Open Joint Stock Company

Power Machines and subsidiaries

Consolidated Financial Statements
For the Year Ended 31 December 2006

OPEN JOINT STOCK COMPANY POWER MACHINES AND SUBSIDIARIES

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006

The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditor's audit report set out on pages 2-4, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of Open Joint Stock Company «Power Machines» and subsidiaries (the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group at 31 December 2006, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Russian Federation;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud and other irregularities.

The consolidated financial statements for the year ended 31 December 2006 were authorised for issue on 25 June 2007 by the Management Board.

On behalf of the Management Board:

B.F. Vainzikher	T.A. Borodina
General Director	Chief Accountant
25 June 2007	25 June 2007

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Open Joint Stock Company "Power Machines":

We have audited the accompanying consolidated financial statements of Open Joint Stock Company "Power Machines" and its subsidiaries (the "Group"), which comprise the consolidated balance sheet as at 31 December 2006, and the consolidated statements of income, cash flows and changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The consolidated financial statements of the Group as at 31 December 2005 and for the year then ended were audited by another auditor whose report dated 25 June 2006 expressed an opinion on those consolidated financial statements, modified in respect of the following departures from International Financial Reporting Standards:

- The management of the Group has not made an estimate of the net realizable value of the recoverable amounts in respect of a suspended construction contract stated at 6,894 thousand U.S. Dollars ("USD") as of 31 December 2005. The predecessor auditor was not able to determine the effect of this matter on the financial statements as of 31 December 2005 and for the year then ended.
- Management has not made an estimate of the recoverable amount of property, plant and equipment and intangible assets stated at USD 237,348 thousand and USD 27,670 thousand, respectively, as of 31 December 2005 in accordance with International Accounting Standard ("IAS") 36 Impairment of Assets. The predecessor auditor was not able to determine the effect of this matter on the financial statements as of 31 December 2005 and for the year then ended.
- As of 31 December 2005, the Group has not recorded a provision for projected losses on a construction contract as required by IAS 11, Construction Contracts in the amount of USD 7,480 thousand. Had such losses been provided for, provision for onerous contracts would have increased by USD 7,011 thousand, deferred expenses would have decreased by USD 469 thousand, loss before tax would have increased by USD 1,534 thousand, taxation benefit would have increased by USD 368 thousand and retained earnings would have decreased by USD 5,685 thousand.
- The Group classified certain loan agreements, that were payable on demand due to the breach of covenants, contained therein, as long-term, rather than current liabilities as of 31 December 2005. The balance outstanding under such loans amounted to USD 88,314 thousand as of 31 December 2005.
- The Group has not disclosed the name of its ultimate controlling party.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of accompanying consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the Group's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for qualified opinion

The amount reported as cost of sales for the year ended 31 December 2006 includes a provision of USD 6,894 thousand with respect to a construction contract, which has been suspended in 2005 because the customer was not able to obtain certain government approvals required to finance the construction. As discussed above, management has not made an estimate of the net realizable value of the amounts recoverable under this contract as of 31 December 2005. We were not able to determine the effect, if any, of this matter on the consolidated statement of income for the year ended 31 December 2006.

During the year ended 31 December 2006, the Group has recorded a loss on a construction contract in the amount of USD 7,480 thousand. This loss relates to the year ended 31 December 2005. International Financial Reporting Standards require prior period errors to be corrected by retrospective restatement. Had the Group appropriately accounted for this correction of an error, cost of sales would have decreased by USD 7,480 thousand, loss before tax, income tax benefit and net loss for the year ended 31 December 2006 would have decreased by USD 7,480 thousand, USD 1,795 thousand and USD 5,685 thousand, respectively, and retained earnings as of 1 January 2006 would have decreased by USD 5,685 thousand. The comparative amounts for the year ended 31 December 2005 would have changed accordingly.

As discussed in Note 9, in the year ended 31 December 2006 the Group identified an error in the calculation of the deferred tax liability as at 31 December 2005. The Group corrected this error by recording an additional income tax expense of USD 3,112 thousand in the year ended 31 December 2006. International Financial Reporting Standards require prior period errors to be corrected by retrospective restatement. Had the Group appropriately accounted for this correction of an error, the income tax benefit for the year would have increased by USD 3,112 thousand and retained earnings as of 1 January 2006 would have increased by USD 3,112 thousand. The comparative amounts for the year ended 31 December 2005 would have changed accordingly.

At 31 December 2005, the Group classified its short-term deposits in the amount of USD 5,843 thousand, with maturities of more than three months after the balance sheet date as cash and cash equivalents. At 31 December 2006, following its accounting policy, the Group classified such instruments as other investments within current assets. Accordingly, the amounts of cash and cash equivalents and other investments within current assets reported at 31 December 2006 are not comparable with the amounts reported at 31 December 2005.

The Group has not disclosed the name of its ultimate controlling party as at 31 December 2006, which is required by IAS 24, Related Party Disclosures.

Qualified opinion

In our opinion, except for the effects of the matters described under “Basis for qualified opinion”, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2006, and the results of its consolidated financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of a matter

Without further qualifying our opinion, we draw attention to Note 32 to the accompanying consolidated financial statements which describes that as of 31 December 2006 the Group’s current liabilities exceeded its current assets by USD 101,043 thousand. Additionally, the Group has incurred net losses and negative cash flows from operating activities for the years ended 31 December 2006 and 2005.

25 June 2007
St. Petersburg, Russia

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006
(In thousand of US dollars)

	Note	2006	2005
Revenue	4	579,072	667,173
Cost of sales		(583,443)	(504,803)
Gross (loss)/profit		(4,371)	162,370
Distribution expenses		(54,558)	(73,934)
Administrative expenses	5	(104,940)	(96,675)
Other operating income	6	7,720	7,760
Other operating expenses	6	(2,557)	(6,084)
Loss from operations		(158,706)	(6,563)
Financial income	8	26,580	6,711
Financial expenses	8	(32,659)	(46,975)
Income from associates	13	354	9
Loss before tax		(164,431)	(46,818)
Income tax benefit	9	32,274	6,295
Net loss for the year		(132,157)	(40,523)
Attributable to:			
Shareholders of the Company		(132,211)	(40,526)
Minority interest		54	3
		(132,157)	(40,523)
Basic and diluted loss per share	27	USD (0.0183)	USD (0.0062)

On behalf of the Management Board:

B.F. Vainzikher	T.A. Borodina
General Director	Chief Accountant
25 June 2007	25 June 2007

The notes on pages 9-34 form an integral part of these consolidated financial statements. The Independent auditors' report is on pages 2-4.

OPEN JOINT STOCK COMPANY POWER MACHINES AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
AS OF 31 DECEMBER 2006
(In thousand of US dollars)

	Note	31 December 2006	31 December 2005
Assets			
Property, plant and equipment	11	244,540	237,348
Intangible assets	12	26,185	27,670
Investments in associates	13	4,645	4,114
Other investments	14	6,000	4,333
Deferred tax assets	23	25,207	-
Other non-current receivables	15	28,605	26,821
Total non-current assets		335,182	300,286
Inventories	16	125,231	91,557
Trade receivables	17	30,852	119,396
Other receivables	18	182,085	167,009
Other investments	14	1,402	3,071
Current tax asset		5,408	68
Cash and cash equivalents	19	40,920	34,483
Total current assets		385,898	415,584
Total assets		721,080	715,870
Equity			
Issued capital	20	10,563	10,563
Additional paid-in capital	20	125,280	125,280
Translation reserve	20	45,926	25,893
(Accumulated deficit)/Retained earnings	20	(29,756)	102,455
Total equity attributable to shareholders of the Company		152,013	264,191
Minority interest		1,129	985
Total equity		153,142	265,176
Liabilities			
Borrowings	21	57,216	119,145
Deferred tax liabilities	23	-	7,239
Other liabilities	26	23,781	33,252
Total non-current liabilities		80,997	159,636
Borrowings	21	246,306	117,206
Current tax liabilities		-	3,260
Trade and other payables	24	150,722	155,907
Provisions	25	89,913	14,685
Total current liabilities		486,941	291,058
Total liabilities		567,938	450,694
Total equity and liabilities		721,080	715,870

On behalf of the Management Board:

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B.F. Vainzikher	T.A. Borodina
General Director	Chief Accountant
25 June 2007	25 June 2007

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CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2006
(In thousand of US dollars)

	2006	2005
Operating activities		
Net loss for the year	(132,157)	(40,523)
Adjustments for:		
Depreciation and amortisation	36,068	31,584
Loss on disposal of property plant and equipment	946	1,859
Loss on disposal of intangible assets	-	909
Gain on disposal of other assets	(2,102)	-
Gain on disposal of investments	-	(2,192)
Loss from disposal of subsidiaries	-	1,555
Impairment of investments	-	2,277
Amortisation of government grant	(3,813)	-
Income from associates	(354)	(9)
Interest income	(3,998)	(6,711)
Interest expense	22,544	27,931
Income tax benefit	(32,274)	(6,295)
Unrealised foreign exchange (gains)/losses	(7,691)	587
Operating (loss) /profit before changes in working capital and provisions	(122,831)	10,972
Increase in inventories	(24,356)	(7,332)
Decrease in trade and other receivables	97,661	61,746
Increase/(decrease) in trade and other payables	40,281	(45,150)
Cash flows from operations before income taxes and interest paid	(9,245)	20,236
Interest paid	(22,974)	(27,173)
Income tax paid	(7,812)	(40,654)
Cash flows utilised by operating activities	(40,031)	(47,591)
Investing activities		
Proceeds from disposal of property, plant and equipment	5,081	2,473
Proceeds from disposal of other assets	2,703	-
Proceeds from disposal of notes available for sale	-	88,175
Interest received	495	6,711
Acquisition of property, plant and equipment and intangible assets	(23,157)	(34,944)
Disposal of subsidiaries, net of cash disposed of	-	(83)
Proceeds from repayment of loans to third and related parties	-	1,012
Net cash flow from other investments	1,306	1,946
Cash flows (utilised by)/from investing activities	(13,572)	65,290
Financing activities		
Proceeds from borrowings	582,414	487,894
Repayments of borrowings	(523,865)	(483,932)
Cash flows from financing activities	58,549	3,962
Net increase in cash and cash equivalents	4,946	21,661
Cash and cash equivalents at the beginning of year	34,483	12,933
Effect of exchange rate fluctuations	1,491	(111)
Cash and cash equivalents at the end of year	40,920	34,483

During 2006 the Group acquired property, plant and equipment with an aggregate cost of USD 467 thousand by means of finance leases.

On behalf of the Management Board:

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B.F. Vainzikher	T.A. Borodina
General Director	Chief Accountant
25 June 2007	25 June 2007

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OPEN JOINT STOCK COMPANY POWER MACHINES AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2006
(In thousand of US dollars)

	Attributable to shareholders of the Company							
	Ordinary shares	**Preference shares**	**Additional paid-in capital**	**Translation reserve**	**(Accumulated deficit)/Retained earnings**	**Total**	**Minority interest**	**Total equity**
Balance at 1 January 2005	8,382	2,181	125,280	36,493	142,981	315,317	1,415	316,732
Net loss	-	-	-	-	(40,526)	(40,526)	3	(40,523)
Currency translation differences	-	-	-	(10,600)	-	(10,600)	(49)	(10,649)
Total recognised income and expenses	-	-	-	-	-	(51,126)	(46)	(51,172)
Conversion of preference shares	2,181	(2,181)	-	-	-	-		-
Disposal of subsidiary	-	-	-	-	-	-	(384)	(384)
Balance at 31 December 2005	**10,563**	**-**	**125,280**	**25,893**	**102,455**	**264,191**	**985**	**265,176**
Net loss	-	-	-	-	(132,211)	(132,211)	54	(132,157)
Currency translation differences	-	-	-	20,033		20,033	90	20,123
Balance at 31 December 2006	**10,563**	**-**	**125,280**	**45,926**	**(29,756)**	**152,013**	**1,129**	**153,142**

On behalf of the Management Board:

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B.F. Vainzikher
General Director

25 June 2007

T.A. Borodina
Chief Accountant

25 June 2007

The notes on pages 9-34 form an integral part of these consolidated financial statements. The Independent auditors' report is on pages 2-4.

1. BACKGROUND

Organisation and operations

The consolidated financial statements of the Open Joint Stock Company "Power Machines" comprise OJSC "Power Machines" (the "Company") and its subsidiaries (the "Group"). The Company is an open joint stock (public) company as defined in the Civil Code of the Russian Federation. The Company is domiciled in the Russian Federation. The registered office of the Company is located at 3 Lit.A, Vatutina str., St.Petersburg, Russian Federation.

The 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 plants Leningradskiy Metalicheskiy Zavod, Electrosila and Zavod Turbinich Lopatok are branches of the Company. 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, produces equipment and further places orders for production of the equipment with other subcontractors.

2. BASIS OF PREPARATION

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

Basis of preparation

The consolidated financial statements are prepared on the historical cost basis except for investments available-for-sale stated at fair value; certain items of property, plant and equipment which were revalued to determine deemed cost as part of the adoption of IFRS as at 1 January 2002; and the carrying amounts of assets, liabilities and equity items in existence at 31 December 2002 that include adjustments for the effects of hyperinflation, which were calculated using conversion factors derived from the Russian Federation Consumer Price Index published by the Russian Statistics Agency, *GosKomStat*. Russia ceased to be hyperinflationary for IFRS purposes as at 1 January 2003.

Functional and presentation currency

The national currency of the Russian Federation is the Russian Rouble ("RUR"), which is the Company's functional currency.

These consolidated financial statements are presented in United States dollars ("USD") since management believes that this currency is more useful for the users of the consolidated financial statements. All financial information presented in USD has been rounded to the nearest thousand.

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

Use of estimates

Management has 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 consolidated financial statements in conformity with IFRS. Actual results could differ from those estimates.

In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies are described in the following notes:

- Note 3 – accounting for construction contracts;
- Note 3 – useful lives of property, plant and equipment;
- Note 3 – useful lives of intangible assets;
- Note 3 – impairment of assets;
- Note 16 – provision for obsolete inventory;
- Note 25 – provision for warranties and onerous contracts;
- Note 32 – tax matters.

3. SIGNIFICANT ACCOUNTING POLICIES

The following significant accounting policies have been applied in the preparation of the consolidated financial statements.

Subsidiaries

Subsidiaries are those enterprises controlled by the Group. Control exists when the Group 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.

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 using the equity method, 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 its interest in the associate, that interest 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.

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.

Foreign currencies

Transactions in foreign currencies are translated to the respective functional currency of each enterprise in the Group 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 the functional currency at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities denominated in foreign currencies that are stated at historical cost are translated to the functional currency at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the functional currency at the foreign exchange rate ruling at the dates the fair values were determined. Foreign exchange differences arising on translation are recognised in the income statement.

Where necessary, the assets and liabilities of Group enterprises are translated into USD at the exchange rate at the end of the year. Revenues and expenses are translated into USD using rates approximating exchange rates at the dates of the transactions. The resulting exchange difference is recorded directly in equity in the foreign currency translation reserve.

Property, plant and equipment

Owned assets

Property, plant and equipment is stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labor and an appropriate proportion of production overheads. The cost of property, plant and equipment at the date of adopting IFRS, 1 January 2002, was determined by reference to its fair value at that date ("deemed cost").

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.

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 below).

Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalised with the carrying amount of the component being written off. Other subsequent expenditure is capitalised if future economic benefit will arise from the expenditure. All other expenditure, including repairs and maintenance expenditure, is recognised in the income statement as an expense as incurred.

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 when an asset is ready for its intended use. Land is not depreciated.

The estimated useful lives are as follows:

- Buildings 30-90 years;
- Machinery and equipment 15-30 years;
- Transportation equipment 5-18 years;
- Other property and equipment 4-25 years.

The depreciation policy for depreciable leased assets is consistent with that for depreciable assets that are owned. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.

Intangible assets

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 labor 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.

Other intangible assets

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

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 2-15 years

Investments

Investments are recognised (derecognised) when the Group obtains (loses) control over the contractual rights inherent in that asset.

Except as outlined below, investments are accounted for as follows:

- Investments held-to-maturity are stated initially at cost. Subsequent to initial recognition they are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period to maturity on an effective interest basis.
- Other investments are classified as available-for-sale and are stated at fair value, with any resultant gain or loss being recognised directly in equity.

The fair value of investments available-for-sale is their quoted bid price at the balance sheet date. 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.

Trade and other receivables

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

Retentions under long-term contracts are recognised as non-current assets where appropriate.

Amounts recoverable on contracts are stated at cost plus profit recognised to date (see accounting policy below) less a provision for foreseeable losses and less progress billings. Cost includes all expenditure related directly to specific projects and an allocation of fixed and variable overheads incurred in the Group's contract activities based on normal operating capacity.

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 the specific identification method and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

Cash and cash equivalents

Cash and cash equivalents comprises cash balances and call deposits. 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 for the purpose of the statement of cash flows.

Impairment

The carrying amounts of the Group's assets, other than inventories (refer to accounting policy above) and deferred tax assets (refer to accounting policy below), 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.

Calculation of recoverable amount

The recoverable amount of the Group's held-to-maturity investments and receivables is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. Receivables with a short duration are not discounted.

The recoverable amount of other assets is the greater of their fair value less costs to sell 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.

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.

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.

Share capital

Preference share capital

Preference share capital, which is non-redeemable and non-cumulative, is classified as equity.

Repurchase of share capital (treasury shares)

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is deducted from equity.

Dividends

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

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.

Employee benefits

The Group makes contributions for the benefit of employees to Russia's State Pension Fund. These contributions are expensed when employees have rendered services.

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.

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.

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.

Trade and other payables

Trade and other payables are stated at their cost.

Government grants

Government grants are recognised in the balance sheet initially as deferred income when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group 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 Group for the cost of an asset are recognised in the income statement as other operating income on a systematic basis over the useful life of the asset.

Revenue

Goods sold and services rendered

Revenue from sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Revenue from services rendered is recognised in the income statement in proportion to the stage of completion of the transaction to the balance sheet date. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due, associated costs or possible return of goods or when substantially all risks and rewards of ownership are not transferred to the buyer.

Construction contracts

As soon as the outcome of a construction contract can be estimated reliably, contract revenue and expenses are recognised in the income statement in proportion to the stage of completion of the contract. The stage of completion is assessed as the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs. An expected loss on a contract is recognised immediately in the income statement.

Rental income

Rental income from investment 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.

Expenses

Agents' fees

The Group pays fees to agents to secure and facilitate the operation of contracts in certain countries outside Russia. Such payments are deferred and charged to the income statement within distribution expenses as the contract to which they relate is completed.

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.

Social costs

To the extent that the Group's contributions to social programs benefit the community at large and are not restricted to the Group's employees, they are recognised in the income statement as incurred.

Financial income and expenses

Financial income and expenses comprise interest expense on borrowings, interest income on funds invested, dividend income, impairment losses and gains and losses on the disposals of available-for-sale investments and foreign exchange gains and losses.

All interest and other costs incurred in connection with borrowings are expensed as incurred as part of financial expenses.

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

Income tax

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

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: the initial recognition of assets or liabilities that, at the time of transaction, 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 substantively 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.

Segment reporting

The Group manufactures energy generating equipment, buys energy generating equipment from subcontractors and sells both types of energy generating equipment to final customers or intermediaries under the same contracts within the framework of turn-key projects. Revenues, results and assets attributable to these activities, which have similar risks and returns, comprise substantially all of the Group's revenues, results and assets. Therefore no separate information in respect of business segments is presented.

The Group's manufacturing operations are all based in Russia. The Group performs sales within and outside Russia.

New standards and Interpretations not yet adopted

Adoption of new and revised IFRS

In the current year, the Group has adopted all of the new and revised standards and interpretations that are relevant to its operations. The adoption of these new and revised standards and interpretations has not resulted in significant changes to the Group's accounting policies.

New accounting pronouncements

The following new or revised standards and interpretations of IASB and IFRIC have been issued at the date of authorisation of the Group's consolidated financial statements for the year ended 31 December 2006 that are mandatory for adoption in the accounting periods beginning on or after 1 January 2007:

- Amendment to IAS 1 "Capital Disclosures";
- Amendment to IAS 23 "Required Capitalisation of Borrowing Costs";
- IFRS 7 "Financial Instruments: Disclosures";
- IFRS 8 "Operating Segments";
- IFRIC 7 "Applying the Restatement Approach under IAS 29 "Financial Reporting in Hyperinflationary Economies";

- IFRIC 8 “Scope of IFRS 2”;
- IFRIC 9 “Reassessment of Embedded Derivatives”;
- IFRIC 10 “Interim Financial Reporting and Impairment”;
- IFRIC 11 “IFRS 2: Group and Treasury Share Transactions”;
- IFRIC 12 “Service Concession Arrangements”.

The impact of adoption of these standards and interpretations in the preparation of the consolidated financial statements in future periods is currently being assessed by management. No material effect on the Group’s accounting policies is anticipated, however, adoption of IFRS 7 “Financial Instrument: Disclosures” will require more comprehensive disclosure of the Group’s financial instruments.

4. REVENUE

In thousands of US dollars	**2006**	**2005**
Energy generating and other equipment	557,548	642,606
Sales of spare parts	21,524	24,567
	579,072	667,173

In thousands of US dollars	**2006**	**2005 (unaudited)**
Export sales	306,108	407,115
Domestic sales	272,964	260,058
	579,072	667,173

5. ADMINISTRATIVE EXPENSES

In thousands of US dollars	**2006**	**2005**
Wages, salaries and related taxes	51,515	46,767
Depreciation	6,480	7,659
Amortisation of intangibles	6,584	4,340
Taxes other than income tax	4,581	5,016
Insurance	4,318	5,314
Bank charges	3,168	2,480
Repair	2,832	-
Consulting	2,258	1,527
Materials	1,892	1,829
Social costs	1,625	4,584
Travel expenses	1,366	1,479
Electricity	993	-
Penalties	597	44
Other administrative expenses	16,731	15,636
	104,940	96,675

6. OTHER OPERATING INCOME AND EXPENSES

In thousands of US dollars	**2006**	**2005**
Other operating income		
Gain on disposals of investments	-	2,192
Gain on disposals of other assets	2,102	1,727
Amortisation of government grants	3,813	946
Decrease in provision for accounts receivable	-	556
Decrease in provision for warranty expenses	569	-
Other operating income	1,236	2,339
	7,720	7,760
Other operating expenses		
Increase in provision for accounts receivable	1,579	-
Loss on disposals of property, plant and equipment	946	1,859
Loss on disposals of subsidiary	-	1,555
Loss on disposal of intangible assets	-	909
Increase in provision for warranty expenses	-	1,761
Other operating expenses	32	-
	2,557	6,084

7. PERSONNEL EXPENSES

In thousands of US dollars	**2006**	**2005**
Wages, salaries and related taxes included in:		
Cost of sales	82,880	72,674
Distribution costs	10,592	7,605
Administrative expenses	51,515	46,767
	144,987	127,046

The average number of employees for the year ended 31 December 2006 was 13,480 (year ended 31 December 2005: 13,840).

8. FINANCIAL INCOME AND EXPENSES

In thousands of US dollars	**2006**	**2005**
Financial income		
Foreign exchange gain	22,480	-
Interest income	3,998	6,711
Other financial income	102	-
	26,580	6,711
Financial expenses		
Interest expense	22,544	27,931
Bank guarantee expenses	10,115	9,028
Loss on disposal of notes receivables	-	7,266
Impairment loss on investments available for sale	-	2,277
Foreign exchange loss	-	473
	32,659	46,975

9. INCOME TAX EXPENSE

In thousands of US dollars	**2006**	**2005**
Current tax expense		
Current year	3,562	10,339
Underprovided in prior years	462	11,656
	4,024	21,995
Deferred tax benefit		
Origination and reversal of temporary differences	(33,186)	(16,634)
Overprovided in prior years	(3,112)	(11,656)
	(36,298)	(28,290)
	(32,274)	(6,295)

In 2005, the Group received a government grant of RUR 400,000 thousand (USD 15,191 thousand at the date of the grant). At 31 December 2005, the Group reported a deferred tax asset in relation to this grant of USD 3,112 thousand. During 2006, management had determined that the receipt of the grant was not taxable to the Group and accordingly, removed the asset from the Group's books, recording an additional deferred tax expense in the same amount.

The Group's applicable tax rate is the corporate income tax rate of 24% (2005: 24%)

Reconciliation of effective tax rate

In thousands of US dollars		**2006**		**2005**
Loss before tax		(164,431)		(46,818)
Income tax using corporate tax rate	24%	(39,463)	24%	(11,236)
Non-deductible expenses	3%	5,342	11%	5,083
Non-taxable income	1%	(1,265)	-	-
Correction of prior years' errors	2%	3,112	0%	(142)
	20%	(32,274)	13%	(6,295)

10. CONSTRUCTION CONTRACTS

Revenues, gross margin and provision charge recognised on long-term contracts during period amounted to:

In thousands of US dollars	**2006**	**2005**
Contract revenue	420,355	466,967
Contract costs	(357,103)	(344,407)
Increase in provision for onerous contracts	(72,417)	(17,035)
Gross (loss)/profit	(9,165)	105,525

11. PROPERTY, PLANT AND EQUIPMENT

In thousands of US dollars	**Land and buildings**	**Machinery and equipment**	**Transpor-tation equipment**	**Other**	**Assets under construction**	**Total**
Cost/deemed cost						
At 31 December 2004	352,877	751,510	15,838	37,166	13,165	1,170,556
Additions	2,297	7,098	943	3,496	13,712	27,546
Transfers	533	4,424	236	1,344	(6,537)	-
Disposals	(3,864)	(16,694)	(820)	(1,650)	(1,415)	(24,443)
Translation adjustments	(12,736)	(26,902)	(503)	(1,418)	(865)	(42,424)
At 31 December 2005	339,107	719,436	15,694	38,938	18,060	1,131,235
Additions	745	4,381	441	6,244	7,297	19,108
Transfers	2,173	13,517	4	1,598	(17,292)	-
Disposals	(851)	(17,370)	(1,062)	(477)	(684)	(20,444)
Translation adjustments	31,571	66,979	1,461	3,625	1,681	105,317
At 31 December 2006	372,745	786,943	16,538	49,928	9,062	1,235,216
Depreciation						
At 31 December 2004	(281,824)	(604,992)	(12,887)	(20,792)	-	(920,495)
Charge for the year	(2,043)	(19,471)	(983)	(4,043)	-	(26,540)
Disposals	3,297	15,425	800	589	-	20,111
Translation adjustments	10,086	21,727	485	739	-	33,037
At 31 December 2005	(270,484)	(587,311)	(12,585)	(23,507)	-	(893,887)
Charge for the year	(2,215)	(20,371)	(1,274)	(4,724)	-	(28,584)
Disposals	350	13,208	1,052	433	-	15,043
Translation adjustments	(25,182)	(54,585)	(1,173)	(2,308)	-	(83,248)
At 31 December 2006	(297,531)	(649,059)	(13,980)	(30,106)	-	(990,676)
Net book value						
At 31December 2005	68,623	132,125	3,109	15,431	18,060	237,348
At 31December 2006	75,214	137,884	2,558	19,822	9,062	244,540

Leased machinery

The Group leases production equipment under a number of finance lease agreements. As at 31 December 2006 the net carrying amount of leased machinery and equipment was USD 9,524 thousand (31 December 2005: USD 8,286 thousand).

12. INTANGIBLE ASSETS

In thousands of US dollars	Development projects Completed	Development projects In process	Other intangible assets	Total
Cost				
At 31 December 2004	2,377	20,738	6,408	29,523
Additions	4,403	1,257	1,738	7,398
Transfers	14,907	(14,988)	81	-
Disposals	(32)	(528)	(703)	(1,263)
Translation adjustments	(87)	(744)	(230)	(1,061)
At 31 December 2005	21,568	5,735	7,294	34,597
Additions	9	3,763	277	4,049
Transfers	356	(3,850)	3,494	-
Disposals	(245)	(397)	(413)	(1,055)
Translation adjustments	2,008	534	679	3,221
At 31 December 2006	23,696	5,785	11,331	40,812
Amortisation				
At 31 December 2004	(962)	-	(1,360)	(2,322)
Amortisation for the year	(2,646)	-	(2,398)	(5,044)
Disposals	13	-	341	354
Translation adjustments	34	-	51	85
At 31 December 2005	(3,561)	-	(3,366)	(6,927)
Amortisation for the year	(5,263)	-	(2,221)	(7,484)
Disposals	158	-	271	429
Translation adjustments	(332)	-	(313)	(645)
At 31 December 2006	(8,998)	-	(5,629)	(14,627)
Net book value				
At 31 December 2005	18,007	5,735	3,928	27,670
At 31 December 2006	14,698	5,785	5,702	26,185

The aggregate amount of research and development expenditure recognised as an expense during 2006 was USD 7,298 thousand.

13. INVESTMENTS IN ASSOCIATES

The Group has the following investments in associates:

	Country of incorporation	Principal activities	Ownership 31 December 2006	Ownership 31 December 2005	Voting interest 31 December 2006	Voting interest 31 December 2005
ZAO Interplast	Russia	Production of equipment	50%	50%	50%	50%
NPO CKTI	Russia	Research and development	35%	35%	35%	35%

Summarised financial information in respect of the Group's associates is set out below:

In thousands of US dollars	**31 December 2006**	**31 December 2005 (unaudited)**
Total assets	18,540	17,789
Total liabilities	(5,585)	(6,315)
Net assets	12,955	11,474
Group's share of associates' net assets	4,645	4,114

	2006	**2005**
Total revenue	25,357	24,351
Total profit for the period	995	455
Group's share of associates' profit for the period	354	9

Carrying amounts of the Group's investments in associates is set out below:

In thousands of US dollars	**31 December 2006**	**31 December 2005**
ZAO Interplast	92	84
NPO CKTI	4,553	4,030
	4,645	4,114

There are no published price quotations of investments in associates and therefore, no reliable information is available to perform estimation of the fair value of investments in associates.

14. OTHER INVESTMENTS

In thousands of US dollars	**2006**	**2005**
Non-current investments		
Available-for-sale investments	4,838	4,326
Bank deposits	1,154	-
Loans	8	7
	6,000	4,333
Current investments		
Debt securities held to maturity	606	2,962
Bank deposits	684	-
Loans	112	109
	1,402	3,071

Available-for-sale investments stated at cost comprise unquoted equity securities in the banking industry. There is no market for these investments and there have been no recent transactions that provide evidence of fair value. In addition, discounted cash flow techniques yield a wide range of fair values due to the uncertainty of future cash flows in this industry. However, management performed a review of the recoverable amount of these investments and believes it unlikely that the fair value would differ significantly from the carrying amount.

15. OTHER NON-CURRENT RECEIVABLES

In thousands of US dollars	**2006**	**2005**
Trade accounts receivable	27,521	26,580
Notes receivable	90	241
Other receivables	994	-
	28,605	26,821

At 31 December 2006 trade accounts receivable included contractual retention amounts billed to customers amounting to USD 22,504 thousand (31 December 2005: USD 11,518 thousand).

16. INVENTORIES

In thousands of US dollars	**2006**	**2005**
Raw materials and consumables	57,314	42,888
Work in progress	33,511	30,010
Finished goods and goods for resale	30,502	27,587
Supplies	8,497	6,407
Other inventories	-	777
	129,824	107,669
Provision for obsolete inventory	(4,593)	(16,112)
	125,231	91,557

Cost of inventories recognized as an expense during 2006 was USD 299,991 thousand (2005: USD 344,331 thousand).

17. TRADE RECEIVABLES

In thousands of US dollars	**2006**	**2005**
Trade accounts receivable	55,253	108,048
Notes receivable	202	287
	55,455	108,335
Less provision for doubtful debts	(1,930)	(1,022)
	53,525	107,313
Costs and earnings in excess of billings on uncompleted contracts	436,789	284,515
Advance payments received related to uncompleted contracts	(459,462)	(272,432)
	(22,673)	12,083
	30,852	119,396

At 31 December 2006 trade accounts receivable included contractual retention amounts billed to customers amounting to USD 10,831 thousand (31 December 2005: USD 915 thousand).

18. OTHER RECEIVABLES

In thousands of US dollars	**2006**	**2005**
Prepayments	105,992	65,197
VAT receivable	47,178	53,632
Deferred expenses	18,671	38,406
Receivables from employees	1,505	1,486
Restricted cash	23	1,218
Other receivables	8,716	7,070
	182,085	167,009

19. CASH AND CASH EQUIVALENTS

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

In thousands of US dollars	**2006**	**2005**
Foreign currency bank accounts	9,422	8,984
Foreign currency bank deposits	22,739	7,040
Rouble bank accounts	7,909	7,487
Rouble bank deposits	-	10,364
Other rouble denominated cash equivalents	850	608
	40,920	34,483

20. EQUITY

Share capital and share premium

Number of shares	**Ordinary shares**		**Non-redeemable preference shares**	
	2006	**2005**	**2006**	**2005**
On issue at beginning of year	7,216,938,708	6,170,912,708	-	1,046,026,000
Conversion	-	1,046,026,000	-	(1,046,026,000)
On issue at end of year	7,216,938,708	7,216,938,708	-	-

Share capital – As at the balance sheet date, authorised share capital comprised 9,359,450,000 ordinary shares (31 December 2005: 9,359,450,000) of which 7,216,938,708 ordinary shares (31 December 2005: 7,216,938,708 ordinary shares) were issued and fully paid. All shares have par value of RUR 0.01 (31 December 2005: 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 additional paid-in capital arose in connection with the formation of the Group in 2002 and 2003 from the excess of fair value over 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, less amounts converted to share capital.

Foreign currency translation reserve **–** Foreign currency translation reserve comprises foreign exchange differences arising from the translation of these consolidated financial statements from the functional to the presentation currency.

Dividends **–** Dividends payable are limited to retained earnings of the Company 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 160,082 thousand.

As disclosed in Note 21, certain of the Company's loan agreements currently prevent the Company from paying dividends.

Voting rights of shareholders **–** The holders of fully paid ordinary shares are entitled to one vote per share at the Company's annual and general shareholders' meetings.

21. LOANS AND BORROWINGS

In thousands of US dollars	**2006**	**2005**
Non-current		
Secured bank loans	37,632	73,566
Unsecured bank facility	10,000	35,000
Secured loan from the Ministry of Finance	5,343	7,279
Unsecured loans with other companies	3,827	2,818
Finance lease liability	414	482
	57,216	119,145
Current		
Current portion of secured bank loans	143,131	-
Unsecured bank facility	100,530	79,033
Unsecured loans with other companies	659	35,034
Current portion of secured loan from the Ministry of Finance	856	989
Current portion of finance lease liability	1,130	2,150
	246,306	117,206

Finance lease liabilities are payable as follows:

In thousands of US dollars		**2006**			**2005**	
	Payments	**Interest**	**Principal**	**Payments**	**Interest**	**Principal**
Less than one year	1,272	142	1,130	2,481	331	2,150
Between one and five years	585	171	414	522	40	482
	1,857	313	1,544	3,003	371	2,632

During the year ended 31 December 2004, the Group obtained a loan from the European Bank for Reconstruction and Development (“EBRD”). The outstanding balance as at the balance sheet date is USD 51,522 thousand (2005: USD 58,362 thousand). Covenants in 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 may not perform mergers, acquisitions, reorganizations and consolidations without the prior written consent of EBRD. As at 31 December 2006, the Group had not complied with some of the financial ratios required by the covenants.

In January 2007 the Group voluntary repaid the EBRD loan. The loan has been classified as current as at the balance sheet date.

During the year ended 31 December 2006 the Group obtained a loan from Donau Bank AG maturing in 2009. The outstanding balance as at 31 December 2006 is EUR 20,000 thousand. Covenants in the loan agreement require the Group to maintain certain financial ratios. As at 31 December 2006, the Group had not complied with some of the financial ratios required by the covenants.

During the year ended 31 December 2006 the Group obtained a loan from Commertzbank (EURASIJA) SAO maturing in 2009. The outstanding balance as at 31 December 2006 is USD 30,000 thousand. Covenants in the loan agreement require the Group to maintain certain financial ratios. As at 31 December 2006, the Group had not complied with some of the financial ratios required by the covenants.

Management believes that the probability that the banks will demand early repayment of the loans solely because of the breach of covenants. Nevertheless, the loans have been classified as current.

22. PLEDGES PROVIDED BY THE GROUP

The following assets have been pledged to secure the Group's borrowings:

In thousands of US dollars	**2006**	**2005**
Property, plant and equipment	61,325	42,209
Inventories and costs and profits recognised to date in excess of progress billings	191,344	147,128
Cash and cash equivalents	1,383	3,486
Revenue from planned supply of equipment in the future	56,085	59,024
	310,137	251,847

Assets pledged to secure borrowings are as follows:

In thousands of US dollars	**2006**	**2005**
Current loans and borrowings		
Pledges in connection with the Group's borrowings	209,837	124,152
Pledges in connection with subcontractors' borrowings	-	6,385
Non-current loans and borrowings		
Pledges in connection with the Group's borrowings	100,300	121,310
	310,137	251,847

23. DEFERRED TAX ASSETS AND LIABILITIES

Deferred tax assets and liabilities are attributable to the following:

In thousands of US dollars	**Assets**		**Liabilities**		**Net**	
	31 December 2006	**31 December 2005**	**31 December 2006**	**31 December 2005**	**31 December 2006**	**31 December 2005**
Cash and cash equivalents	-	257	-	-	-	257
Other short-term investments	511	-	-	-	511	-
Property, plant and equipment	-	-	(19,433)	(22,025)	(19,433)	(22,025)
Intangible assets	-	-	(4,228)	(2,917)	(4,228)	(2,917)
Other long-term investments	2,872	3,556	-	-	2,872	3,556
Inventories	9,808	5,715	-	-	9,808	5,715
Trade and other accounts receivable	8,133	-	-	(317)	8,133	(317)
Trade and other accounts payable	6,785	5,806	-	-	6,785	5,806
Loans and borrowings	-	-	(815)	(240)	(815)	(240)
Provisions	21,574	2,926	-	-	21,574	2,926
Tax assets/(liabilities)	49,683	18,260	(24,476)	(25,499)	25,207	(7,239)

24. TRADE AND OTHER PAYABLES

In thousands of US dollars	**2006**	**2005**
Trade accounts payable	72,199	83,981
Advances from customers	52,083	41,968
Employees-related liabilities	13,037	11,216
Other taxes payable	7,225	9,262
Other current liabilities	3,609	7,839
Interest payable	1,353	1,310
Accrued liabilities	980	266
Deferred income	236	65
	150,722	155,907

25. PROVISIONS

In thousands of US dollars	Provision for warranties	Provision for onerous contracts	Total
Balance at 1 January 2005	4,252	567	4,819
Provisions made during the year	1,761	17,035	18,796
Provisions used during the year	(3,399)	(5,182)	(8,581)
Translation differences	(124)	(225)	(349)
Balance at 1 January 2006	2,490	12,195	14,685
Provisions made during the year	116	72,417	72,533
Provisions used during the year	(1,025)	-	(1,025)
Translation differences	222	3,498	3,720
Balance at 31 December 2006	1,803	88,110	89,913

Provision for warranties – The Group gives warranties on certain products and undertakes to repair or replace items that fail to perform satisfactorily. A provision of USD 1,803 thousand has been recognised at 31 December 2006 (31 December 2005: USD 2,490 thousand) for expected warranty claims based on past experience of the level of repairs and returns.

Provision for onerous contracts – Provisions for onerous contracts are recognised when the expected revenues are lower than the expected costs to completion.

26. OTHER NON-CURRENT LIABILITIES

In thousands of US dollars	2006	2005
Trade accounts payable	13,544	20,285
Government grant	10,237	12,967
	23,781	33,252

In 2005, the Group received a government grant of RUR 400,000 thousand (USD 15,191 thousand at the date of the grant) for the development of a technology of gas-steam turbines production. To date the Group recognised USD 4,954 thousand in its consolidated statement of income in respect of this grant. The remaining amount of deferred income will be amortised over the same period as the related development costs are amortised.

27. LOSS/EARNINGS PER SHARE

The loss or earnings per share is calculated by dividing the loss or profit attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year. The Group has no potentially dilutive shares.

28. 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 Group’s policy is to obtain collateral in respect of financial assets in 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.

At the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

Interest rate risk – Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group’s exposure should be attributed to fixed or variable rates. However, at the time of taking new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

The following tables show the contractual maturities of interest-bearing financial liabilities.

2006 *In thousands of US dollars*	**Average interest rate** **Contract**	**Effective**	**0-6 mths**	**6-12 mths**	**1-2 yrs**	**2-3 yrs**	**3-4 yrs**	**4-5 yrs**	**Over 5 yrs**	**Total**
Secured bank loans:										
RUR	7.81%	7.81%	-	78,884	-	-	-	-	-	78,884
USD	LIBOR + 2.95% to 4.5%	6.78%	51,848	11,177	11,418	2,850	-	-	-	77,293
EUR	EURIBOR + 2.75%	8.29%	611	611	1,222	22,142	-	-	-	24,586
Secured Loan from Ministry of Finance										
USD	3%	9.89%	-	856	1,041	1,233	1,434	1,635	-	6,199
Unsecured bank loans:										
RUR	6.5%	6.5%	9,115	-	-	-	-	-	-	9,115
EUR	EURIBOR + 2.5%	5.54%	26,354	61	-	-	-	-	-	26,415
USD	LIBOR + 2.65 to 2.7%	7.85%	47,500	17,500	-	5,000	5,000	-	-	75,000
Unsecured loans with other companies										
RUR	0%	13%	-	659	-	3,827	-	-	-	4,486
Finance lease liabilities – RUR	29.81%	28.93%	1,130	-	414	-	-	-	-	1,544
			136,558	109,748	14,095	35,052	6,434	1,635	-	303,522

2005 *In thousands of US dollars*	**Average interest rate** **Contract**	**Effective**	**0-6 mths**	**6-12 mths**	**1-2 yrs**	**2-3 yrs**	**3-4 yrs**	**4-5 yrs**	**Over 5 yrs**	**Total**
Secured bank loans:										
RUR	9.4%	9.56%	2	35,790	-	-	-	-	-	35,792
EUR	7.9%	7.83%	944	10,428	1,329	1,215	1,102	-	-	15,018
USD	LIBOR+ 2.95% to 4.5%	6.95%	101,790	-	-	-	-	-	-	101,790
Secured Loan from Ministry of Finance										
USD	3%	9.89%	-	989	1,168	1,328	1,473	1,601	1,709	8,268
Unsecured bank loans:										
USD	LIBOR+ 2.5% to 3.75%	7.10%	70,034	-	-	-	-	-	-	70,034
Unsecured loans with other companies										
RUR	0%	13%	-	-	1,656	-	1,161	-	-	2,817
Finance lease liabilities – RUR	28.9%	28.93%	-	2,150	482	-	-	-	-	2,632
			172,770	49,357	4,635	2,543	3,736	1,601	1,709	236,351

Foreign currency risk – The Group incurs foreign currency risk on sales, purchases and borrowings that are denominated in a currency other than the functional currencies of the respective Group entities. The currency giving rise to this risk is primarily the USD. Management does not hedge the Group's exposure to foreign currency risk.

Fair value – The carrying amounts of financial instruments approximate their fair value.
The fair values were determined as follows:

Trade and other receivables and payables. For receivables and payables with a maturity of less than twelve months fair value is not materially different from the carrying amount because the effect of the time value of money is not material. For other receivables and payables, expected future principal and interest cash flows were discounted at rates of between 8.8% and 18.69%.

Loans and borrowings. Fair value is not materially different from the carrying amount because contractual interest rates were not materially different from market rates.

29. RELATED PARTY TRANSACTIONS

Transactions with management

Key management received the following remuneration during the year, which is included in personnel costs:

In thousands of US dollars	**2006**	**2005**
Salaries and bonuses	5,985	3,904
Termination benefits	226	238
	6,211	4,142

Transactions with other related parties

As of 31 December 2006 the immediate shareholders of the Group are RAO "UES Rossii" (22.43%), Siemens Aktiengesellschaft (25%) and Burbot Limited (30.42%).

The Group considers all subsidiaries, fellow subsidiaries and associates of its shareholders as related parties. The Group considers all parties that control or have significant influence on its shareholders as related parties. As one of the Group's shareholders (RAO "UES Rossii") is controlled by the government of the Russian Federation the Group considers the government to be a related party.

In thousands of US dollars	**2006**	**2005**
Sales of goods		
Entities with significant influence	51,985	1,019
	51,985	1,019

In thousands of US dollars	**2006**	**2005**
Services provided		
Entities with significant influence	4,036	348
Associates	25	24
	4,061	372

In thousands of US dollars	**2006**	**2005**
Trade and other receivables		
Entities with significant influence	5,572	1,362
Associates	19	-
	5,591	1,362

In thousands of US dollars	**2006**	**2005**
Prepayments made		
Entities with significant influence	18,230	651
Associates	273	257
	18,503	908

In thousands of US dollars	**2006**	**2005**
Purchases of goods		
Entities with significant influence	26,994	1,354
Associates	92	-
	27,086	1,354

In thousands of US dollars	**2006**	**2005**
Purchases of services		
Entities with significant influence	4,979	-
Associates	389	596
Fellow subsidiaries	-	11
	5,368	607

In thousands of US dollars	**2006**	**2005**
Trade and other payables		
Entities with significant influence	2,611	383
Associates	126	130
	2,737	513

In thousands of US dollars	**2006**	**2005**
Prepayments received		
Government of Russian Federation	15,229	-
Entities with significant influence	131,676	8,037
	146,905	8,037

In addition, the Group received government grant disclosed in Note 26.

In addition, the Group received a loan from the Ministry of Finance of the Russian Federation, disclosed in Note 21.

30. SUBSIDIARY COMPANIES

Listed below are all the significant companies included in the consolidated financial statements:

Significant subsidiaries	Country of incorporation	Ownership interest % 2006	Ownership interest % 2005
OOO Reostat	Russia	100.00%	100.00%
ZAO Gazovie Turbini	Russia	-	100.00%
LMZ Energy Limited	Ireland	100.00%	100.00%
OOO Interturbo	Russia	55.12%	55.12%
OAO SK Selecta	Russia	80.36%	80.36%
EMEC LTDa Columbia	Columbia	99.99%	99.99%
Enermach Handels GMBH	Germany	100.00%	100.00%
Power Machines de Mexico	Mexico	99.90%	99.90%
Power Machines (India) Limited (formerly LMZ Energy (India) Limited)	India	100.00%	100.00%

In September 2006 ZAO Gazovie Turbiny ceased its operations. All assets and liabilities held by this subsidiary at the date of disposal were transferred to the parent company.

31. COMMITMENTS

(i) Capital commitments

At 31 December 2006, the Group was committed to capital expenditure (property, plant and equipment) of approximately USD 1,066 thousand (31 December 2005: USD 5,300 thousand).

(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 expensed in the year they are incurred.

32. CONTINGENCIES

(i) Financial Guarantees

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

In thousands of US dollars	2006	2005
Maturity in one year or more		
Third party suppliers	686,318	698,039
Maturity in less than one year		
Third party suppliers	-	8,154
	686,318	706,193

During the period ended 31 December 2006, 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, or USD 129,652 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 indicated above.

(ii) 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, third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group operations.

(iii) Litigation

The Group had a number of claims and litigation including contract related disputes for contract delays or additional work which have arisen in the ordinary course of business. Based on experience in resolving such claims management believes that none of them, individually or in aggregate, will have a material adverse impact on the Group.

(iv) Taxation contingencies

The taxation system in the Russian Federation is at a relatively early stage of development, and is characterised by numerous taxes, frequent changes and inconsistent enforcement at federal, regional and local levels.

The government of the Russian Federation has commenced a revision of the Russian tax system and passed certain laws implementing a tax reform. The new laws reduce the number of taxes and overall tax burden on businesses and simplify tax litigation. However, these new tax laws continue to rely heavily on the interpretation of local tax officials and fail to address many existing problems. Many issues associated with practical implication of new legislation are unclear and complicate the Group's tax planning and related business decisions.

Under the Russian tax legislation, authorities have a period of up to three years to re-open tax declarations for further inspection. Changes in the tax system that may be applied retrospectively by authorities could affect the Group's previously submitted and assessed tax declarations.

While management believes that it has adequately provided for tax liabilities based on its interpretation of current and previous legislation, the risk remains that tax authorities in the Russian Federation could take differing positions with regard to interpretive issues. This uncertainty may expose the Group to additional taxation, fines and penalties that could be significant.

With regards to matters where practice concerning payment of taxes is unclear, management estimated a possible tax exposures at 31 December 2006 to be approximately USD 16,343 thousand.

(v) 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 but could become material.

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

(vi) Russian business environment

As an emerging market, the Russian Federation does not possess a fully developed business and regulatory infrastructure including stable banking and judicial systems, which would generally exist in a more mature market economy. The economy of the Russian Federation is characterized by a currency that is not freely convertible outside of the country, currency controls, low liquidity levels for debt and equity markets, and continuing inflation. As a result, operations in the Russian Federation involve risks that are not typically associated with those in more developed markets.

Stability and success of Russian economy and the Group's business mainly depends on the effectiveness of economic measures undertaken by the government as well as the development of legal and political systems.

(vii) Working capital deficiencies

As of 31 December 2006 the Group's current liabilities exceeded its current assets by USD 101,043 thousand which was primarily attributed to the long-term loans of USD 107,876 thousand reclassified to short-term as a result of breach certain covenants in loan agreements (see Note 21).

Management believes that the probability that the banks will demand early repayment of these loans solely because of the breach of covenants is low and intends to receive waiver letters from Donau Bank AG and Commertzbank (EURASIJA) SAO. Management believes that future cash flows from operating and financing activities will be sufficient for the Group to meet its obligations as they become due.

33. POST BALANCE SHEET EVENTS

In 2007 management decided to perform a restructuring of its liabilities and as a result voluntary repaid the loan due to EBRD of USD 51,522 thousand. In May 2007 the Group received a long-term loan from VTB Bank EUROPE plc of USD 70,000 thousand. Future cash proceeds under some sales contracts are collateralised under this agreement. Covenants in the loan agreement require the Group to maintain certain financial ratios, prohibit any change to the general nature of the business, limit disposal of assets. The Group may not perform mergers, acquisitions, reorganizations and consolidations without prior written consent of VTB Bank EUROPE plc.

On 4 June 2007 the board of directors approved an increase in share capital of OAO "Power Machines" through issuance of 1,492,000,000 ordinary shares with par value each of RUR 0.01. The shares are to be issued on a local market.