>
MINORITY INTEREST		191	-
SHAREHOLDERS' EQUITY:			
Share capital	12	21,476	3,186
Retained earnings		<u>27,638</u>	<u>28,972</u>
Total shareholders' equity		<u>49,114</u>	<u>32,158</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		<u>\$ 96,811</u>	<u>\$ 84,207</u>

See notes to consolidated financial statements.

OAO CONCERN “KALINA”

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2001 AND 2000 (in US Dollars and in thousands)

	Note	2001	2000
NET SALES		\$ 130,831	\$ 118,246
COST OF SALES		<u>85,160</u>	<u>79,613</u>
GROSS PROFIT		45,671	38,633
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES		<u>30,066</u>	<u>25,614</u>
OPERATING INCOME		15,605	13,019
OTHER INCOME (EXPENSES):			
Interest expenses, net		(2,159)	(896)
Foreign currency exchange gains, net		1,726	614
Other expenses, net		<u>(1,504)</u>	<u>28</u>
INCOME BEFORE MINORITY INTEREST AND INCOME TAX EXPENSE		13,668	12,765
Minority interest		<u>14</u>	<u>143</u>
INCOME BEFORE INCOME TAX EXPENSE		13,682	12,908
INCOME TAX EXPENSE	11	<u>4,999</u>	<u>6,917</u>
NET INCOME		<u>\$ 8,683</u>	<u>\$ 5,991</u>

See notes to consolidated financial statements.

OAO CONCERN "KALINA"

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2001 AND 2000 (in US Dollars and in thousands)

	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 8,683	\$ 5,991
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,106	2,262
Minority interest	(14)	(143)
Loss on disposal of fixed assets	103	55
Gain on disposal and reversal of allowance on investments	(572)	
Deferred tax expense / (benefit)	(713)	578
Changes in operating assets and liabilities:		
Accounts receivable	2,762	(5,954)
Accounts payable and accruals	(7,745)	8,938
Inventories	(8,567)	(5,861)
Advances to suppliers and prepaid expenses	4,930	(3,326)
Taxes receivable	(3,064)	(333)
Taxes payable	161	2,379
Net cash provided by / (used in) operating activities	<u>(1,930)</u>	<u>4,586</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant, equipment and intangible assets	(9,872)	(3,332)
Proceeds from sale of fixed assets	131	-
Purchase of securities	(11,444)	(13,266)
Proceeds from sale of securities	<u>9,205</u>	<u>13,363</u>
Net cash used in investing activities	<u>(11,980)</u>	<u>(3,235)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from short-term debt	98,375	35,468
Repayment of short-term debt	(94,935)	(24,766)
Proceeds from long-term debt	2,358	-
Repayment of long-term debt	(2,214)	-
Own shares repurchased and retired	-	(1,322)
Proceeds from issue of shares	8,676	-
Purchase of treasury shares	(256)	(99)
Dividends declared and paid	<u>(147)</u>	<u>(124)</u>
Net cash provided by financing activities	<u>11,857</u>	<u>9,157</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	(2,053)	10,508
CASH AND CASH EQUIVALENTS, beginning of year	<u>11,312</u>	<u>804</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 9,259</u>	<u>\$ 11,312</u>
CASH PAID DURING THE PERIOD FOR:		
Income tax	7,042	4,295
Interest	2,094	875

See notes to consolidated financial statements.

OAO CONCERN “KALINA”

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2001 AND 2000 (in US Dollars and in thousands)

	Share capital	Additional Paid In Capital	Retained Earnings	Total Shareholders' Equity
Balance December 31, 1999	\$ 4,693	\$ -	\$ 23,019	\$ 27,712
Retired shares	(1,408)	-	86	(1,322)
Dividends declared	-	-	(124)	(124)
Treasury stock	(99)	-	-	(99)
Net Income	-	-	5,991	5,991
Balance December 31, 2000	<u>\$ 3,186</u>	<u>\$ -</u>	<u>\$ 28,972</u>	<u>\$ 32,158</u>
Share Issuance	612	8,064	-	8,676
Increase in par value of shares	17,934	(8,064)	(9,870)	-
Treasury stock	(256)	-	-	(256)
Dividends Declared	-	-	(147)	(147)
Net Income	-	-	8,683	8,683
Balance December 31, 2001	<u>\$ 21,476</u>	<u>\$ -</u>	<u>\$ 27,638</u>	<u>\$ 49,114</u>

See notes to consolidated financial statements.

OAo CONCERN “KALINA”

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2001 AND 2000

1. DESCRIPTION OF BUSINESS

OAo Concern “Kalina” (hereinafter the “Company”), a Russian Open Joint Stock Company, was incorporated on December 12, 1992 as OAo “Uralskiye Samotsveti” under the laws of the Russian Federation (“RF”) and renamed as OAo Concern “Kalina” on November 30, 1999. The consolidated financial statements presented herein include the financial statements of the Company, a wholly owned subsidiary DP “Pallada Vostok” and its 56% owned subsidiary CJSC “Lola Atir Upa” incorporated in Uzbekistan, and a 65.48% owned subsidiary NPKK “Aliye Parusa” incorporated in Ukraine (hereinafter referred jointly as “Operating Subsidiaries” or separately as “Operating Subsidiary”). The Company and its Operating Subsidiaries (collectively referred to as the Group) manufacture a wide range of perfume, cosmetics and household products for the CIS countries.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation – The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“US GAAP”).

The consolidated financial statements include the Company and its Operating Subsidiaries. All significant intercompany transactions and balances have been eliminated.

The accounts of the Company are prepared in accordance with RF accounting laws and accounting regulations in Russian roubles (“RUR”) and then converted to accounting principles that are generally accepted in the United States of America (“US GAAP”). The accounts of the Operating Subsidiaries are prepared in accordance with local laws and accounting regulations and then converted to accounting principles that are generally accepted in the United States of America (“US GAAP”).

Business Combinations – For business combinations that have been accounted for under the purchase method of accounting, the Company includes the results of operations of the acquired businesses from the date of acquisition. The excess of the fair value of identifiable tangible and intangible net assets acquired over the purchase price (negative goodwill) was used to reduce the fair values of all noncurrent nonmonetary assets acquired in the accompanying consolidated balance sheet.

Use of estimates – The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses of the reporting period. Actual results could differ from those estimates.

Concentration of credit risk – Financial instruments that potentially expose the Group to concentration of credit risk consist primarily of cash, cash equivalents and accounts receivable. The carrying amount of financial instruments, including cash and cash equivalents and short-term obligations, approximates fair value due to the short-term maturities of these instruments.

Foreign currency translation – The Group follows a translation policy in accordance with Statement on Financial Accounting Standards No. 52, “Foreign Currency Translation”. Due to the hyperinflationary economies in the RF, Uzbekistan and Ukraine, the Group’s reporting currency, US dollar, has been designated as the Group’s functional currency. Accordingly, all foreign currency financial statements are translated into US dollars using the remeasurement method. Monetary assets and liabilities are translated into US dollars at the rate in effect as at the balance sheet date. Non-monetary balance sheet amounts are translated at the rate prevailing on the date of the transaction. Revenue and expenses are translated at the daily rates or at period average rates when such

transactions occurred. Translation gains and losses are included in foreign currency exchange gains (net).

The Russian rouble, Uzbekistan soum and Ukraine hrivna are not fully convertible currencies outside of the territory of the RF, Uzbekistan and Ukraine, respectively. The translation of rouble, soum and hrivna denominated assets and liabilities into US dollars for the purpose of these financial statements does not indicate that the Company and its Operating Subsidiaries could realize or settle in US dollars the reported values of the assets and liabilities. Likewise, it does not indicate that the Group could return or distribute the reported US dollar values of capital and retained earnings to its shareholders.

Cash and cash equivalents – Includes cash on hand and bank deposits. Cash equivalents include financial instruments with a maturity of less than ninety days when purchased.

Accounts receivable – Accounts receivable are stated at their net realizable value after deducting a provision for doubtful accounts. Such provision reflects either specific cases or estimates based on evidence of recoverability.

Investments – Investments in marketable securities consist primarily of JSC “Zhirovoy Kombinat” (Ekaterinburg), JSC “Khabarovskenergo” and Novorossiysk Steam Navigation, which are not considered to be “trading” and, accordingly, are carried on the balance sheet at cost. Gains/losses from the sale of marketable securities have been recorded in earnings.

Inventories – Inventories are stated at the lower of cost, determined by the first in first out method for raw materials and weighted average for finished goods, or market value.

Property, plant and equipment – Property, plant and equipment are carried at cost less accumulated depreciation. Depreciation is charged using the straight-line method over the asset’s estimated useful lives. When assets are retired or otherwise disposed of, the cost and the accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the statement of operations. The cost of maintenance and repairs is charged to the statement of operations as incurred. Significant renewals and betterment, that extend an asset’s estimated useful life, are capitalized.

The overall useful economic lives of the assets for depreciation purposes are as follows:

Description	Useful Life (years)
Buildings	50
Machinery and equipment	10-15
Vehicles	5
Office equipment and other assets	5

Treasury shares – Treasury shares are carried at cost as a reduction in share capital.

Sales recognition – Sales are recognized when products are shipped to the customer, net of discounts.

Income taxes – Income tax payable have been computed in accordance with the laws of the RF, Ukraine and Uzbekistan. The Group accounts for deferred taxes on income using the asset and liability method wherein material deferred tax assets and liabilities are recognized based on the future consequences of temporary differences between the financial reporting carrying amounts and tax bases of assets and liabilities using the current enacted income tax rates.

3. ACCOUNTS RECEIVABLE, NET

Accounts receivable consisted of the following at December 31, 2001 and 2000 (in thousands):

	2001	2000
Accounts receivable – trade	\$ 14,507	\$ 16,891
Bad debt allowance	(758)	(380)
Total	<u>\$ 13,749</u>	<u>\$ 16,511</u>

4. ADVANCES TO SUPPLIERS AND PREPAID EXPENSES, NET

Advances to suppliers and prepaid expenses consisted of the following at December 31, 2001 and 2000 (in thousands):

	2001	2000
Advances to suppliers	\$ 3,981	\$ 8,893
Prepaid expenses	53	270
Allowance for non-recoverability	-	(199)
Total	<u>\$ 4,034</u>	<u>\$ 8,964</u>

5. INVENTORIES

Inventories consisted of the following at December 31, 2001 and 2000 (in thousands):

	2001	2000
Raw materials	\$ 19,536	\$ 15,961
Work in process	668	1,411
Finished goods	17,086	11,351
Total	<u>\$ 37,290</u>	<u>\$ 28,723</u>

As of December 31, 2001 and 2000 inventory amounts of \$ 9,823,000 and \$ 12,775,000 respectively were pledged as security for short-term loans. See also note 10.

6. TAXES RECOVERABLE AND PAYABLE

Current taxes recoverable consisted of the following at December 31, 2001 and 2000 (in thousands):

	2001	2000
VAT	\$ 5,352	\$ 868
Other taxes	-	48
Allowance for unrecoverable VAT	(1,372)	-
Total	<u>\$ 3,980</u>	<u>\$ 916</u>

Current taxes payable consisted of the following at December 31, 2001 and 2000 (in thousands):

	2001	2000
Income tax	\$ 2,880	\$ 4,210
VAT	1,678	1,395
Road users tax	887	876
Other taxes	4,751	3,554
Total	<u>\$ 10,196</u>	<u>\$ 10,035</u>

7. INVESTMENTS

Investments consisted of the following at December 31, 2001 and 2000 (in thousands):

	2001	2000
Equity investments in JSC “Zhirovoi Kombinat” (Ekaterinburg) (EZhK) – 19.19%	\$ 1,610	\$ -
Other short-term investments	1,318	622
Allowance for other short-term investments	-	(381)
Total	<u>\$ 2,928</u>	<u>\$ 241</u>

During 2001 the Company acquired 27.24% of JSC “Zhirovoi Kombinat” (Ekaterinburg) (“EZhK”). EZhK is a Ekaterinburg-based fat and fat-based food producer. The purchase was made through acquisition of small blocks of shares from different third party investors. The intent of the purchase was to consolidate a greater block of shares from small blocks and to sell it at a substantial profit to a strategic investor in the near future. 8.05% of these shares were immediately sold to the related party OOO “Souzspezstroy” with a profit on sale of \$ 61,000. See also note 13. As a result at December 31, 2001 the Company owned 19.19% of the equity of the EZhK. The company accounts for this investment at cost.

8. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consisted of the following at December 31, 2001 and 2000 (in thousands):

	2001	2000
Land	\$ 429	\$ 429
Buildings	19,399	18,088
Machinery and equipment	56,852	58,134
Vehicles	2,906	2,802
Office equipment and other assets	1,239	765
Construction in progress	7,309	1,137
Less: accumulated depreciation	(63,046)	(64,611)
Total	<u>\$ 25,088</u>	<u>\$ 16,744</u>

At December 31, 2001 and 2000 property, plant and equipment with a net book value of \$ 1,232,000 and \$ 1,772,000 respectively were pledged as security for short-term loans. See also note 10.

9. ACCOUNTS PAYABLE

Accounts payable consisted of the following at December 31, 2001 and 2000 (in thousands):

	2001	2000
Accounts payable – trade	\$ 18,518	\$ 11,343
Short-term promissory notes issued	669	2,252
Other payables	1,142	14,841
Total	<u>\$ 20,329</u>	<u>\$ 28,436</u>

Short-term promissory notes issued by the Company have maturities of less than 12 months and bear no interest.

10. SHORT-TERM DEBT

At December 31, 2001 and 2000 the Group had \$ 14,875,000 and \$ 11,329,000 of outstanding credit facilities, respectively. These facilities are provided predominantly in RUR at an average annual interest rate of 22% and 23% for 2001 and 2000 respectively. At December 31, 2001 and 2000 these facilities are secured by the Company's finished goods and raw materials in amount of \$ 9,823,000 and \$ 12,775,000 and fixed assets in an amount of \$ 1,232,000 and \$ 1,772,000, respectively.

11. TAXES

Total tax expense consisted of the following at December 31, 2001 and 2000 (in thousands):

	2001	2000
Current tax expense	\$ 5,712	\$ 6,339
Deferred tax expense/(benefit)	(713)	578
Total	<u>\$ 4,999</u>	<u>\$ 6,917</u>

The Group provides for current taxes based on the statutory financial statements maintained and prepared in local currencies and in accordance with local statutory regulations which differ significantly from US GAAP. The Group was subject to a tax rate of 35% and 30% in Russia, 30% and 30% in Ukraine, and 20% and 26% in Uzbekistan in years 2001 and 2000, respectively. The Russian enacted tax rate for 2002 is 24%, therefore deferred tax assets and liabilities as of December 31, 2001 have been measured using this enacted tax rate.

The recruitment and employment of handicapped people resulted in the Company receiving a tax credit of 50% of the current income tax expense in 2001.

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rates to income before income taxes. The items causing this difference are as follows (in thousands):

	2001	2000
Income tax expense at statutory rates	\$ 4,788	\$ 3,872
Adjustments due to:		
Change in enacted tax rate	(321)	-
Tax credit	(5,093)	-
Permanent non-deductible differences	5,625	3,045
Income tax expense	<u>\$ 4,999</u>	<u>\$ 6,917</u>

The tax effects of temporary differences that give rise to deferred tax assets and liabilities at December 31, 2001 and 2000 are as follows (in thousands):

	2001	2000
Current deferred tax liabilities:		
Accrued Expenses	\$ 65	\$ 73
Income from Sales at accrual basis	(1,021)	(1,705)
	<u>\$ (956)</u>	<u>\$ (1,632)</u>
Non-current deferred tax assets:		
Excess of financial over tax depreciation	<u>\$ 256</u>	<u>\$ 219</u>

12. SHARE CAPITAL

As of December 31, 2000 the Group had 7,285,671 authorised, issued and outstanding (net of 283,453 treasury shares) ordinary shares at RUR 10 per share.

During the year ending December 31, 2001 an additional 1,735,030 shares at par value of RUR 10 were issued and sold to the European Bank for Reconstruction and Development (EBRD) at \$ 5 each. In December of 2001 the Group increased the par value of its shares from RUR 10 to RUR 70 per share.

As of December 31, 2001 the Group had authorized, issued and outstanding 9,020,701 (net of 655,793 treasury shares) ordinary shares with a par value of RUR 70.

The Company is owned 61.24% by an individual, 17.84% by EBRD and 20.92% by other shareholders.

13. RELATED PARTY TRANSACTIONS

The Company has two parties related by means of common control – OOO “Soyuzspetzstroy” and OOO “Stroykomplektmontazh”.

Payables to related parties as of December 31, 2001 and 2000 were as follows (in thousands):

	2001	2000
OOO “Stroykomplektmontazh”	\$ 136	\$ -
Total	<u>\$ 136</u>	<u>\$ -</u>

Receivables from related parties as of December 31, 2001 and 2000 were as follows (in thousands):

	2001	2000
OOO “Soyuzspetzstroy”	\$ 1,000	\$ 15
OOO “Stroykomplektmontazh”	-	1,181
Total	<u>\$ 1,000</u>	<u>\$ 1,196</u>

Purchases from related parties during 2001 and 2000 were as follows (in thousands):

	2001	2000
OOO "Soyuzspezstroy"		
Purchases of "Soyuzspezstroy" notes	\$ -	\$ 398
Purchase of the Company's shares (372,340 ordinary shares)	256	-
Purchase of services	100	-
OOO "Stroykomplektmontazh"		
Purchases of third party notes	-	11
Purchases of services (construction & repair)	1,280	1,199
Total	<u>\$ 1,636</u>	<u>\$ 1,608</u>

Sales to related parties for 2001 and 2000 were as follows (in thousands):

	2001	2000
OOO "Soyuzspezstroy"		
Sales of third party shares	\$ 745	\$ -
Total	<u>\$ 745</u>	<u>\$ -</u>

14. POST RETIREMENT BENEFITS

Employees of the Group are beneficiaries of the RF, Ukraine and Uzbekistan state-administered defined contribution pension program. The Group remits a required percentage of the aggregate employees' salaries to the statutory Pension Funds. As at December 31, 2001 the Group was not liable for any supplementary pensions, post retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

15. COMMITMENTS AND CONTINGENCIES

Operating environment – The Company's principal business activities are within the Russian Federation and CIS countries. Laws and regulations affecting businesses operating in the Russian Federation and CIS countries are subject to rapid changes and the Company's assets and operations could be at risk due to negative changes in the political and business environment.

Tax environment – Due to the presence in Russian, Ukrainian and Uzbek commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgment of business activities, if a particular treatment based on Management's judgment of the Group's business activities was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest. Tax years remain open to review by the tax authorities for three years.

16. SUBSEQUENT EVENT

In March 2002 the Company purchased an additional 19% of NPKK "Aliye Parusa" for \$ 450,000.