Management's discussion and analysis of financial condition and results of operations for 2007

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1. The Group's operating results

Management's discussion and analysis of financial condition and results of operations for 2007 represents management's opinion in relation to the Group's operating and financial results, including discussions of:

- key performance indicators of certain business units and subsidiaries;
- financial position as at 31 December 2007;
- issues of liquidity, solvency and capital sources; as well as
- significant events of the Company.

This discussion should be read in conjunction with the consolidated financial statements for 2007 and 2006, prepared in accordance with International Financial Reporting Standards (IFRS).

1.1 Summary of performance results

USD thousand	2007	2006 (restated)	2006
Gold sales revenue	**849,023**	**734,559**	**734,559**
Other revenue	18,096	18,127	-
Cost of gold sales	(509,158)	(422,512)	(422,512)
Other costs	**(25,866)**	**(18,816)**	-
Gross profit, including:	**332,095**	**311,358**	**311,358**
Gross profit on gold sales	**339,865**	**312,047**	**312,047**
Gross profit margin, including:	**39%**	**41%**	**42%**
Gross profit margin on gold sales	40%	42%	42%
Operating expenses	(278,322)	(99,266)	(102,767)
Operating profit	**53,773**	**212,092**	**212,072**
Operating profit margin	**6%**	**28%**	**29%**
Income/(expenses) from financial and investment activities	64,491	1,021,734	1,018,253
Income before taxation	**118,264**	**1,233,826**	**1,230,325**
Pretax margin	**14%**	**-**	**-**
Income tax expense	(71,177)	(74,385)	(73,087)
Net profit for the year	**47,087**	**1,159,441**	**1,157,238**
Minority interest	5,999	(414)	(732)
Net profit attributable to shareholders of the parent	**41,088**	**1,159,855**	**1,157,970**
Net profit margin	**5%**	**-**	**-**
EBITDA	**334,814**	**305,964**	**300,817**
EBITDA margin	**39%**	**41%**	**41%**

[1] Where in the tables hereinafter the year 2006 is not presented with a breakdown into restated and audited, the restatement does not affect the indicators in such tables

1.2 Gold sales revenue

In the reporting year Polyus Gold's revenue from gold sales reached a historical high and totaled USD 849,023 thousand, having increased by 15.6% as compared to 2006.

The positive revenue dynamics resulted solely from favorable market conditions. This year Polyus Gold produced 1,214 thousand ounces (37.8 tonnes) of refined gold, almost the same as in 2006 (1,215 thousand ounces). The Company sold 1,210 thousand ounces in 2007, which is 6 thousand ounces less than in 2006 (1,216 thousand ounces).

During the reporting period the global price of gold increased by more than 30%. On 2 January 2007, the first business day in the market, the gold price was fixed at USD 639.75[2] per ounce,
and on 28 December 2007, the last business day in the market, the gold price was fixed at USD 833.75[3] per ounce.

The Company's policy of selling gold at spot market prices (without using any type of hedging instruments) made it possible to reflect the growth in the gold price in full in the financial results for 2007. Thus, the weighted average selling price in 2007 was USD 706.48 per ounce as compared to USD 604.00 per ounce in 2006.

It should be noted that the weighted average selling price for 2007 exceeded the average evening fixing price in London by more than USD 11 per ounce, as compared to only USD 0.54 per ounce in 2006.

	2007	**2006**	**Change**
Gold sales (USD thousand)	849,023	734,559	15.40%
Gold sales (thousand troy ounces)	1,210	1,216	-0.49%
In the domestic market	1,050	874	20.14%
For export	161	342	-52.92%
The average gold selling price (USD per troy ounce)	706.48[4]	604.00	16.97%
The average evening fixing price in London (USD per troy ounce)	695.39	603.46	15.23%
Excess of average selling price over average evening fixing price, USD	11.09	0.54	-

The sales structure changed significantly. Whereas in 2006 export accounted for almost 30% of sales, in 2007 gold was largely sold in the domestic market to Russian banks (87% of sales). The increase of sales in the domestic market is explained by more favorable contracts terms concluded with Russian banks.

Like in prior years, some gold was sold under contracts which stipulated the delivery of fixed volumes at regular intervals during the year, at the same time, there was an increase in the share of gold sold under once-off deals within master agreements. Within the centralized distribution system CJSC Polyus sold both its own gold and the metal of its subsidiaries on the basis of agency agreements concluded with the subsidiaries.

[2] The evening fixing of the gold price in London
[3] The evening fixing of the gold price in London
[4] The average selling price in USD is calculated per each day, while the IFRS revenue in USD is calculated based on the Group's functional currency (Russian ruble) at the average exchange rate for 2007.

Some gold was sold under an export contract which was concluded for one year. In compliance with Good Delivery standards of the London Bullion Market Association, the gold bullion was delivered directly to the buyer's storage.

1.3 Cost of sales

In 2007 cost of sales increased by USD 86,646 thousand and totaled USD 509,158 thousand.[5]

External market factors affecting the cost of sales

All the costs included in the Group's cost of sales, and many operating costs directly or indirectly depend upon the prices for the four main consumable products, i.e. oil, steel and energy, as well as the exchange rate of the national currency to USD.

In 2007 all four consumable components saw a significant movement as compared to 2006:

	2007	**2006**	**Change**
Oil (Brent brand) (USD per barrel)	72.5	65.1	11.3%
Steel (hot rolled), (USD per tonne)	563.2	499.4	12.8%
Energy (average level of tariffs approved by energy suppliers to wholesale market) RUB/ MWth	666.9	579.9	15.0%
Average USD/RUB rate	25.5772	27.1852	-5.9%

Source: Bloomberg, RAO UES of Russia, Central Bank of Russian Federation

Changes in the oil price always impacts the prices of diesel fuel, gasoline and lubricants for mining and construction equipment and tipper trucks. The Olimpiadinskoe deposit will be severely affected with its own power plant which operates on crude oil, and the Nezhdaninsky deposit which operates an oil-fired plant.

Steel forms the basis for the price of all rolled metal products, pipes, machinery and vehicles.

The Group buys large volumes of energy from regional generating companies which set their own tariffs depending on how the region is supplied with energy and the efficiency of the distribute networks. However, the Federal Tariff Service establishes the limits for average tariffs. In the regions where the Group operates the lowest tariffs for energy in 2007 were effective in the Irkutsk region (32.47 kopecks/KWth), where the Group also owns the Vitimenergo hydro power plant. The highest tariffs were charged in the Magadan region.

The Group receives settlements with respect to gold sales either in USD or based on USD whilst most of the Group's costs are denominated in Russian Rubles. The devaluation of the USD versus the Ruble results in a decrease of profitability.

Furthermore, the Group's productive facilities are equipped with coal-based boiler houses. Blagodatnoye deposit is planned to be equipped with a coal-fired station, instead of oil-fired station provided in the project materials, as we expect higher growth in oil prices. The coal prices directly impact the tariff setting by energy generating companies.

[5] We also provide a breakdown of cost growth by each Group entity in Section 3 "Financial results by structural business units"

Cash operating costs

The main reason for the increase in cost of sales is the increase of cash operating costs within all the Group's production entities. During 2007, cash operating costs included in cost of sales amounted to USD 442,224 thousand.

The largest item included in cash operating costs is materials and spare parts used during the mining, concentration and smelting processes. The materials and spare parts which the Group procures consist of spare parts for mining and construction machines, fuel, lubricants, rolled metal products, cables, and technological materials for the gold mill.

The cost of materials and spare parts consumed in 2007 totaled USD 200,601 thousand as compared to USD 152,854 thousand in 2006 (an increase of 17%). The growth is primarily due to the increase in ore volumes processed. The biggest increase of approximately 30% was registered at the Group's largest mining entity – Olimpiada mine (about 60% of the Group's cost of materials and spare parts in 2007 and 2006).

Moreover, the cost of some materials and spare parts which the Group procured in the reporting year also increased. Provided below is a comparative table which shows the main materials purchased by the Krasnoyarsk business unit:

No.	Description	Unit of measure-ment	2007		2006	
			Volume	Cost USD million	Volume	Cost USD million
1	Summer diesel fuel	tonne	49,947	29.5	39,440	24.0
2	Winter diesel fuel	tonne	33,951	22.7	30,121	20.3
3	Spare parts for tipper trucks and digging machines			12.2		8.0
6	Grinding balls	tonne	7,218	6.8	2,600	1.5
9	Pipes for current operations	tonne	752	1.3	525	0.8
10	Spare parts for road-building machines			1.0		1.3
11	Metal rolling products for current operations	tonne	718	0.8	717	0.5
13	A80 gasoline	tonne	420	0.3	420	0.3
14	Ai-92 gasoline	tonne	312	0.2	240	0.2
Total				**74.9**		**56.8**

As can be seen from the table above, the procurement of materials and spare parts by the Krasnoyarsk business units in USD terms grew by 31.8% from USD 56.8 million to USD 74.9 million.

The volume of purchases in physical terms increased mainly on account of diesel fuel and grinding balls (due to the commissioning of Mill No. 3). In monetary terms the increase was due to purchase of spare parts.

General review of the materials and spare parts purchased by the Krasnoyarsk business unit shows that prices increased for pipes, metal rolling products and grinding balls. Conversely, the prices for diesel fuel and gasoline in 2007 were somewhat lower than in the previous year which is explained by tough regulation on prices for oil products in Russia rather than by market conditions.

The second largest item in cash operating costs is payroll expense. Whereas in 2006 the payroll expenses for production staff amounted to USD 104,358 thousand (including USD 77,808 thousand for mining staff payroll and USD 26,550 thousand for concentration and smelting staff payroll), in 2007 these expenses increased to USD 144,008 thousand. The 38% increase is higher than the increase in labor costs across Russia (~ 20% in 2007), is aimed to offset the inflationary component. The reason for this is that in 2007 the employees of the Olimpiada mine received bonuses for early commissioning of Mill No. 3. Moreover, all the Group's production entities are located in the Far North regions or the regions which are equivalent to the Far North, as a result of which the Group is obliged to pay additional compensation.

Due to the increase in the gold price the Group paid USD 51,138 thousand in mineral extraction tax (MET), which is USD 8,777 thousand more than in 2006. In accordance with Chapter 26 of the Tax Code of the Russian Federation, the MET tax base includes concentrate or any other semi-product containing precious metal obtained by extraction of this metal from ore, alluvial or industrial deposits, i.e. the gold produced by the Group. Concentrates and other semi-products containing gold are liable to the tax at the rate equal to 6% of the cost of these semi-products. The cost is determined based on the taxpayer's selling prices for the relevant tax period.

Depreciation of property, plant and equipment

Depreciation of property, plant and equipment included in cost of sales increased by 18% from USD 73,718 thousand to USD 87,196 thousand. This amount includes depreciation accrued using the straight-line method (USD 71,097 thousand) and amortization of the mineral rights (USD 16,180 thousand). The increase resulted mainly from commissioning of new mining and metallurgical facilities, including Mill No. 3.

1.4 Selling, general and administrative expenses

Selling, general and administrative expenses represent 95% of operating costs and amount to USD 261,776 thousand. During 2007 the Group's selling, general and administrative expenses increased by 229% from USD 79,678 thousand.

Payroll

The payroll for administrative staff increased by USD 32,272 thousand to USD 76,291 thousand. All the Group's entities demonstrated an increase in administrative staff payroll. Thus, the Krasnoyarsk business unit (the Olimpiada mine) accounting for 46% of these expenses, demonstrated a 43% increase. The Irkutsk hard rock business unit (Zapadny mine) demonstrated a 17% increase in administrative staff payroll costs.

Taxes, other than MET and income tax

In addition to metal extracting tax and income tax the Group pays property tax, VAT, unified social tax and other taxes. In 2007 the Group expensed USD 20,724 thousand to the Russian federal budget and the regional budgets in the form of tax payments other than MET and income tax. It is almost 83% more than in 2006. This is due to an increase of non-recoverable VAT. The amount of non-recoverable VAT increased significantly at CJSC Polyus (Krasnoyarsk business unit) which made contributions to the share capitals of new subsidiaries in non-monetary form and for this reason reversed VAT for a total amount of about USD 2.7 million.

USD million	**2007**	**2006**
VAT	10.092	3.377
Property tax	8.231	5.135
Other taxes	2.397	2.708
Tax penalties	0.4	0.102

Share option plan

In April 2007 the Board of Directors passed a resolution to implement a share option plan. As at 31 December 2007 4,575,065 shares were sold, which is 2.40% of the Company's issued share capital. In 2007 the costs associated with the implementation of the share option plan totaled USD 132,548 thousand.

Other selling, general and administrative expenses

Other selling, general and administrative expenses which for the purpose of this review include rental and communication costs, professional and banking service fees, and repair and maintenance costs increased by USD 7,876 thousand and amounted to USD 32,213 thousand.

Other selling, general and administrative expenses increased mainly due to product selling costs, for instance, the costs for transportation of finished products increased more than 5 times to USD 1,027 thousand. The Group's expenses for professional service fees also increased by more than 50% and totaled USD 7,528 thousand in 2007.

1.5 Research and development, exploration and mining costs

These costs decreased by USD 1,357 thousand and amounted to USD 6,217 thousand mainly due to the decrease of exploration and mining workings costs overall within the Group.

1.6 Other operating gains and expenses

During 2007 the Group's other operating expenses amounted to USD 7,696 thousand which is USD 5,602 thousand more than in 2006. The increase is due to changes in the provision for long-term VAT recoverable (+USD 3,641 thousand). Moreover, in 2007 the Group reached an amicable settlement with one of its creditors, as a result of which it was released from payment of interest on a loan totaling USD 4,055 thousand.

Other operating expenses increased by 27.8% to USD 18,025 thousand. Key expenses in this group in 2007 included:

- losses arising from property, plant and equipment write-off – USD 6,421 thousand. Compared to 2006 the losses increased fourfold, which is mainly due to the difference in property, plant and equipment valuation in accordance with RAS and IFRS;
- charity expenses amounted to USD 3,868 thousand in the reporting year, or twice as much as in 2006;
- increase in losses due to the impairment of inventories.

1.7 Finance costs

In 2007 the finance costs did not change significantly and amounted to USD 6,629 thousand.

1.8 Investment income/(expense)

Investment income in the reporting period amounted USD 61,537 thousand, which is twice lower than the restated investment income for 2006 in the amount of USD 121,649 thousand (income is restated for the once-off income arising from the sale of Gold Fields shares in the amount of USD 980,462 thousand). Decrease of income from investing activity relates primarily to a reduction of income from interest on bank deposits and a reduction of the effective yield on money placed in trust management. At the year-end 2007, bank deposits amounted to USD 443,653 thousand as compared to USD 608,957 thousand at the end of 2006.

1.9 Foreign exchange gain/(loss)

During 2007 the Group recognized a foreign exchange gain of USD 9,583 thousand, as compared to a loss of USD 73,924 thousand in 2006. During 2006, net foreign exchange loss from investing activity of the Group amounted to USD 82,321 thousand and related mainly to the effect of translation of foreign operations, which is recognized in the statement of changes in equity from 2007.

1.10 Income tax

During 2007 the Group accrued USD 71,177 thousand in income tax. The effective income tax rate (ratio of current and deferred tax to IFRS income before tax and minority interest) in 2007 was 60%, whereas the statutory income tax rate in Russia established in 2007 was 24%. (refer to note to financial statements 16).

1.11 Other revenues and cost of sales

Revenues received by the Group from the sale of other products (other than gold) and services virtually did not change from 2006 and amounted to USD 18,096 thousand. This revenue includes sales of electricity, revenue from transportation, handling and warehousing services, and other revenues.

In 2007 the cost of sales of other products and services was higher than the revenue from their sale and amounted to USD 25,866 thousand. This had a negative effect on the Group’s gross profit, which was USD 332,095 thousand as compared to USD 339,865 thousand, without non-core operations.

A gross loss on sale of other products and services amounted to USD 7,770 thousand, which is explained by the fact that revenue and cost of sale include heterogeneous works and services.

Thus, sale of electricity to third parties accounts for most of other revenues – USD 8,078 thousand. For comparison, in 2006 the Company sold energy only for several USD thousands.

At the same time, the most considerable items of the other cost of sales include materials and payroll costs.

2. Calculation of key performance indicators not stipulated by IFRS standards

For analysis of financial statements many analysts and investors use key performance indicators which are not envisaged by IFRS but which are nevertheless calculated on the basis of financial statements prepared in accordance with IFRS.

Earnings before interest, taxes, depreciation and amortization ("EBITDA")

EBITDA is a key performance analytical indicator comprising of income before interest expenses, payment of taxes and depreciation charges.

The Group's EBITDA in 2007 was USD 334,814 thousand, which is USD 28,850 thousand more than in 2006. The Group calculates EBITDA as follows:

USD million	**2007**	**2006 (restated)**	**2006**
Income for the year	47,087	1 159,441	1 157,238
+ Income tax paid	71,177	74,385	73,087
+ Depreciation and amortization for the period	92,415	78,477	79,025
+ Interest expense [6]	2,574	6,453	6,453
- Interest income	51,493	107,616	107,616
- Income on disposal of investments	9,898	987,696	987,696
-/+ Foreign exchange gain/(loss)	9,583	73,924	73,924
+ Loss from disposal of property, plant and equipment and work-in-progress	6,421	1,494	1,494
Impairment of property, plant and equipment	312	-	-
+ Reversal of environmental obligations	-	2,094	2,094
+ Excess of the acquisition price of the subsidiary over the fair value of net assets acquired at date of acquisition	-	2,194	-
+ Change of provision for VAT receivable	-	2,814	2,814
+ Losses from stock option plan obligations	132,548	-	-
+ Excessive stripping	53,254	-	-
EBITDA	**334,814**	**305,964**	**300,817**

[6] Excluding interest remission

Total cash costs ("TCC")

TCC is a key performance indicator reflecting the cost of goods sold adjusted for non-cash costs for depreciation, change of provision for vacation payments and provision for land rehabilitation, and stated in the report per troy ounce of the gold sold.

	2007	2006
Cost of sales (USD thousand)	509,158	422,512
- property, plant and equipment depreciation (USD thousand)	87,196	73,718
- provision for annual vacation payment (USD thousand)	4,190	2,663
- provision for land rehabilitation (USD thousand)	482	7,318
+ non-monetary changes in inventories (USD thousand)	3,944	1,167
TCC, (USD thousand)	421,234	339,980
Gold sales, thousand troy ounces	1 210	1 216
TCC, USD/oz.	348	280
TCC without excessive stripping, USD/oz.	304	280
TCC without excessive stripping, RUB/oz.	7 775	7 612

Management deems it reasonable to present TCC calculation net of excessive stripping. Starting 2007, the Group significantly increased the volume of stripping work at one of its key mining entities, Olimpiada mine. This fact relates to depletion of oxidized ore reserves and beginning of sulfide ore mining. Sulfide ore has a lower gold grade.

In order to mine sulfide ore, the Group began a major program of mine preparation work which does not relate to the ore mined in the period and is called excessive stripping. Until now, the Group accounted for this work in the cost of gold produced and sold for the period for the purposes of IFRS consolidated financial statements.

Currently, the Group is analyzing the current practice of accounting for excessive stripping in accordance with IFRS, in particular, is evaluating possible approaches and options of recognizing this work as capital expenditure with subsequent depreciation.

Furthermore, it is practical to analyze TCC taking into account USD devaluation. When presenting the TCC (net of excessive stripping) in Russian rubles, we see that the actual growth of TCC amounted to only 2.1%, whereas without changing the rate it amounted to 8.6%.

Capital expenditures ("Capex")

Capex represent the Company's investment into the purchase and modernization of property, plant and equipment and the costs connected with the service of loans used for the purchase of property, plant and equipment.

USD million	**2007**	**2006 (restated)**	**2006**
Acquisition of subsidiaries, net of cash acquired, and increase of ownership in subsidiaries	-	307,667	307,667
+ Deferred payments for acquisition of subsidiaries	38,228	61,817	61,817
- Proceeds from disposal of subsidiary, net of cash disposed of	-	-	-
+ Purchase of property, plant and equipment	382,802	267,551	261,856
- Proceeds from sale of property, plant and equipment	17,952	12,030	12,030
+ Interest expenses capitalized	-	-	-
Total capital expenditures	**403,078**	**625,005**	**619,310**

3. Financial results by structural business units

This section deals only with the review of financial results of business units. Operating activities, key operation indicators, and technology of mining and processing operations are reviewed in Section 4.1. Operating activities in 2007 (by business unit).

3.1 Summary table of performance results by business-units

	Revenue USD '000	**Production 000 oz**	**Sales 000 oz**	**Net profit USD '000**	**TCC USD/oz.**
Krasnoyarsk business unit	602,867	861	856	173,892	307
Irkutsk hard rock business unit	23,231	32	34	(4,977)	471
Irkutsk alluvial gold business unit	124,111	179	179	6,918	491
Yakutia business unit	98,032	142	142	5,277	452
Group total	849,023	1,214	1,211	47,087	348

3.2 Krasnoyarsk business unit (Olimpiada mine)

USD thousand	**2007**
Revenue	602,867
Cost of sales	(311,557)
Gross profit	291,310
Gross profit margin	48.3%
Operating expenses	(71,852)
Operating profit	219,458
Operating profit margin	36.4%
Financial and other non-operating losses	(17,746)
Income tax	(63,312)
Net profit	173,892
Net profit margin	28.8%

The Krasnoyarsk business unit is the Group's leading mining operation. In 2007, revenues of the Krasnoyarsk business unit were USD 602,867 million.

In 2007 the entity sold 856.2 thousand ounces of gold from 861 thousand ounces of gold produced during the reporting period. 81% or 695.6 thousand ounces of gold were sold in the domestic market and the remaining 160.6 thousand ounces of gold were exported. Some of the gold for export was sold under a contract which was concluded for a one-year period. In compliance with Good Delivery standards of the London Bullion Market Association, the gold bullion was delivered directly to the buyer's storage.

The mine's TCC in 2007 amounted to USD 307 per ounce compared to USD 210 per ounce in 2006. The increase in TCC was mainly due to complication with mining and geological conditions.

Primarily this refers to the transition to the sulfide ores processing. Whereas in 2006 sulfide ores represented 67% of the total volume of ores processed, in 2007 this figure increased to 73%. As the Group anticipates, in 2009 the Olimpiada mine will completely convert to the processing of sulfide ores.

Sulfide ores represent metasomatic ore bodies, which are refractory in nature, with the average gold grade several times lower than in oxidized ores, and that require a special processing technology. To produce one ounce of gold the entity has to process much larger quantities of such ore compared to oxidized ore. For instance in 2006 to produce one ounce of gold the Olimpiada mine processed 3.7 tonnes of ore, while in 2007 5.2 tonnes of ore were required for the same purposes.

Secondly, there was an increase in the volume of stripping works. During 2007 we observed a 30% growth with respect to these types of work owing to the fact that upon transition to production of sulfide ores the entity significantly extended the pit boundary.

However the Krasnoyarsk business unit remains one of the most profitable entities of the Group and the Olimpiada mine's TCC indicator is one of the lowest in the world gold production sector. The gross margin during 2007 was 48.3%. Operating costs increased from USD 48 million in 2006 to USD 72 million in 2007. This is primarily explained by the growth of general and administrative expenses.

During the reporting period Krasnoyarsk business unit's (Olimpiada mine) investment income amounted to USD 14 million and the exchange rate gains amounted to USD 9 million. This resulted in recognition of a net profit margin in the amount of 28.8%.

3.3 Irkutsk hard rock business unit (Zapadny mine)

USD thousand	**2007**
Revenue	23,231
Cost of sales	(23,776)
Gross loss	(0,545)
Gross profit margin	-
Operating expenses	(1,535)
Operating loss	(2,080)
Operating profit margin	-
Financial and other non-operating losses	(0,488)
Income tax	(2,409)
Net loss	(4,977)
Net profit margin	-

The Irkutsk business unit (Zapadny mine) mines Zapadny deposit in the Bodaibo district of the Irkutsk region.

The Zapadny mine's IFRS revenue amounted to USD 23,231 million, which is somewhat more than in 2006. In 2007 the Irkutsk business unit mined 750 thousand tonnes of ore as compared to 803 thousand tonnes in 2006; however, it produced 1 tonne (34 thousand ounces) of gold retaining production at 2006 level. Thus, insignificant revenue growth is associated solely with growth of gold price in the reporting period.

In 2007 the Irkutsk business unit sold 33.5 thousand ounces of gold, which is more than the volume produced in the reporting period (gold was also sold out of stock).

The Zapadny mine's TCC in 2007 amounted to USD 471 per ounce compared to USD 408 per ounce in 2006. TCC grew by 15.4% primarily due to inflationary growth of the cost of sales.

During 2007, Zapadny mine incurred a net loss of USD 4,977 million. The gold mill at Zapadny mine was commissioned in 2004 only, primarily for the purpose of the development of ores of the Sukhoy Log ore field. The mill is in the process of improving mining work technology, which is a normal process during the first years of operations. Application of state-of-the-art technologies, and implementation of a system of transportation flows management will allow Zapadny mine not only to develop the Sukhoy Log's ores but also to become a profitable company in the nearest future.

3.4 Irkutsk alluvial gold business unit (Alluvial deposits)

USD thousand	**2007**
Revenue	124,111
Cost of sales	(101,952)
Gross profit	22,159
Gross profit margin	*17.9%*
Operating expenses	(14,841)
Operating profit	7,317
Operating profit margin	*5.9%*
Financial and other non-operating losses	(0,057)
Income tax	(0,342)
Net profit	6,918
Net profit margin	*5.6%*

The Irkutsk alluvial gold business unit develops a number of alluvial deposits in the Irkutsk region.

In 2007, revenues of the Irkutsk alluvial gold business unit amounted to USD 124,111 thousand. In 2007 the total gold production from the alluvial deposits amounted to 5.58 tons or 179 thousand ounces compared to 5.32 tonnes or 172 thousand ounces in 2006.

In 2007 the Irkutsk alluvial gold business unit sold 178.9 thousand ounces of gold from 179 thousand ounces of gold produced within the reporting period. Both the parent, OJSC "Lenzoloto", and its subsidiaries sell the gold.

Alluvial deposits' TCC in 2007 amounted to USD 491 per ounce as compared to USD 514 per ounce in 2006. The TCC reduction by 4.5% is primarily due to the fact that the entity managed to increase production volumes with costs being comparable to the 2006 level, as well as to the fact that during the reporting year the entity did not incur any costs for land rehabilitation

The net profit of the Irkutsk alluvial gold business unit amounted to USD 6.9 million, and net profit margin to 5.6%

3.5 Yakutia business unit (Kuranakh mine)

USD thousand	**2007**
Revenue	98,032
Cost of sales	(76,319)
Gross profit	21,713
Gross profit margin	*22.1%*
Operating expenses	(11,693)
Operating profit	10,020
Operating profit margin	*10.2%*
Financial and other non-operating losses	(2,953)
Income tax	(1,791)
Net profit	5,277
Net profit margin	*5.4%*

The Kuranakh mine holds licenses for the development of 11 hard rock gold deposits in the Aldan district of the Republic of Sakha (Yakutia).

IFRS revenue of the Yakutsk business-unit totaled USD 98,032 thousand compared to USD 94,656 thousand in 2006. The revenue growth is associated solely with the growth of the selling price; the physical production of refined gold by the Kuranakh mine in 2007 went down and amounted to 4.4 tonnes or 142 thousand ounces compared to 4.8 tonnes or 156 thousand ounces in 2006. The decrease of gold production by Kuranakh mine relates primarily to deterioration of the average gold grade of the processed ore.

In 2007 the Yakutia business-unit sold 141.8 thousand ounces of gold from 142 thousand ounces of gold produced within the reporting period.

Kuranakh mine’s TCC in 2007 amounted to USD 452 per ounce compared to USD 411 per ounce in 2006. Growth of TCC by 10.0% relates to growth of transportation costs (transportation, handling, warehousing).

The operating margin in 2007 was 10.2% compared to 13.9% in the previous year. The Kuranakh mill was commissioned in 1965 and is one of the oldest enterprises in the industry. Obsolete production facilities explain gradual reduction of profitability. In 2007-2008 the Company is implementing a modernization program which will result in gradual increase in profitability and production in the nearest future. In 2007 a decision was taken to increase the Mill’s productivity from 36.6 million tonnes of ore per year to 4.5 million tonnes of ores per year; and an agreement was signed with the general designer. We anticipate that the works on Mill modernization will be completed by October 2008.

The net profit of the Yakutia business unit amounted to USD 5.3 million, and net profit margin to 5.4%.

4 Review of financial sustainability and solvency

4.1 Analysis of balance sheet items

Assets

Non-current assets

In 2007 the Group's assets structure did not go through significant changes. Whereas in 2006 non-current assets accounted for 43% of all the assets, in the reporting period their share increased up to 49%.

It is primarily due to the increase of the carrying value of all types of property, plant and equipment. In 2007 the Group was actively involved in geological exploration and construction works, therefore the capitalized expenses for exploration and evaluation works (125%) and assets used in construction-in-progress works (15%) increased more than any other property, plant and equipment. The value of the most significant group of assets – mining assets – increased by 18% and amounted to USD 1,253,565 thousand.

Current assets

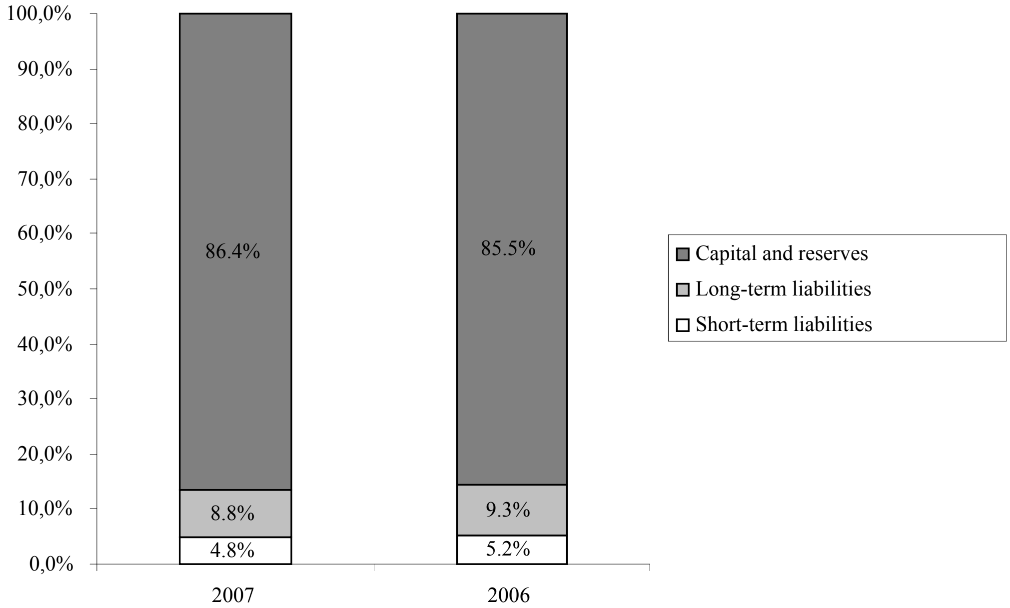
In the reporting period there was an increase in the most significant groups of current assets, such as investments in securities and other financial assets, inventories and accounts receivable, while cash and cash equivalents, on the contrary, decreased.

As at 31 December 2007 the value of short-term investments into securities and other financial assets increased by almost 3% and amounted to USD 1,270,918 thousand. This primarily refers to loans under repurchase agreements which grew by USD 90 million, bank deposits and investments in securities available for sale also grew significantly.

Cash and cash equivalents on the Group's accounts decreased by almost USD 70 million. As at 31 December 2007 the Group's balance sheet included USD 226,174 million of cash compared to USD 294,197 million at the end of 2006. This is explained by the growth of investments in securities and a capital expenditure program. Such an intensive program of capital expenditure required significant investments. The Group's management pursues a policy of using its own current assets to finance the program in order to retain OAO Polyus Gold's financial sustainability and to delay debt financing as long as possible.

Inventories increased by 37% and amounted to USD 231,985 thousand. Materials and spare parts which amount to 73% of the total inventories value, increased by 32% compared to 2006 to USD 170,373 thousand. The volumes of diesel fuel, grinding balls and spare parts purchased for mining equipment significantly increased. It is explained by the fact that there was a several times increase in the volumes of processing at the Olimpiada mine. The cost of gold under processing also increased and amounted to USD 62,414 thousand compared to USD 40,706 thousand.

Capital and liabilities



It follows from the chart that the structure of the Group's capital and liabilities did not significantly change compared to 2006.

Share capital and reserves

As at 31 December 2007 the share capital and reserves amounted to USD 3,236,183 thousand, compared to USD 2,834,269 thousand in 2006.

The value of treasury shares at the end of the reporting period amounted to USD 730,450 thousand, which is 27% less than at the end of 2006. This is due to the fact that during the reporting period the company sold 4,575,065 shares out of earlier purchased shares under the stock option program.

The additional paid-in capital decreased insignificantly and totaled USD 2,118,165 thousand (compared to USD 2,190,661 thousand in 2006).

During the reporting period retained earnings did not change significantly and amounted to USD 1,337,346 thousand. During the reporting period the company paid out dividends based on 2006 results for the first time; the amount of dividends paid was approximately USD 24 million.

Long-term liabilities

The largest group of non-current liabilities is represented by deferred tax liabilities which at 31 December 2007 amounted to USD 183,356 thousand compared to USD 176,495 thousand in the previous year.

The rest of non-current liabilities changed insignificantly.

Current liabilities

The current liabilities structure slightly changed. First of all, the Group retained liabilities under the unused stock option plan in the amount of USD 5,357 thousand, which corresponds to the fair value of the option for 0.1% of treasury shares representing the reserve for the stock option plan.

Trade payables virtually did not change and amounted to USD 21,651 thousand. Other payables and interest payable as at 31 December 2007 were USD 78,575 thousand, which is 58% more than in the previous year. This relates mainly to an increase in the volumes of property, plant and equipment purchases. Furthermore, the Group's outstanding amounts on payroll settlements as of the year end were USD 28,069 thousand compared to USD 9,255 thousand as at 31 December 2006, which is mainly explained by technical difficulties – complexity of non-cash settlements at the end of the financial year.

Current tax liabilities as at the end of 2007 amounted to USD 33,850 thousand, which is 32% more compared to 2006. The growth mainly occurred on account of income tax (+68%) and VAT (+43%) liabilities.

4.2 Analysis of profitability indicators

USD mln., unless otherwise indicated	**2007**	**2006 (restated)**	**2006**
Net profit	47,087	1,159,441	1,157,238
Net profit adjustment	132,548	(980,462)	(980,462)
Adjusted net profit	179,635	178,979	176,776
Assets	4,107,079	3,651,478	3,644,002
Equity attributable to shareholders of the parent	3,499,010	3,090,622	3,085,097
Non-current and current loans and borrowings	19,308	12,116	12,116
Asset profitability, %	4.37%	4.90%	4.85%
Equity profitability, %	5.13%	5.79%	5.73%
Invested capital profitability, %	5.11%	5.77%	5.71%

Profitability of both assets and equity as well as invested capital did not significantly change but had a slight tendency to decrease. It is explained by the general profitability decrease within the sector due to the growth of inflationary costs which is not fully offset by the growth of product prices.

4.3 Cash flow analysis

USD thousand	**2007**	**2006**
Cash provided by operations	187,010	147,087
Cash provided by/(used in) investing activities	(311,110)	695,490
Net cash (used in)/ provided by financing activities	42,085	(632,895)
Effect of translation to presentation currency	13,992	56,157
Net increase in cash		
Cash, beginning of year	294,197	28,408
Cash, end of year	226,174	294,197

In 2007 net cash provided by operations increased by USD 39,923 thousand up to USD 187,010 thousand. Growth of net inflow of cash from operations resulted from a USD 39,710 thousand reduction in current income tax provision.

During 2007 the Group used USD 311,110 thousand in investment activities[7] while in 2006 it received USD 695,490 thousand from investment activities.

Total change of net cash flows from investment activities amounted to USD 1,006.600 thousand and was mainly caused by the following:

- during 2006 the Group sold Gold Fields shares which were purchased in 2005, which made it possible to recognize income in the amount of USD 1,925,402 thousand;
- during the year ended 31 December 2006 the Group received interest income of USD 109,078 thousand (USD 88,382 thousand more than in 2007) and final dividends for 2005 from Gold Fields in the amount of USD 6,420 million;
- during 2007 the company was actively purchasing property, plant and equipment. The total amount spent for these purposes totaled USD 382,802 thousand.

Cash received from financing activities for the year ended 31 December 2007 totaled USD 42,085 thousand compared to cash used in financing activities in the amount of USD 632,895 thousand. Net cash outflow in 2006 was mainly explained by the redemption by the Group of OJSC Polyus Gold shares issued in November 2006 for the amount of USD 995,557 thousand, which was partly offset by cash inflows from OJSC MMC Norilsk Nickel in the amount of USD 360,197 thousand in the process of spin-off. During the reporting year under the stock option plan implementation the Group received cash from the sale of its shares in the amount of USD 64,051 thousand.

[7] Capital expenditure represents part of cash used in investing activity