Open Joint Stock Company Power Machines and subsidiaries

Consolidated Financial Statements

for the year ended 31 December 2004

Contents

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Independent Auditor's Report

To the Board of Directors of
Open Joint Stock Company Power Machines and subsidiaries

1 We have audited the accompanying consolidated balance sheet of Open Joint Stock Company Power Machines and its subsidiaries (the "Group") as of 31 December 2004 and the related statements of income, changes in shareholders' equity and cash flows for the year then ended. These consolidated financial statements, as set out on pages 5 to 33, are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2 Except as described in paragraphs 3 and 4, we conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3 The inventory balances of the Group include USD 3,660 thousand of finished goods and work in progress that was produced to customer orders that were subsequently cancelled by the customers. No provision has been created for these balances as of 31 December 2004 based on the fact that management believes that this inventory may be further used in the production of other equipment or sold to other customers in the future. As of the date of our opinion management had not provided us with an analysis of the net realizable value of this inventory and the items had not been utilized in production or sold. It was not practicable for us to extend our procedures to sufficiently satisfy ourselves as to the carrying value of this inventory and the related decrease of deferred income tax expense and liability.

4 The Group has not recorded a provision for the expected future loss of USD 5,946 thousand for an onerous contract and the relative decrease of deferred income tax expense and liability of USD 1,427 thousand. Subsequent to balance sheet date management negotiated with the customer an increase in the contract price subject to approval by the government of the country in which the customer is located on the basis of increased material costs incurred. Management believes it is probable that approval will be obtained from the government and that a loss will not be incurred under the contract. As of the date of our opinion the negotiation of an increase in the price of the contract had not been approved by the government. Additionally, the existing contract does not allow for price escalation based on an increase in material costs of production. Due to the fact that there was no written documentation available on which to base the decision not to create a provision, it was not practicable for us to extend our procedures to sufficiently satisfy ourselves that a provision of USD 5,946 thousand is not required and that there is no need to decrease the deferred income tax expense and liability by USD 1,427 thousand.

5 The Group has breached two covenants under a long-term agreement with a bank, and has received a waiver from that bank for such breaches to date. However projections have indicated that it is probable that the Group will breach the same ratios during the 12 months following balance date. No waivers have been received from the bank in respect of these expected breaches, but management expects to be able to negotiate extensions with the bank until such time when the Group will meet the covenants.

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In terms of IAS 1 the Group has not met the criteria for continuing to classify the amount of USD 41,408 thousand as a long-term liability, and is required under those terms to reclassify this amount as a current liability. Such a reclassification would result in the violation of the conditions of another long-term loan with another bank, and render it necessary to reclassify the long-term liability of USD 15,000 thousand to that bank to current liabilities. Therefore the Group has not reclassified the total of such liabilities of USD 56,408 thousand in contravention of the terms of IAS 1.

In our opinion, except for the matter in paragraph 5 above and except for the effect, if any, had we been able to satisfy ourselves in respect of the matters discussed in paragraph 3 and 4, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2004 and the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

ZAO KPMG
05 May 2005

Consolidated balance sheet

As at 31 December 2004 *In thousands of US dollars*	Note	2004	2003
Assets			
Property, plant and equipment	12	250,061	218,248
Intangible assets	13	26,376	14,995
Investments in associates	14	5,991	10,918
Other investments	15	6,842	17,921
Notes receivable available-for-sale		75,073	85,360
Other non-current receivables	16	26,771	31,891
Total non-current assets		391,114	379,333
Inventories	17	87,495	114,545
Trade receivables	18	185,949	57,547
Other receivables	19	175,153	147,713
Notes receivable available-for-sale		14,810	15,530
Other investments	15	2,173	14,563
Cash and cash equivalents	20	12,933	65,973
Total current assets		478,513	415,871
Total assets		869,627	795,204
Shareholders' equity	21		
Ordinary shares		8,382	7,789
Preference shares		2,181	2,181
Additional paid-in capital		125,280	125,873
Treasury shares		-	(27)
Translation reserve		36,493	18,132
Retained earnings		142,981	132,966
Total shareholders' equity		315,317	286,914
Minority interest		1,415	1,284
Total shareholders' equity and minority interest		316,732	288,198
Liabilities			
Loans and borrowings	22	133,033	31,910
Deferred tax liabilities	24	35,750	45,918
Other non-current liabilities	26	33,239	31,413
Total non-current liabilities		202,022	109,241
Loans and borrowings	22	104,163	200,018
Trade and other payables	25	246,710	197,747
Total current liabilities		350,873	397,765
Total liabilities		552,895	507,006
Total shareholders' equity, minority interest and liabilities		869,627	795,204

The consolidated financial statements were approved on 05 May 2005 and signed by:

E.K. Yakovlev
Chief Executive Officer

N.A. Kuznetsov
Chief Financial Officer

The consolidated balance sheet is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 9 to 33.

Consolidated income statement

For the Year ended 31 December 2004

In thousands of US dollars	Note	2004	2003
Revenues	4	661,967	352,305
Cost of sales		(483,941)	(224,185)
Gross profit		178,026	128,120
Distribution expenses		(47,608)	(13,925)
Administrative expenses	5	(89,177)	(78,807)
Social costs		(4,077)	(4,287)
Other operating income/(expenses)	6	17,451	(1,261)
Profit from operations		54,615	29,840
Net financing expenses	8	(30,721)	(18,865)
Income/(loss) from associates		29	(62)
Profit before tax and minority interest		23,923	10,913
Income tax expense	9	(13,709)	(6,397)
Profit before minority interest		10,214	4,516
Minority interest		(199)	(1,279)
Net profit for the period		10,015	3,237

The consolidated income statement is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 9 to 33.

Consolidated statement of cash flows

For the Year ended 31 December 2004

In thousands of US dollars	2004	2003
Operating activities		
Net profit for the year	10,015	3,237
Adjustments for:		
Depreciation and amortisation	25,250	17,640
Gain on disposal of property plant and equipment	(5,692)	(404)
Gain from disposal of investments	(516)	(282)
Impairment of investments	11,276	588
(Income)/ Loss from associates	(29)	62
Interest income	(9,971)	(6,372)
Interest expense	26,845	24,203
Income tax expense	13,709	6,397
Unrealised foreign exchange gains	(9,472)	(3,336)
Minority interests	199	1,279
Operating profit before changes in working capital and provisions	61,614	43,012
(Increase)/decrease in inventories	33,427	7,307
Increase in trade and other receivables	(118,507)	(41,900)
Increase/(Decrease) in trade and other payables	16,037	(4,176)
Cash flows from operations before taxes and interest paid	(7,429)	4,243
Interest paid	(26,719)	(24,420)
Income tax paid	(3,641)	(4,599)
Cash flows from operating activities	(37,789)	(24,776)
Investing activities		
Proceeds from sale of property, plant and equipment	8,287	4,722
Interest received	9,971	6,372
Acquisition of property, plant and equipment and intangible assets	(49,655)	(35,470)
Acquisition of investments in associates	(10,368)	(5,138)
Sale of investments in associates	15,240	-
Net change in loans given to third and related parties	829	3,792
Net cash flow from other investments	13,482	20,161
Cash flows from investing activities	(12,214)	(5,561)
Financing activities		
Proceeds from borrowings	524,745	554,439
Repayments of borrowings	(529,754)	(472,242)
Acquisition of minority shareholdings	-	(10,111)
Sale/(repurchase) of treasury shares	28	(26)
Cash flows from financing activities	(4,981)	72,060
Net increase/(decrease) in cash and cash equivalents	(54,984)	41,723
Cash and cash equivalents at the beginning of period	65,973	20,841
Effect of exchange rate fluctuations	1,944	3,409
Cash and cash equivalents at the end of period	12,933	65,973

The consolidated statement of cash flows is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 9 to 33.

Consolidated statement of changes in shareholders' equity

For the Year ended 31 December 2004

In thousands of US dollars	Ordinary shares	Preference shares	Additional paid-in capital	Treasury shares	Transla - tion reserve	Retained earnings	Total
Balance at 1 January 2003, as previously stated	7,198	2,345	33,704	-	-	134,989	178,236
Correction of error (refer to Note 11)	-	-	-	-	-	(5,260)	(5,260)
Restated balance at 1 January 2003	7,198	2,345	33,704	-	-	129,729	172,976
Currency translation differences	-	-	-	-	18,132	-	18,132
Net profit	-	-	-	-	-	3,237	3,237
Issue of share capital	721	-	-	-	-	-	721
Repurchase of shares	(130)	(164)	-	-	-	-	(294)
Acquisition of treasury shares	-	-	-	(27)	-	-	(27)
Contributions from shareholders	-	-	92,169	-	-	-	92,169
Balance at 31 December 2003	7,789	2,181	125,873	(27)	18,132	132,966	286,914
Currency translation differences	-	-	-	-	18,361	-	18,361
Net profit	-	-	-	-	-	10,015	10,015
Shares issued	593	-	(593)	-	-	-	-
Sale of treasury shares	-	-	-	27	-	-	27
Balance at 31 December 2004	8,382	2,181	125,280	-	36,493	142,981	315,317

The consolidated statement of changes in shareholders equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 9 to 33.

Notes to the consolidated financial statements

1. Background

(a) Organisation and operations

The consolidated financial statements of the Open Joint Stock Company Power Machines comprise the parent company OJSC Power Machines ("the Company" or "the Parent Company") and its subsidiaries ("the Group"). The Parent Company is an open joint stock (public) company as defined in the Civil Code of the Russian Federation. The Parent Company is domiciled in the Russian Federation.

The Parent Company was established as a state owned enterprise in 1966. It was incorporated as a closed joint stock company on 21 June 1991, as part of the Russian Federation privatisation program and as an open joint stock company on 28 June 2002. The principal activity of the Group is power and automation technologies including production of turbines, generators and other energy generating equipment at plants located in St. Petersburg, Russia. The products are sold in the Russian Federation and abroad. The Group participates in international and national tenders for the supply of energy generating equipment and further places orders for production of the equipment with Group companies and other subcontractors.

(b) Russian business environment

The Russian Federation has been experiencing political and economic change which has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks, which do not typically exist in other markets. The accompanying financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

2. Basis of Preparation

(a) Statement of compliance

The Group maintains its accounting records in accordance with the legislative requirements of the countries in which the individual entities are located (the Russian Federation, Ireland, Germany, Columbia and Czech Republic). The accompanying financial statements have been prepared from those accounting records and adjusted as necessary to comply with the requirements of International Financial Reporting Standards ("IFRS"), as promulgated by the International Accounting Standards Board ("IASB").

(b) First-time application of IFRS

The Group first adopted IFRS as its primary basis of accounting from 1 January 2002. Following the IFRS 1 exemptions for first-time adoption of IFRS the Group elected to measure property, plant and equipment at the date of transition to IFRS at its fair value and use that fair value as its deemed cost as at that date.

(c) Going concern

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business. The recoverability of the Group's assets, as well as the future operations of the Group, may be significantly affected by the current and future economic environment (refer note 1(b)). The accompanying financial statements do not include any adjustments should the Group be unable to continue as a going concern.

2. Basis of preparation continued

(d) Use of estimates

Management of the Group have made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with IFRS. Actual results could differ from those estimates.

(e) Functional and Presentation Currency

The national currency of the Russian Federation is the Russian rouble (“RUR”). Management have determined the RUR to be the Company’s functional currency as it reflects the economic substance of the underlying events and circumstances of the Company. For the purposes of these consolidated financial statements, management has elected to use the United States dollar (“USD”) as the presentation currency.

All financial information presented in USD has been rounded to the nearest thousand.

The Russian rouble is not a convertible currency outside the Russian Federation and, accordingly, any conversion of Russian rouble amounts to US dollars should not be construed as a representation that Russian rouble amounts have been, could be, or will be in the future, convertible into US dollars at the exchange rate shown, or at any other exchange rate.

3. Significant accounting policies

The following significant accounting policies have been consistently applied by the Group in the preparation of the financial statements.

(a) Subsidiaries

Subsidiaries are those enterprises controlled by the Parent Company. Control exists when the parent company has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases.

(b) Associates

Associates are those enterprises in which the Group has significant influence, but does not have control over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates accounted for on an equity accounting basis, from the date that significant influence effectively commences until the date that significant influence effectively ceases. When the Group's share of losses exceeds the carrying amount of the associate, the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associate.

(c) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains and losses arising from transactions with associates are eliminated to the extent of the Group's interest in the enterprise. Unrealised gains and losses are eliminated against the investment in the associate. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

(d) Foreign currency translation

(i) Measurement currency

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to measurement currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies which are stated at historical cost, are translated to Russian Roubles at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies whose carrying amounts were determined using fair values are translated to measurement currency at foreign exchange rates ruling at the dates the values were determined.

(ii) Presentation currency

All assets and liabilities are translated from functional currency to presentation currency at the exchange rate effective at the reporting date. Equity items are translated from functional currency to presentation currency at the historical exchange rate. Income statement transactions are translated from functional to presentation currency with application of a period weighted average rate approximating the rate ruling at the dates of the transactions. Translation adjustments arising from translation of equity are included in translation reserve. For the purposes of these financial statements, the provisions of IAS 21 (Revised) have been applied.

The closing rate of exchange effective at 31 December 2004 and 2003 was 1 USD to 27.75 Roubles and 1 USD to 29.45 Roubles, respectively.

3. Significant accounting policies continued

(e) Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses (refer accounting policy (k)). The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. Furthermore, borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets are included in the cost.

The fair value of property, plant and equipment acquired or constructed prior to 1 January 2002 was determined by an independent appraiser as at 1 January 2002. This was treated as the deemed cost in accordance with first time application of IFRS 1.

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and equipment acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payment at inception of the lease less accumulated depreciation and impairment losses (see accounting policy (k)).

(iii) Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul expenditure, is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as incurred.

(iv) Depreciation

Depreciation is charged to the income statement on a straight line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated.

Depreciation is charged as follows:

■ buildings	70-90 years
■ machinery and equipment	25-30 years
■ transport equipment	15-18 years
■ other property and equipment	8-28 years

3. Significant accounting policies continued

(f) Intangible assets

(i) Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense as incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses.

(ii) Other intangible assets

Other intangible assets, which are acquired by the Group, are stated at cost less accumulated amortisation (refer below) and impairment losses (refer accounting policy (k)). Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

(iii) Subsequent expenditure

Subsequent expenditure on intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

(iv) Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets from the date they are available for use.

The estimated useful lives are as follows:

■ development costs	7 years
■ other intangible assets	5-20 years

(g) Investments

Investments held for trading are classified as current assets and are stated at fair value, with any resultant gain or loss being recognised in the income statement. Where the Group has the positive intent and ability to hold debt securities to maturity, they are stated at amortised cost less impairment losses (refer accounting policy (k)). Other investments held by the Group are classified as being available-for-sale and are stated at fair value, with any resultant gain or loss being recognised in the income statement.

The fair value of investments held for trading and available for sale is based on their quoted market price at the balance sheet date without any deduction for transaction costs. Investments in equity securities that are not quoted on a stock exchange, and where fair value cannot be estimated on a reasonable basis by other means, are stated at cost less impairment losses.

Investments held for trading and available-for-sale investments are recognised/derecognised by the Group on the date it commits to purchase/sell the investments. Investments held-to-maturity are recognised/ derecognised on the day they are transferred to/by the Group.

(h) Trade and other receivables

Trade and other receivables are stated at their cost less impairment losses (refer accounting policy (k)) except for trade receivables available for sale that are stated at fair value.

3. Significant accounting policies continued

(i) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of inventories is calculated on the weighted average basis or using a specific identification of individual costs method and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition.

(j) Cash and cash equivalents

Cash and cash equivalents comprises cash balances, call deposits and liquid bank promissory notes. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents in the statement of cash flows.

(k) Impairment

The carrying amounts of the Group's assets, other than inventories (refer accounting policy (i)) and deferred tax assets (refer accounting policy (t)), are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amounts are estimated. For intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

(i) Calculation of recoverable amount

The recoverable amount of the Group's investments in held to maturity securities and receivables is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset.

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

(ii) Reversals of impairment

An impairment loss in respect of a held-to-maturity security or receivable is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of goodwill is not reversed unless the loss was caused by a specific external event of an exceptional nature that is not expected to recur, and the increase in recoverable amount relates clearly to the reversal of the effect of that specific event.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

3. Significant accounting policies continued

(l) Share capital

(i) Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity.

(ii) Dividends

Dividends are recognised as a liability in the period in which they are declared.

(m) Loans and borrowings

Loans and borrowings are recognised initially at cost, net of any transaction costs incurred. Subsequent to initial recognition, loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

When borrowings are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is recognised immediately in the income statement.

(n) Employee benefits

The Group pays into the Russian Federation State Pension Fund a percentage of each employee's wage based on a scale as specified in, and required by the Russian Tax Code. These amounts are expensed when they are incurred.

(o) Provisions

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(i) Warranties

A provision for warranties is recognised when the underlying products or services are sold. The provision is based on historical warranty data and a weighting of all possible outcomes against their associated probabilities.

(ii) Onerous contracts

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract.

(p) Trade and other payables

Trade and other payables are stated at their cost.

(q) Government grants

A government grant is recognised in the balance sheet initially as deferred income when there is reasonable assurance that it will be received and that the Company will comply with the conditions attaching to it. Grants that compensate the Company for expenses incurred are recognised as revenue in the income statement on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Company for the cost of an asset are included in Other Liabilities as deferred income and are recognised in the income statement as revenue on a systematic basis over the useful life of the related asset.

3. Significant accounting policies continued

(r) Revenue

(i) Goods sold and services rendered

Revenue other than from construction fixed-price contracts is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Revenues from long-term construction contracts are recognised under the percentage-of-completion method when the outcome of a construction contract can be estimated reliably. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized as an expense immediately. Revenues under fixed-price long-term service contracts are recognized under the percentage-of-completion method, based on the percentage of costs to date compared to the total estimated contract costs. Management determines the method to be used for each contract based on its judgment as to which method best measures actual progress towards completion. No revenue is recognised if there are significant uncertainties with regard to recovery of the consideration due, associated costs or the possible return of goods.

(ii) Rental income

Rental income from property is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income to be received.

(s) Expenses

(i) Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease payments made.

(ii) Social costs

Capital expenditure of a social nature which benefits the community as a whole and is not expected to bring significant future economic benefits to the Group is recognised in the income statement as incurred.

(iii) Net financing costs

Net financing costs comprise interest on borrowings, except for interest which is capitalised, interest income, dividend income, results of revaluation of fair value of available-for-sale and held for trading assets and foreign exchange gains and losses.

Interest is recognised in the income statement as it accrues, taking into account the effective yield on the asset and the liability. Dividend income is recognised in the income statement on the date that the dividend is declared.

(t) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

3. Significant accounting policies continued

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit and investments in subsidiaries where the parent is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the unused tax losses and credits can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(u) Comparative information

During the current year the Group made reclassifications to certain comparative balances in the consolidated financial statements with respect to:

- Advances received in relation to contracts outsourced to subcontractors, which were reclassified from accounts payable to advance payments received related to uncompleted contracts.
- The allocation of the deferred tax liability between the types of temporary differences.
- The classification of expenses paid for bank guarantees which were reclassified into net financing expenses.
- The reclassification of the part of work in progress into property, plant and equipment and intangible assets.

4. Revenues

In thousands of US dollars	2004	2003
Energy generating and other equipment	625,630	323,947
Sales of spare parts	36,337	28,358
	661,967	352,305

Percentage of sales by location of customer

	2004	2003
Russia and the CIS	48%	50%
Asia	37%	36%
Europe	10%	14%
Latin America	3%	-
Other	2%	-
	100%	100%

5. Administrative expenses

In thousands of US dollars	2004	2003
Wages, salaries and related taxes	46,684	41,148
Depreciation	6,232	5,431
Insurance	5,455	5,875
Taxes other than income tax	4,451	6,438
Bank charges	3,928	2,763
Travel expenses	2,699	1,880
Consulting	2,640	2,584
Materials	1,763	2,062
Penalties	913	531
Amortisation of intangibles	255	265
Other administrative expenses	14,157	9,830
	89,177	78,807

6. Other operating (income)/expenses

In thousands of US dollars	2004	2003
Net gain on sale of investments	(516)	(282)
(Decrease)/Increase in accounts receivable provision	(2,862)	2,311
Decrease in provision for inventories	(6,361)	(897)
Net gain on disposal of property, plant and equipment	(5,691)	(404)
Net gain on disposal of other assets	(2,248)	(17)
Increase/(Decrease) in provision for onerous contracts	(610)	1,001
Increase/(Decrease) in provision for warranty expenses	2,564	(1,877)
Net gain on disposal of subsidiary	(2,826)	-
Other operating expenses	1,099	1,426
	(17,451)	1,261

7. Personnel expenses

In thousands of US dollars	2004	2003
Wages, salaries and related taxes included in:		
cost of sales	60,059	45,459
distribution costs	7,141	3,175
administrative expenses	46,684	41,148
	113,884	89,782

The average number of employees during the year ended 31 December 2004 was 13,828 (31 December 2003: 14,575).

8. Net financing expenses

In thousands of US dollars	2004	2003
Interest expense	26,845	24,203
Interest income	(9,971)	(6,372)
Net foreign exchange gain	(4,119)	(2,141)
Bank guarantee expenses	6,691	2,587
Impairment loss on assets available for sale	11,275	588
	30,721	18,865

9. Income tax expense

In thousands of US dollars	2004	2003
Current tax expense		
Current year expense	24,661	2,987
Under provided in prior years	2,139	-
	26,800	2,987
Deferred tax expense		
Origination and reversal of temporary differences	(13,091)	3,410
	(13,091)	3,410
	13,709	6,397

The Parent Company's applicable tax rate is the corporate income tax rate of 24% (2003: 24%) and 24% for measuring deferred taxes (2003: 24%).

Reconciliation of effective tax rate

In thousands of US dollars		2004		2003
Profit before tax		23,923		10,913
Income tax using corporate tax rate	24%	5,742	24%	2,619
Non-deductible expenses	30%	7,249	36%	3,979
Non-taxable income		-	(11%)	(1,286)
Effect of tax losses utilized	(6%)	(1,421)	10%	1,085
Under provided in prior years	9%	2,139	-	-
	57%	13,709	59%	6,397

10. Construction contracts

The revenues and gross margin recognized on long-term contracts amounted to:

In thousands of US dollars	**2004**	**2003**
Contract revenue	385,524	138,785
Contract costs	(263,864)	(79,999)
Gross margin	121,660	58,786

11. Restatement of the opening retained earnings

The accounts receivable balance at 1 January 2003 was overstated by USD 5,260 thousand (net of a tax effect of USD 1,661 thousand) due to an error in the recording of retentions and a commission charge relating to a long term contract.

12. Property, plant and equipment

In thousands of US dollars	**Land and Buildings**	**Machinery and equipment**	**Transportation equipment**	**Other**	**Assets under construction**	**Total**
Cost						
Balance at 1 January 2004	330,271	680,805	15,081	30,719	10,132	1,067,008
Translation effect	20,389	42,920	920	2,058	712	66,999
Additions	1,340	27,233	849	4,225	10,366	44,013
Transfers	1,976	3,777	134	760	(6,647)	-
Disposals	(1,099)	(3,225)	(1,146)	(596)	(1,398)	(7,464)
Balance at 31 December 2004	352,877	751,510	15,838	37,166	13,165	1,170,556
Depreciation						
Balance at 1 January 2004	(264,578)	(555,507)	(12,109)	(16,566)	-	(848,760)
Translation effect	(16,301)	(34,716)	(745)	(1,137)	-	(52,899)
Charge for the period	(1,868)	(16,986)	(1,024)	(3,810)	-	(23,688)
Disposals	923	2,217	991	721	-	4,852
Balance at 31 December 2004	(281,824)	(604,992)	(12,887)	(20,792)	-	(920,495)
Carrying amount						
At 1 January 2004	65,693	125,298	2,972	14,153	10,132	218,248
At 31 December 2004	71,053	146,518	2,951	16,374	13,165	250,061

Leased machinery

The Group leases production equipment under a number of finance lease agreements. As at 31 December 2004 the net carrying amount of leased machinery and equipment was USD 12,095 thousand (31 December 2003: USD 6,845 thousand).

13. Intangible assets

In thousands of US dollars	Development costs	Other intangible assets	Intangible assets under development	Total
Cost				
Balance at 1 January 2004	648	4,332	11,188	16,168
Translation effect	102	310	1,016	1,428
Additions	1,614	1,183	8,860	11,657
Transfers	162	164	(326)	-
Disposals	(149)	(164)	-	(313)
Balance at 31 December 2004	2,377	5,825	20,738	28,940
Amortisation				
Balance at 1 January 2004	(92)	(1,081)	-	(1,173)
Translation effect	(37)	(82)	-	(119)
Amortisation for the year	(969)	(590)	-	(1,559)
Disposals	136	151	-	287
Balance at 31 December 2004	(962)	(1,602)	-	(2,564)
Carrying amount				
As at 1 January 2004	556	3,251	11,188	14,995
As at 31 December 2004	1,415	4,223	20,738	26,376

14. Investments in associates

The Group has the following investments in associates:

	Country of incorporation	Ownership 2004	Ownership 2003	Voting interest 2004	Voting interest 2003
ZAO Interplast	Russia	50%	50%	50%	50%
OAO Kaluzhsky Turbinnyi Zavod	Russia	-	20%	-	26%
NPO CKTI	Russia	35%	35%	35%	35%

In thousands of US dollars	2004	2003
ZAO Interplast	88	73
OAO Kaluzhsky Turbinnyi Zavod	-	5,396
NPO CKTI	5,903	5,449
	5,991	10,918

14. Investments in associates continued

OAO Obyedinennie Mashinostroitelnye Zavody ("OMZ")

During the year ended 31 December 2004 the Group purchased a 7% interest in OAO Obyedinennie Mashinostroitelnye Zavody ("OMZ") for USD 42,739 thousand. The purpose of the acquisition of shares represented part of the process to merge OMZ and the Group, which was expected to ultimately result in the Group being the acquirer of OMZ. Management of the Group were appointed to key managerial positions of OMZ enabling the Group to exercise significant influence over OMZ's financial and operating policy decisions. In July 2004 the planned merger of the Group and OMZ was terminated, the investment in OMZ was sold for its carrying value and management of the Group resigned from their managerial positions of OMZ.

15. Other investments

In thousands of US dollars	**2004**	**2003**
Non-current investments		
Equity securities available-for-sale	6,812	11,615
Debt securities held to maturity	23	5,184
Loans given	7	1,122
	6,842	17,921
Current investments		
Debt securities held to maturity	808	11,608
Equity securities available-for-sale	220	2,180
Loans given	1,145	775
	2,173	14,563

16. Other non-current receivables

In thousands of US dollars	**2004**	**2003**
Trade accounts receivable	26,055	35,232
Notes receivable	716	1,059
Less provision for doubtful debts	-	(4,400)
	26,771	31,891

At 31 December 2004 trade accounts receivable included contractual retention amounts billed to customers amounting to USD 11,649 thousand (31 December 2003: USD 27,857 thousand). Retentions in the amount of USD 1,329 thousand were considered to be doubtful and were provided for in full as at 31 December 2003; at 31 December 2004 no retention amounts were considered doubtful.

17. Inventories

In thousands of US dollars	**2004**	**2003**
Work in progress	27,408	35,543
Raw materials and consumables	37,445	41,879
Finished goods and goods for resale	17,157	32,376
Supplies	4,914	2,116
Other inventories	571	2,631
	87,495	114,545

18. Trade receivables, current

In thousands of US dollars	2004	2003
Trade accounts receivable	77,031	64,063
Notes receivable	603	1,094
Less provision for doubtful debts	(2,608)	(8,271)
	75,026	56,886
Costs and earnings in excess of billings on uncompleted contracts	246,443	122,167
Advance payments received related to uncompleted contracts	(135,520)	(121,506)
	110,923	661
	185,949	57,547

Costs and earnings in excess of billings on uncompleted contracts represent revenue earned and recognised under the percentage-of-completion method which has not been billed.

At 31 December 2004 trade accounts receivable included contractual retention amounts billed to customers amounting to USD 744 thousand.

19. Other receivables

In thousands of US dollars	2004	2003
Prepayments	75,651	72,529
VAT receivable	43,302	33,579
Deferred expenses	37,470	22,238
Restricted cash	2,386	5,223
Income tax receivable	33	3,921
Receivables from employees	812	931
Other receivables	15,499	9,292
	175,153	147,713

20. Cash and cash equivalents

Cash and cash equivalents comprise local and foreign currency bank balances, call deposits and bank promissory notes.

In thousands of US dollars	2004	2003
Rouble bank accounts	5,604	14,575
Foreign currency bank accounts	6,263	4,896
Other rouble denominated cash equivalents	803	3,856
Foreign currency bank deposits	-	297
Rouble bank deposits	263	42,349
	12,933	65,973

21. Equity

Share capital and share premium

In shares	Ordinary shares		Non-redeemable preference shares	
	2004	**2003**	**2004**	**2003**
On issue at opening balance	5,362,500,000	31,500	1,050,000,000	10,500
Issuance	811,462,708	22,125	-	-
Repurchased	(3,050,000)	-	(3,974,000)	-
Effect of split of shares	-	5,362,446,375	-	1,049,989,500
On issue at closing balance	6,170,912,708	5,362,500,000	1,046,026,000	1,050,000,000

Share capital

As at the balance sheet date, the authorised share capital comprised 9,359,450,000 ordinary shares (31 December 2003: 9,362,500,000) and 1,046,026,000 non redeemable preference shares (31 December 2003: 1,050,000,000) of which 6,170,912,708 ordinary shares (31 December 2003: 5,362,500,000) and 1,046,026,000 preference shares (31 December 2003: 1,050,000,000) were issued and paid. All shares have a par value of RUR 0.01 (31 December 2003: RUR 0.01). All shares rank equally with respect to the Group's residual assets, except that preference shareholders participate only to the extent of the nominal value of the shares adjusted for any dividends in arrears.

Additional paid-in capital

Contributions to the additional paid-in capital arose from the excess of the fair value over the purchase price of shares of the Company’s subsidiaries sold to the Group by entities under common control of the majority shareholder or acquired from minorities.

Translation reserve

Translation reserve includes the currency translation differences arising from the translation of these financial statements from the functional to the presentation currency.

Dividends

Holders of non-redeemable preference shares are entitled to receive a fixed dividend amounting to 200% of the nominal value of the preference shares. According to legislation in the Russian Federation, non cumulative preference shareholders have the same voting right as ordinary shareholders in the event of default on full payment of declared dividends to preference shareholders.

Dividends payable are limited to the maximum retained earnings of the Group as determined in accordance with the legislation of the Russian Federation. As at the balance sheet date reserves available for distribution in accordance with Russian legislation amounted to USD 129,909 thousand.

As at the balance sheet date the Board of Directors had not recommended the payment of dividends.

Voting rights of shareholders

The holders of fully paid ordinary shares are entitled to one vote per share at the annual and general shareholder meetings of the Group. Shareholders who own fully paid preference shares shall ordinarily participate in the general meeting of shareholders with the right to vote only on issues of reorganisation or liquidation of the Company, and issues concerning amendments to the Parent company charter that would restrict their rights.

Issuance of shares

In 2003 the Group issued 811,462,708 ordinary shares, that were registered in 2004, in order to acquire the remaining 25% minority share holdings in LMZ, Electrosila and ZTL.

22. Loans and borrowings

In thousands of US dollars	Effective interest rate	2004	Effective interest rate	2003
Current loans and borrowings				
Secured loans:- RUR, fixed	10%	40,303	11%	70,676
- USD, fixed & variable	10%	467	10%	25,571
- EURO, fixed & variable	6%	314	12%	22,493
Current portion of secured loans:				
- RUR, fixed	-	-	9%	1,413
- USD, variable	5%	35,442	-	-
- EURO, fixed	7%	2,126	11%	552
- CHF, variable	6%	618	-	-
Current portion of unsecured loans:				
- USD, variable	6%	15,000	-	-
Current portion of Loan from Ministry of Finance,USD, fixed	3%	731	-	-
Unsecured loans:- RUR, fixed	-	-	6%	6,165
- USD, fixed	9%	4,951	7%	70,339
Current portion of finance lease liabilities	30%	4,211	27%	2,809
		104,163		200,018
Non-current loans and borrowings				
Secured loans: - RUR, fixed	11%	18,019	11%	1,055
- USD, fixed & variable	6%	64,693	5%	14,291
- EURO, fixed	7%	6,309	11%	1,104
- CHF, variable	-	-	6%	561
Unsecured loans:- RUR, fixed	14%	1,740	0%	1,518
- USD, variable	6%	30,004	-	-
Loan from Ministry of Finance, USD, fixed	3%	10,029	0%	11,243
Non-current finance lease liabilities	30%	2,239	27%	2,138
		133,033		31,910

22. Loans and borrowings continued

Non-current debt repayment schedule

Presented below is the debt repayment schedule for non-current debts outstanding at 31 December 2004 (other than finance lease liabilities (see below)).

In thousands of US dollars	**Total**	**Less than 1 year**	**1-2 years**	**2-3 years**	**3-4 years**	**4-5 years**	**More than 5 years**
Secured bank loans							
- RUR, fixed	18,019	-	18,019	-	-	-	-
- USD, variable	100,135	35,441	39,150	6,862	7,314	5,058	6,310
- EUR, fixed	8,435	2,126	2,126	1,525	1,394	1,264	-
- CHF, fixed	618	618	-	-	-	-	-
Unsecured loans							
- RUR, fixed	1,740	-	-	1,085	-	655	-
- USD, variable	45,004	15,000	30,004	-	-	-	-
Loan from Ministry of Finance, USD	10,760	731	990	1,248	1,518	1,799	4,474
	184,711	53,916	90,289	10,720	10,226	8,776	10,784

During the 12 months ended 31 December 2004 the Group obtained a loan of USD 61,500 thousand from the EBRD. The outstanding balance as at the balance sheet date comprises USD 59,708 thousands. Covenants to the loan agreement require the Group to maintain certain financial ratios, limit capital expenditure, and restrict the amount of outstanding payables related to the acquisition of fixed assets. The Group is restricted from performing mergers, acquisitions, reorganizations and consolidations without the prior written consent of the EBRD. As at 31 December 2004 the Group has not complied with two financial ratios required by the covenants. Management of the Group believes that there is a low probability that the bank will demand earlier settlements of the loan solely on the basis of violation of these ratios. Nevertheless management of the Group plans to negotiate with the bank amendments to existing contract that would resolve the issue of following the covenants imposed by the bank.

During the 12 months ended 31 December 2004 the Group obtained a loan of USD 30,004 thousand from HSBC, which is the outstanding as at the balance sheet date. Covenants to the loan agreement require the Group to maintain certain financial ratios; also the covenants restrict the Group from obtaining a new secured loan which requires pledges in the amount exceeding the level of pledged assets as at the date of obtaining the loan from HSBC. The covenants to the loan agreement restrict the Group from making dividends payments during the period of the loan.

Finance lease liabilities repayment schedule

Finance lease liabilities are payable as follows:

		2004			**2003**	
In thousands of US dollars	Payments	Interest	Principal	Payments	Interest	Principal
Less than one year	5,420	1,209	4,211	3,807	998	2,809
Between one and five years	2,692	453	2,239	2,538	400	2,138
	8,112	1,662	6,450	6,345	1,398	4,947

23. Pledges provided by the Group

Companies within the Group are subject to the following pledges of assets:

In thousands of US dollars	2004	2003
Property, plant and equipment	41,325	81,777
Inventories and costs and earnings in excess of billings on uncompleted contracts	113,023	93,607
Notes receivable, current	-	690
Notes receivable, non-current and available for sale	43,569	15,782
Debt securities held to maturity, current	-	2,784
Cash and cash equivalents	2,865	3,291
Revenue from planned supply of equipment in the future	59,708	49,245
	260,490	247,176

The distribution of the assets pledged of the Group is as follows:

In thousands of US dollars	2004	2003
Current loans and borrowings		
Pledges provided for the debt of the Group	84,960	147,365
Pledges provided for the debt of third parties	-	515
Non-current loans and borrowings		
Pledges provided for the debt of the Group	168,907	83,350
Pledges provided for the debt of third parties	6,623	15,946
	260,490	247,176

24. Deferred tax liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
In thousands of US dollars	2004	2003	2004	2003	2004	2003
Cash and cash equivalents	(16)	(311)	-	-	(16)	(311)
Property, plant and equipment	-	-	24,039	23,239	24,039	23,239
Intangible assets	-	-	2,682	1,373	2,682	1,373
Other investments	(3,326)	(893)	-	1,316	(3,326)	423
Inventories	(28,706)	(17,000)	-	11,650	(28,706)	(5,350)
Trade and other accounts receivable	-	(10,235)	41,515	37,076	41,515	26,841
Trade and other accounts payable	-	(3,632)	852	4,850	852	1,218
Loans and borrowings	(1,290)	(1,986)	-	471	(1,290)	(1,515)
Tax (assets)/liabilities	(33,338)	(34,057)	69,088	79,975	35,750	45,918

25. Trade and other payables

In thousands of US dollars	2004	2003
Advances from customers	107,719	106,137
Trade accounts payable	72,084	44,517
Income tax payable	22,981	2,884
Other taxes payable	15,032	15,161
Employee related liabilities	11,826	8,033
Provision for warranties	4,252	1,497
Interest payable	586	428
Contract related reserves	567	1,131
Accrued liabilities	183	356
Deferred income	125	129
Current portion of government grant	-	726
Other current liabilities	11,355	16,748
	246,710	197,747

26. Other non-current liabilities

In thousands of US dollars	2004	2003
Trade accounts payable	22,436	26,396
Other non-current liabilities	-	659
Government grant	10,803	4,358
	33,239	31,413

The Company was awarded a government grant of USD 15,278 thousand for the development of technology to produce gas-steam turbines. As at the balance sheet date the Company had received USD 10,803 thousand of the government grant and recorded it as deferred income in other non current liabilities. The amount of deferred income will be amortised over the same period as the related development costs will be amortised.

27. Financial instruments

Exposure to credit, interest rate and currency risk arises in the normal course of the Group's business. The Group does not use derivative financial instruments to reduce exposure to fluctuations in foreign exchange rates and interest rates.

Credit risk

Financial instruments that potentially subject the Group to significant credit risk consist primarily of accounts receivable. Credit evaluations are performed for all banks in which the Group holds deposits, and all customers requiring credit over a certain amount. The Groups policy is to obtain collateral in respect of financial assets in the form of government guarantees or letters of credit where possible. The maximum exposure to credit risk is represented by the carrying amount of each financial asset and financial guarantees provided by the Group to certain third party suppliers (refer note 31).

As of the balance sheet date the Group had USD 113,811 thousand of notes and trades receivable from one significant customer (31 December 2003: USD 124,819 thousand). The recoverability of these receivables is secured by a guarantee of the Indian Government.

27. Financial instruments continued

Interest rate risk

The Group incurs interest rate risk primarily on accounts receivable, accounts payable, loans and borrowings. The Group borrows on both a fixed and variable interest rate basis. All variable interest rate loans and borrowings are re-priced on a monthly basis.

Foreign currency risk

The Group bears foreign currency risk on transactions that are denominated in a currency other than the Russian Rouble. Management consider the Group's major foreign currency risk as being the movement of the US dollar against the Rouble.

Fair value

The carrying amounts of financial instruments except for equity securities approximate their fair value. The fair value of equity securities could not be determined as the securities are not publicly traded.

28. Related party transactions

The Group had the following related party transactions during the period:

	Sales		Purchases		Interest expense	
In thousands of US dollars	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**
OAO Kalugskiy Turbiniy Zavod	1,979	1,142	-	-	-	-
OAO Rosbank	-	-	-	-	1,070	1,736
Elaine Ventures Inc	-	16,332	-	-	-	-
Brightwood Ventures Limited	-	-	-	5,138	-	848
Midway Management Ltd and Kestrel Ventures Inc	4,888	-	-	-	-	-
Other related parties	20	12,532	488	-	-	-

As at the balance sheet date the Group had the following related party balances outstanding with:

	Receivable		Payable	
In thousands of US dollars	**2004**	**2003**	**2004**	**2003**
OAO Kalugskiy Turbiniy Zavod – advances, current	10,312	2,393	-	105
OAO Kalugskiy Turbiniy Zavod – creditors	-	-	19	77
OAO Kalugskiy Turbiniy Zavod – debtors	-	5,612	-	-
OAO Kalugskiy Turbiniy Zavod – loans given, current	426	202	-	-
RB Leasing – advances	-	-	1,707	5,376
Burbott Limited – debtors	-	19	-	-
NPO CKTI – debtors	154	-	-	-
NPO CKTI – advances	299	-	-	-
NPO CKTI – creditors	-	-	23	70
ZAO Interplast – debtors	58	7	-	-
OAO Rosbank – promissory notes	-	6,304	-	-
OAO Rosbank – loans received	-	-	-	10,000

28. Related party transactions continued

The nature of the related party relationships is as follows:

Burbott Limited
Burbott Limited is the principal shareholder of the Group. 1,804,234,678 ordinary shares of the Group owned by Burbott Limited were pledged by Burbott Limited as a security for EBRD loan which had been obtained by the Group.

OAO Kalugskiy Turbiniy Zavod
During the year ended 31 December 2004 the Group sold its interest in OAO Kaluzhskiy Turbiniy Zavod to Midway Management Limited and Kestrel Ventures Inc. Previously the investment was recognized as an associate of the Group.

NPO CKTI
NPO CKTI is an associate of the Group.

OAO Rosbank
Two members of the board of directors of OAO Rosbank are members of the board of directors of the Group.

Elaine Ventures Inc
Elaine Ventures Inc is a company under the control of the majority shareholder of the Group. In 2003 the Group sold equity securities available for sale to this company at a price equal to the carrying value of these securities at the date of sale.

Brightwood Ventures Limited ("BVL")
In 2003 the Group acquired an 18% interest in the share capital of NPO CKTI from BVL. The entity is under the control of the majority shareholder of the Group. As at 31 December 2004 the Group owned a 35% investment in NPO CKTI.

RB Leasing
RB Leasing is a leasing company located in Russia. RB leasing is under the control of the majority shareholder of the Group.

Midway Management Limited ("MML") and Kestrel Ventures Inc ("KVI")
MML and KVI are the companies under the control of the majority shareholder of the Group. During the year ended 31 December 2004 the Group sold shares in OAO Kaluzhsky Turbiniy Zavod to these companies for an amount equal to their carrying value.

Other related parties
In 2003 the Group sold equity securities available for sale totalling USD 12,532 million to other companies under the control of the majority shareholder of the Group for amounts equal to their carrying value at the date of sale.

Financial guarantees provided to related parties
Details of financial guarantees provided to related parties are disclosed in note 31.

29. Subsidiary Companies

Listed below are all the significant companies included in the consolidated balance sheet:

Significant subsidiaries	Country of incorporation	Ownership interest % 2004	Ownership interest % 2003
OAO Leningradskiy Metalicheskiy Zavod	Russia	branch	100.00%
OAO Electrosila	Russia	branch	100.00%
OAO Zavod Turbinich Lopatok	Russia	branch	100.00%
OOO Reostat	Russia	100.00%	100.00%
ZAO Gazovie Turbini	Russia	100.00%	100.00%
ZAO LMZ Invest	Russia	100.00%	100.00%
ZAO LMZ Engineering	Russia	0.00%	100.00%
LMZ Energy Limited	Ireland	100.00%	100.00%
OOO Interturbo	Russia	55.12%	55.12%
OAO SK Selecta	Russia	96.43%	96.43%
Energomachimpex Czech Republic	Czech Republic	80.00%	80.00%
EMEC LTDa Columbia	Columbia	99.99%	99.99%
Energomach Handels GMBH	Germany	100.00%	100.00%

30. Commitments

(i) *Capital commitments*

The Group is committed to capital expenditure of approximately USD 8,101 thousand (31 December 2003: USD 20,258).

(ii) *Social commitments*

The Group makes contributions to mandatory and voluntary social programs. The Group's social assets, as well as local social programs, benefit the community at large and are not normally restricted to the Group's employees. The Group has transferred certain social operations and assets to local authorities; however, management expects that the Group will continue to fund these social programs for the foreseeable future. These costs are recorded in the year they are incurred.

31. Contingencies

(i) *Financial Guarantees*

The Group has provided financial guarantees for certain third party suppliers and related parties of the Group. Amounts related to the Group's financial guarantees are as follows.

In thousands of US dollars	**2004**	**2003**
Maturity in one year or more		
Third party suppliers	697,727	28,034
Maturity in less than one year		
Third party suppliers	43,339	5,408
OAO Kalugskiy Turbiniy Zavod	3,964	-
	745,030	33,442

31. Contingencies, continued

During the year ended 31 December 2004 the Group was a co-signatory to a guarantee of USD 682,381 thousand given by a consortium of companies (including the Group) against a loan obtained by CIISA. CIISA is an entity that is constructing a power station in Mexico in which the Group holds a 19% interest and participates in the construction. The Group's exposure under this guarantee is estimated to be the equivalent 19% interest in the project, USD 129,614 thousand.

The Group's contingent maximum exposure to credit losses in the event of non-performance by all other parties to these financial guarantees would amount to the total contractual amount of the guarantee stipulated above. Assets of the Group were also pledged against certain of the third party supplier guarantees (Note 23).

(ii) Contingencies

As at 31 December 2003 the Company entered into a restructuring agreement with the Ministry of Finance of Russia for the restructuring of the overdue loan and relevant penalties imposed. Under the restructuring agreement the Group has to pledge assets as security for the loan, the pledge document of which has yet to be signed by the Group's counterparties thereto. The terms of the restructuring agreement waive these penalties if all conditions of restructuring are met by the Company. The penalties which amount to USD 7,475 thousand have not been recorded as a liability in financial statement of the Company. Management believe all conditions will be met and that the penalties will be waived.

(iii) Insurance

The insurance industry in the Russian Federation is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have full coverage for its plant facilities, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Company's operations and financial position.

(iv) Litigation

Litigation includes a number of small claims relating to sales made to domestic customers. Based on experience in resolving such matters, management believes that these will be resolved without significant loss to the Group and, accordingly, no provision has been made for these unresolved claims and litigation.

(v) Taxation contingencies

The taxation system in the Russian Federation is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities, which have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

These circumstances may create tax risks in the Russian Federation that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Russian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these preliminary IFRS financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

31. Contingencies continued

(vi) Environmental liabilities

Environmental regulations are currently under consideration in the Russian Federation and the Group is continuously evaluating its obligations relating to new and changing legislation. The likelihood and amount of liabilities relating to environmental obligations under proposed or any future legislation cannot be reasonably estimated at present and could become material.

Under existing legislation, management believes that there are no significant unrecorded liabilities or contingencies, which could have a significant adverse effect on the operating results or financial position of the Group.

32. Subsequent events

Subsequent to the balance sheet date the Group was in process of selling the following stakes in its subsidiaries:

- 99.99% stake in EMEC LTDa, Columbia;
- 80% stake in Energomachimpex, Czech Republic.

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