Summary and discussion of Polus Group financial results

The following summary and discussion of results is intended to provide investors and potential investors with a brief overview on a consolidated basis of the results of Polus Group for the years ended 2003, 2004 and 2005. These results are presented in accordance with IFRS standards and were audited by Deloitte & Touche.

(in million of US Dollars or as otherwise indicated)

	2005	2004	2003
Key income statement items			
Gold sales	473	442	299
Cost of gold sold	266	235	109
Gross profit from metals sales	207	207	190
Selling, general and administrative expenses	60	32	16
Other net operating expense (income)	25	(9)	15
Operating profit	122	184	159
Impairment of goodwill on acquisition	-	115	-
Profit before taxation	167	72	164
Income tax expense	(52)	(62)	(44)
Profit for the year	115	10	120
Key balance sheet items			
Property, plant and equipment	965	516	216
Capital construction-in-progress	107	62	31
Investments in securities and other financial assets	2,23	397	114
Inventories	124	70	27
Advances to suppliers and other receivables	25	12	3
Cash and cash equivalents	28	13	4
Other current assets	90	68	14
Total assets	**3,57**	**1,13**	**409**
Deferred tax liabilities	162	89	32
Environmental obligations	61	10	7
Trade and other payables	190	36	7
Short-term loans and borrowings	26	36	-
Long-term loans and obligations under finance lease	5	9	-
Taxes payable	23	15	24
Total liabilities	**467**	**195**	**70**
Share capital and reserves	3,10	943	339
Per Share Information[1]			
Weighted average number of the ordinary shares issued	247	137	243
Number of preference shares convertible into ordinary shares	120	120	120
Basic and diluted earnings per share, in thousands of US Dollars			
- basic	467	110	492
- diluted	314	59	492

Note:

1) Please note that the per share information is calculated based on the number of the shares issued prior to the spin-off of the Polus Group from OJSC MMC Norilsk Nickel Total shares issued as of 17 March, 2006, the effective date of the Polus Group spin-off from OJSC MMC Norilsk Nickel, amounted to 190,627,747.

Factors influencing financial results

The major factors that influenced the financial results of the Polus Group in 2005 were as follows:

- increase in the average realized gold selling price of 10% in 2005;
- more complicated geological conditions in Olimpiada Mine (increase of the stripping ratio, deepening of the mine slopes, decrease in gold yield in the ore);
- general price increase for fuel and materials, for fuel by 7.7% and for chemical reagents by 7.4%;
- acquisition of gold mining subsidiaries in Yakutia – OJSC Aldanzoloto GRK, OJSC Yuzhno-Verkhoyanskaya Mining Company and OJSC Yakutskaya Mining Company – and consolidation of its financial results since the date of acquisition in the fourth quarter of 2005;
- strengthening of Russian rouble in relation to the US dollar by 2% using respective annual average exchange rate.

Gold sales

	Years ended 31 December		
	2005	**2004**	**2003**
Gold sales (millions of US dollars)	473	442	299
Gold sold by the Group (‘000 troy ounces)	1,049	1,086	794
Average realized gold selling price (USD per troy ounce)	449	407	377

The increase in the gold sales of 7% resulted from the following:

- increase in the average gold selling price both on domestic and export markets in 2005 by 10% to USD 449 per ounce compared to 2004 with the average export selling price in 2005 of USD 457 per ounce (in 2004 the Group had no export sales);
- decrease in physical sales volume from 1,086 thousand ounces in 2004 to 1,049 thousand ounces in 2005 due to a decrease in alluvial gold extraction by OJSC Lenzoloto partially compensated by an increase in gold sales by the newly acquired OJSC Aldanzoloto GRK and OJSC Yuzhno-Verkhoyanskaya Mining Company.

Cost of gold sold

Millions of US dollars	For the years ended 31 December		
	2005	**2004**	**2003**
Cash operating costs	233	193	88
Consumables and spares	108	83	33
Labour	67	64	31
Mining tax and ecological payments	30	26	18
Utilities	14	12	3
Refining costs	3	3	2

Other cash operating costs	11	5	1
Amortisation and depreciation of operating assets	42	41	23
Increase in metal inventories	(11)	(2)	(3)
Provision for land rehabilitation	2	3	-
Cost of gold sold	**266**	**235**	**108**

In 2005 cost of gold sales increased by 13% and totaled USD 266 million compared to USD 235 million in 2004.

Cash operating costs

In 2005 cash operating costs increased by 20% and equaled USD 233 million compared to USD 193 million in 2004. Consumables and spares remained the most significant item of cash operating costs making 46% of the total (2004: 43%). However, the percentage of labour in the total cash operating costs decreased to 29% (2004: 33%).

The main growth factors for cash operating costs in 2005 were:

- increase in purchase prices for fuel, consumables and spares;
- more complicated geological conditions in Olimpiada Mine in 2005 resulted in an increase of mining and concentrating costs;
- increase in sulphide ore share in the total quantity of ore processed by 4% in 2005. The processing of sulphide ore requires twice as much reagents and materials as oxidized ore, and about 3 times more electricity;
- strengthening of Russian rouble in relation to the US dollar, that lead to an increase in costs when US dollar measured;
- consolidation of cash operating costs of the acquired subsidiaries in Yakutia for the fourth quarter of 2005 in the amount of USD 13 million.

Consumables and spares

Consumables and spares cost increased by USD 25 million to USD 108 million. This increase was primarily due to the increase in purchase prices for fuel (7.7%) and chemical reagents (7.4%), as well as increase in fuel and materials usage per ton of ore processed due to increased complication of the geological conditions.

Labour

Labour cost increased in 2005 by USD 3 million to USD 67 million. The increase was due to the consolidation of the subsidiaries in Yakutia acquired during 2005, as well as increase of costs in US dollar measure due to Russian Rouble strengthening against US dollar.

Mining tax and ecological payments

Mining tax expense and ecological payments increased in 2005 from USD 26 million to USD 30 million that was mainly attributable to the growth of gold selling price by 10% compared to 2004.

Amortisation and depreciation of operating assets

In 2005 amortisation and depreciation charges remained nearly the same when compared to 2004 and equaled USD 42 million. However, the average depreciable amount in 2005 was substantially higher than in 2004.

The reason for the above was revision of useful economic lives of the production assets relating to concentrating and smelting of gold. As a consequence the depreciation rates decreased compared to 2004 and depreciation charge decreased accordingly. In accordance with IFRS such a change was treated as a change in accounting estimate and was accounted for prospectively, without any restatement for the prior year.

Increase in metal inventories

In 2005 increase in metal inventories grew by USD 9 million to USD 11 million due to increase of gold stock in CJSC Polus as of 31 December 2005 compared to 31 December 2004.

Cost of gold produced by Polus and its subsidiaries

	For the years ended 31 December		
	2005	**2004**	**2003**
Gold produced by the Group (‘000 troy ounces)	1,038	1,085	832
Cost of gold production (US dollars per troy ounce)	244	209	133
Cash operating costs (US dollars per troy ounce)	206	175	107

Depreciation and amortization was a significant component of cost of production in 2005 and totaled USD 38 per troy ounce.

In 2005 cost of gold production per troy ounce by the Polus Group increased by USD 35 per troy ounce to USD 244 per troy ounce while cash operating costs of the Polyus Group increased by USD 31 per troy ounce to USD 206 per troy ounce.

Cost of gold production per troy ounce by Polus Group increased in 2005 mainly due to the following:

- consolidation of financial results of the newly acquired subsidiaries in Yakutia with higher production costs;
- increase of purchase prices for fuel and materials;
- more complicated geological conditions in Olimpiada Mine in 2005;
- strengthening of Russian rouble in relation to the US dollar.

The table below details production costs per troy ounce and cash operating costs of the Polyus Group for 2005 by business unit.

Business unit	Cost of production, USD per troy ounce	Cash operating costs, USD per troy ounce
CJSC Polyus	196	159
Lenzoloto	373	337
Yakutia companies	534	457

Selling, general and administrative expenses

Selling, general and administrative expenses ("S,G & A") of the Group increased in 2005 by USD 28 million to USD 60 million by 88%. Such a significant increase is a result of the Group's anticipation of becoming an independent company positioned to maximize the development and exploration opportunities foreseen by management in the running a fully integrated entity from a planning operational and control perspective. The increase resulted mainly from the following:

- increase in audit, legal and other professional service costs by USD 2.1 million (148%) due to the preparation of the spin-off information document of gold mining assets from OJSC MMC Norilsk Nickel and incorporation of the new holding company;
- increase in transportation costs by USD 2.6 million or 347% compared to 2004 due to increased expenses on the transportation of the seasonal workers to the mine sites, emergence of costs occurred from direct export sales and increased business trip expenses relating to the formation of the holding company;
- increase in payroll cost to USD 33.5 million by USD 13.8 million or 70% compared to 2004. This increase is mainly attributable to the growth in business activities of the corporate center of the Group and the holding of LLC Lenskaya Zolotorudnaya Company, as well as the consolidation of newly acquired subsidiaries in Yakutia in the amount of USD 1.4 million;
- increase in tax payments by USD 1.4 million (41%) primarily due to increased property tax payments relating to the acquisition of property, plant and equipment.

Other net operating expenses (income)

Other net operating income of USD 9 million in 2004 was succeeded by other net operating expense if USD 25 million in 2005 giving the total change of USD 35 million. The change was mainly due to the following:

- recognition of impairment of assets in the amount of USD 6 million relating to the accrual of decommissioning liability in OJSC Matrosov Mine. Whereas the production running of the assets was ceased and their recoverable amount equaled zero due to the liquidation of the mine, the liability was expensed in full;
- a write-off of construction-in-progress in OJSC Lenzoloto in the amount of USD 5 million;
- recording a tax accrual in the amount of USD 2 million in 2005, primarily due to the risk of non-recoverability of value added tax, as compared to reversal of the respective tax accrual in 2004 in the amount of USD 15 million.

Income tax expense

Million of US dollars	**For the year ended 31 December**		
	2005	**2004**	**2003**
Current income tax	60	52	50
Deferred income tax	(8)	10	(5)
Total income tax expense	**52**	**62**	**45**

Current income tax expense increased from USD 52 million in 2004 to USD 60 million in 2005 by USD 8 million due to the following:

- increase in current income tax expense of CJSC Polyus by USD 6 million caused by an increase in gold sales in 2005 due to increased selling prices, with consistent ratio of taxable profit to sales revenue in both years;
- increase in current income tax of Lenzoloto group by USD 2 million. This increase resulted from OJSC Lenzoloto selling shares and interests in subsidiaries to LLC Lenskaya Zolotorudnaya Company with related taxable income of USD 9 million.

Deferred income tax expense of USD 10 million in 2004 was succeeded by deferred tax income of USD 8 million in 2005. The latter amount was caused by the following:

- impairment of property, plant and equipment recorded in 2005 in the amount of USD 12 million. Deferred tax assets and income, respectively, totaled USD 3 million. The impairment was split nearly equally between OJSC Matrosov Mine and Lenzoloto group;
- write-off 100% amortization of asset relating to decommissioning liability was recorded in OJSC Matrosov Mine in 2005.

Profit for the year

Profit for the year increased from USD 10 million in 2004 to USD 115 million in 2005.

Balance sheet

Below is detailed analysis of significant changes in the consolidated balance sheet lines of CJSC Polyus at 31 December 2005 compared to 31 December 2004.

Property, plant and equipment

As of 31 December 2005 net book value of property, plant and equipment totaled USD 965 million as compared to USD 516 million at 31 December 2004. The increase in net book value by USD 449 million or 87% resulted from the following:

- consolidation of the subsidiaries acquired in 2005 that resulted in the increase of consolidated property, plant and equipment by USD 424 million, including USD 327 million of mineral rights;
- acquisition of property, plant and equipment of USD 79 million and put into operation of USD 20 million;
- change in accounting policy with regard to exploration costs being a transition from expensing them as incurred to capitalization till achievement of commercial production volumes, or expensing them in case of insufficient evidence of proved and probable reserves. This change in the accounting policy caused an increase in property, plant and equipment by USD 32 million;
- revision of decommissioning liability that resulted in an increase in net book value of property, plant and equipment by USD 27 million.

The above increases were partially compensated by disposal of property, plant and equipment in the amount of USD 21 million (net of accumulated depreciation of USD 3.5 million) including that upon the disposal of subsidiaries, the effect of translation from functional into presentation currency in the amount of USD 27 million, and depreciation charge for 2005 in the amount of USD 53 million.

Investments in securities and other financial assets

As of 31 December 2005 investments in securities and other financial assets totaled USD 2,234 million as compared to USD 397 million at 31 December 2004. The increase of USD 1,837 million was mainly due to the acquisition by the Group in May, 2005 of 100% shares in Jenington International Inc., the holder of a 20% stake in a South-African gold mining company Gold Fields and increase in Gold Fields shares market value up to USD 1,736 million by December, 31, 2005.

Inventories

As of 31 December 2005 the total value of inventories consisting of refined gold, work-in-progress and stores and materials was USD 124 million as compared to USD 70 million at 31 December 2004. The increase in inventories was mainly due to the increase in the value of fuel and materials of CJSC Polyus by USD 25 million relating to the acquisition of spare parts for fixed assets acquired in 2005, and a growth in fuel price. Also the growth in Group inventory in part of USD 19 million was due to the consolidation of subsidiaries acquired in 2005.

Advances to suppliers and other receivables

As of 31 December 2005 advances to suppliers and other receivables totaled USD 25 million as compared to USD 12 million at 31 December 2004. The increase was mainly due to the consolidation of receivables of the newly acquired subsidiaries in Yakutia in the amount of USD 10 million, and the disposal of shares in OJSC Bank of Moscow in the amount of USD 2 million with deferred payment.

Cash and cash equivalents

As of 31 December 2005 cash and cash equivalents equaled USD 28 million as compared to USD 13 million at 31 December 2004.

Other current assets

As of 31 December 2005 other assets totaled USD 90 million as compared to USD 68 million at 31 December 2004. This growth was primarily due to an increase in value added tax recoverable by USD 24 million after the deduction of provision for this tax in the amount of USD 1 million.

Trade and other payables

As of 31 December 2005 trade and other payables totaled USD 50 million as compared to USD 36 million at 31 December 2004. The growth in trade in other payables by USD 14 million related to an increase in purchases that in turn was due to higher level of capital construction activities.

Contingent consideration for acquisition of subsidiaries

Contingent consideration for acquisition of subsidiaries appeared on the balance sheet at 31 December 2005 due to the settlement for the subsidiaries acquired in 2005 being deferred till 2006.

Short-term loans and borrowings (including current portion of long-term loans and borrowings)

As of 31 December 2005 short-term loans and borrowings totaled USD 26 million as compared to USD 36 million at 31 December 2004. The decrease in the liabilities was due to OJSC Matrosov Mine fully repaying its short-term promissory note obligations of USD 23 million during 2005. Apart from that Lenzoloto group repaid most of its short-term loans in the amount of USD 6 million. These decreases were partially counter-balanced by the consolidation of short-term loans and borrowings of USD 21 million attributable to the subsidiaries in Yakutia acquired during 2005.

Long-term loans and obligations under finance lease

As of 31 December 2005 long-term loans and obligations under finance lease of the Polyus Group totaled USD 5 million as compared to USD 9 million at 31 December 2004. The decrease resulted from the redemption of long-term bank loans in the amount of USD 4 million.

Share capital and reserves

As of 31 December 2005 share capital and reserves totaled USD 3,106 million (including minority interests in the amount of USD 30 million) as compared to USD 943 million (including minority interests in the amount of USD 44 million) at 31 December 2004. The main reasons for the increase were:

- ordinary share issue by CJSC Polyus that caused an increase in the Group's capital by USD 1,300 million;
- surplus from the revaluation of securities available-for-sale in the amount of USD 819 million including that attributable to shares owned by the Group in South-African gold mining company Gold Fields;
- growth in the Group retained earnings by USD 115 million.

Cash flows

Net cash inflow from operating activities

Net cash inflow from operating activities were USD 52 million in 2005 that was by USD 75 million lower than in 2004. The decrease in net cash inflow resulted from the following:

- increase in cash costs included in the value of work-in-process by USD 14 million. Cash spent to create work-in-process during 2005 as of 31 December 2005 was not yet matched with cash proceeds from further sale of the finished goods that represented a timing difference.
- increase in cash operating costs by USD 40 million;
- increase in selling, general and administrative expenses in terms of cash by USD 27 million;
- increase in cash costs included in the value of inventory (fuel, spare parts, materials) by USD 24 million. This increase was mainly due to purchases of spare parts for the property, plant and equipment acquired during 2005, as well as a growth in the purchase prices and an increase in the volume of fuel and materials consumed as a result of processing higher volumes of ore.

The above increases in cash operating costs were partially compensated by gold sales growth by USD 30 million.

Net cash outflow from investing activities

During 2005 and 2004 cash was invested mainly in the acquisition of subsidiaries; property, plant and equipment; securities and other financial assets.

Cash used in investing activities increased from USD 593 million in 2004 to USD 1,307 million in 2005 by USD 714 million. This increase was primarily due to the following:

- acquisition of 100% shares in Jenington International Inc., the holder of 20% shares in a South-African gold mining company Gold Fields, for USD 945 million;

- increase in the amounts spent to acquire property, plant and equipment from USD 70 million in 2004 to USD 146 million in 2005 by USD 76 million;

- the above increases were partially compensated by a decrease in the amounts spent to acquire subsidiaries from USD 270 million in 2004 to USD 153 million in 2005 by USD 117 million, as well as a decrease in the amounts used to purchase promissory notes from USD 756 million in 2004 to USD 613 million in 2005 by USD 143 million.

Net cash inflow from financing activities

The main source of cash inflows for the Polyus Group both in 2005 and 2004 was net cash inflow from financing activities mainly represented by proceeds from share issues. In 2005 net cash inflows from financing activities of the Polyus Group were USD 1,270 million (2004: USD 471 million), including proceeds from share issue of USD 1,300 million (2004: USD 499 million).