

**Open Joint Stock Company Power
Machines and subsidiaries**

Interim consolidated Financial Statements
for the 9 months ended 30 September 2004

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Independent Auditor's Report

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

- 1 We have audited the accompanying interim consolidated balance sheet of Open Joint Stock Company Power Machines and its subsidiaries (the "Group") as of 30 September 2004 and the related statements of income, changes in shareholders' equity and cash flows for the nine months then ended. These interim consolidated financial statements, as set out on pages 5 to 35, are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.
- 2 Except as described in the paragraph 4, we conducted our audit in accordance with International Standards on Auditing as issued by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
- 3 The Group has reflected an item of property, plant and equipment in its 30 September 2004 balance sheet at the amount the Group sold this property for in December 2004. This is not in accordance with IAS 16 and the Group's accounting policies under which property, plant and equipment should be recorded at cost less accumulated depreciation and any accumulated impairment losses. If the Group reflected this property in accordance with IAS 16 and its accounting policies, property, plant and equipment and other operating income would be reduced by USD 3,462 thousand and the deferred income tax liability and the deferred income tax expense would be reduced by USD 830 thousand.
- 4 As of 30 September 2004 the Group has included into revenue and current receivables an amount of USD 2,900 thousand which relates to revenue recognized in relation to one of its construction contracts accounted for under the stage of completion method. The amount has been determined based on management's assessment that it is probable that the contract price for one of these long term construction contracts will increase. As of the date of our opinion the amendment to the contract relating to increase has not been signed by the counterparty and it was not practicable to extend our procedures to sufficiently satisfy ourselves as to the fairness of carrying value of accounts receivable and revenue of USD 2,900 and the related deferred income tax expense and liability of USD 696 thousand.
- 5 The accompanying interim consolidated financial statements do not include comparative interim statements of income, changes in shareholders' equity and cash flows for the nine months and three months ended 30 September 2003, which are required by IAS 34 Interim Financial Reporting.



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In our opinion, except for the omission of comparative financial information and the matter discussed in paragraph 3 above and except for the effect, if any, had we been able to satisfy ourselves in respect of the matter discussed in paragraph 4, the interim consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 30 September 2004 and the results of its operations, changes in equity and cash flows for the nine months then ended in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

ZAO KPMG
St. Petersburg, Russian Federation
11 February 2005

Interim consolidated balance sheet

As at 30 September 2004

| <i>In thousands of US dollars</i> | Note | 30 September 2004 | 31 December 2003 |
|--|------|----------------------|---------------------|
| Assets | | | |
| Property, plant and equipment | 12 | 244,196 | 218,242 |
| Intangible assets | 13 | 17,590 | 14,416 |
| Investments in associates | 14 | 5,691 | 10,918 |
| Other investments | 15 | 6,640 | 17,921 |
| Notes receivable available-for-sale | | 73,920 | 85,360 |
| Other non-current receivables | 16 | 20,931 | 31,891 |
| Total non-current assets | | 368,968 | 378,748 |
| Inventories | 17 | 101,598 | 115,130 |
| Trade receivables | 18 | 120,575 | 57,547 |
| Other receivables | 19 | 163,534 | 147,713 |
| Notes receivable available-for-sale | | 14,810 | 15,530 |
| Other investments | 15 | 3,980 | 14,563 |
| Cash and cash equivalents | 20 | 43,563 | 65,973 |
| Total current assets | | 448,060 | 416,456 |
| Total assets | | 817,028 | 795,204 |
| Shareholders' equity | | | |
| | 21 | | |
| Ordinary shares | | 8,382 | 7,789 |
| Preference shares | | 2,181 | 2,181 |
| Additional paid-in capital | | 125,280 | 125,873 |
| Treasury shares | | - | (27) |
| Translation reserve | | 20,443 | 18,132 |
| Retained earnings | | 140,966 | 132,966 |
| Total shareholders' equity | | 297,252 | 286,914 |
| Minority interest | | 1,133 | 1,284 |
| Total shareholders' equity and minority interest | | 298,385 | 288,198 |
| Liabilities | | | |
| Loans and borrowings | 22 | 110,328 | 31,910 |
| Deferred tax liabilities | 24 | 39,533 | 45,918 |
| Other non-current liabilities | 26 | 32,257 | 31,413 |
| Total non-current liabilities | | 182,118 | 109,241 |
| Loans and borrowings | 22 | 120,433 | 200,018 |
| Trade and other payables | 25 | 216,092 | 197,747 |
| Total current liabilities | | 336,525 | 397,765 |
| Total liabilities | | 518,643 | 507,006 |
| Total shareholders' equity, minority interest and liabilities | | 817,028 | 795,204 |

The interim consolidated financial statements were approved on 11 February 2005 and signed by:

E.K. Yakovlev
Chief Executive Officer

N.A. Kuznetsov
Chief Financial Officer

The interim consolidated balance sheet is to be read in conjunction with the notes to and forming part of the interim consolidated financial statements set out on pages 9 to 35.

Interim consolidated income statement

For the 9 months ended 30 September
2004

| <i>In thousands of US dollars</i> | Note | 9 months ended 30 September 2004 | 3 months ended 30 September 2004 (Unaudited) | 12 months ended 31 December 2003 |
|--|------|--|---|--|
| Revenues | 4 | 470,624 | 187,817 | 352,305 |
| Cost of sales | | (337,815) | (118,833) | (224,185) |
| Gross profit | | 132,809 | 68,984 | 128,120 |
| Distribution expenses | | (35,807) | (20,237) | (13,925) |
| Administrative expenses | 5 | (61,800) | (22,934) | (78,807) |
| Social costs | | (3,040) | (1,349) | (4,287) |
| Other operating income/(expenses) | 6 | 13,216 | 218 | (1,261) |
| Profit from operations | | 45,378 | 24,682 | 29,840 |
| Net financing expenses | 8 | (26,352) | (17,473) | (18,865) |
| Income/(loss) from associates | | 30 | 46 | (62) |
| Profit before tax and minority interest | | 19,056 | 7,255 | 10,913 |
| Income tax expense | 9 | (11,219) | (7,485) | (6,397) |
| Profit before minority interest | | 7,837 | (230) | 4,516 |
| Minority interest | | 163 | 14 | (1,279) |
| Net profit for the period | | 8,000 | (216) | 3,237 |

The interim consolidated income statement is to be read in conjunction with the notes to and forming part of the interim consolidated financial statements set out on pages 9 to 35.

Interim consolidated statement of cash flows

For the 9 months ended 30 September 2004

| <i>In thousands of US dollars</i> | 9 months ended 30 September 2004 | 12 months ended 31 December 2003 |
|--|---|---|
| Operating activities | | |
| Net profit for the year | 8,000 | 3,237 |
| Adjustments for: | | |
| Depreciation and amortisation | 16,118 | 17,640 |
| Gain on disposal of property plant and equipment | (1,471) | (404) |
| Gain from disposal of investments | (1,395) | (282) |
| Impairment of investments | 7,209 | 588 |
| (Income)/Loss from associates | (30) | 62 |
| Interest income | (5,870) | (6,372) |
| Interest expense | 21,080 | 24,203 |
| Income tax expense | 11,219 | 6,397 |
| Revaluation of property, plant and equipment | (3,462) | - |
| Unrealised foreign exchange gains | (385) | (3,336) |
| Minority interests | (163) | 1,279 |
| Operating profit before changes in working capital and provisions | 50,850 | 43,012 |
| (Increase)/decrease in inventories | 14,619 | 7,307 |
| Increase in trade and other receivables | (57,407) | (41,900) |
| Increase/(Decrease) in trade and other payables | 3,623 | (4,176) |
| Cash flows from operations before taxes and interest paid | 11,685 | 4,243 |
| Interest paid | (20,901) | (24,420) |
| Income tax paid | (472) | (4,599) |
| Cash flows from operating activities | (9,688) | (24,776) |
| Investing activities | | |
| Proceeds from sale of property, plant and equipment | 2,899 | 4,722 |
| Interest received | 5,870 | 6,372 |
| Acquisition of property, plant and equipment and intangible assets | (35,525) | (35,470) |
| Acquisition of investments in associates | (10,368) | (5,138) |
| Sale of investments in associates | 15,240 | - |
| Net change in loans given to third and related parties | (352) | 3,792 |
| Net cash flow from other investments | 17,431 | 20,161 |
| Cash flows from investing activities | (4,805) | (5,561) |
| Financing activities | | |
| Proceeds from borrowings | 408,878 | 554,439 |
| Repayments of borrowings | (417,599) | (472,242) |
| Acquisition of minority shareholdings | - | (10,111) |
| Sale/(repurchase) of treasury shares | 28 | (26) |
| Cash flows from financing activities | (8,693) | 72,060 |
| Net increase/(decrease) in cash and cash equivalents | (23,186) | 41,723 |
| Cash and cash equivalents at the beginning of period | 65,973 | 20,841 |
| Effect of exchange rate fluctuations | 776 | 3,409 |
| Cash and cash equivalents at the end of period | 43,563 | 65,973 |

The interim consolidated statement of cash flows is to be read in conjunction with the notes to and forming part of the interim consolidated financial statements set out on pages 9 to 35.

Interim consolidated statement of changes in shareholders' equity

For the 9 months ended 30 September 2004

| <i>In thousands of US dollars</i> | Ordinary shares | Preference shares | Additional paid-in capital | Treasury shares | Transla - tion reserve | Retained earnings | Total |
|---|--------------------|----------------------|----------------------------------|--------------------|------------------------------|----------------------|----------------|
| Balance at 1 January 2003, as previously stated | 7,198 | 2,345 | 33,704 | - | - | 134,989 | 178,236 |
| Correction of error (refer to Note 11) | - | - | - | - | - | (5,260) | (5,260) |
| Restated balance at 1 January 2003 | 7,198 | 2,345 | 33,704 | - | - | 129,729 | 172,976 |
| Currency translation differences | - | - | - | - | 18,132 | - | 18,132 |
| Net profit | - | - | - | - | - | 3,237 | 3,237 |
| Issue of share capital | 721 | - | - | - | - | - | 721 |
| Repurchase of shares | (130) | (164) | - | - | - | - | (294) |
| Acquisition of treasury shares | - | - | - | (27) | - | - | (27) |
| Contributions from shareholders | - | - | 92,169 | - | - | - | 92,169 |
| Balance at 31 December 2003 | 7,789 | 2,181 | 125,873 | (27) | 18,132 | 132,966 | 286,914 |
| Currency translation differences | - | - | - | - | 2,311 | - | 2,311 |
| Net profit | - | - | - | - | - | 8,000 | 8,000 |
| Shares issued | 593 | - | (593) | - | - | - | - |
| Sale of treasury shares | - | - | - | 27 | - | - | 27 |
| Balance at 30 September 2004 | 8,382 | 2,181 | 125,280 | - | 20,443 | 140,966 | 297,252 |

The interim consolidated statement of changes in shareholders' equity is to be read in conjunction with the notes to and forming part of the interim consolidated financial statements set out on pages 9 to 35.

Notes to the interim consolidated financial statements

1. Background

(a) Organisation and operations

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

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

(b) Russian business environment

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

2. Basis of Preparation

(a) Statement of compliance

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

(b) First-time application of IFRS

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

(c) Going concern

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

2. Basis of preparation continued

(d) Use of estimates

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

(e) Measurement and Presentation Currency

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

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

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

3. Significant accounting policies

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

(a) Subsidiaries

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

(b) Associates

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

(c) Transactions eliminated on consolidation

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

(d) Foreign currency translation

(i) Measurement currency

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

(ii) Presentation currency

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

The closing rate of exchange effective at 30 September 2004 and 31 December 2003 was 1 USD to 29.22 Roubles and 1 USD to 29.45 Roubles, respectively.

3. Significant accounting policies continued

(e) Property, plant and equipment

(i) Owned assets

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

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

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

(ii) Leased assets

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

(iii) Subsequent expenditure

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

(iv) Depreciation

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

Depreciation is charged as follows:

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

3. Significant accounting policies continued

(f) Intangible assets

(i) Research and development

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

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

(ii) Other intangible assets

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

(iii) Subsequent expenditure

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

(iv) Amortisation

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

The estimated useful lives are as follows:

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

(g) Investments

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

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

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

(h) Trade and other receivables

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

3. Significant accounting policies continued

(i) Inventories

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

(j) Cash and cash equivalents

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

(k) Impairment

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

(i) Calculation of recoverable amount

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

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

(ii) Reversals of impairment

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

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

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

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

3. Significant accounting policies continued

(l) Share capital

(i) Repurchase of share capital

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

(ii) Dividends

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

(m) Loans and borrowings

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

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

(n) Employee benefits

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

(o) Provisions

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

(i) Warranties

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

(ii) Onerous contracts

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

(p) Trade and other payables

Trade and other payables are stated at their cost.

(q) Government grants

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

3. Significant accounting policies continued

(r) Revenue

(i) *Goods sold and services rendered*

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

(ii) *Rental income*

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

(s) Expenses

(i) *Operating lease payments*

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

(ii) *Social costs*

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

(iii) *Net financing costs*

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

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

(t) Income tax

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

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

3. Significant accounting policies continued

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

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

(u) Comparative information

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

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

4. Revenues

| <i>In thousands of US dollars</i> | 9 months ended 30 September 2004 | 3 months ended 30 September 2004 (Unaudited) | 12 months ended 31 December 2003 |
|---------------------------------------|---|---|---|
| Energy generating and other equipment | 442,148 | 175,678 | 323,947 |
| Sales of spare parts | 28,476 | 12,139 | 28,358 |
| | <u>470,624</u> | <u>187,817</u> | <u>352,305</u> |

Percentage of sales by location of customer

| | 9 months ended 30 September 2004 | 12 months ended 31 December 2003 |
|--------------------|---|---|
| Russia and the CIS | 49% | 50% |
| Asia | 35% | 36% |
| Europe | 11% | 14% |
| Latin America | 3% | - |
| Other | 2% | - |
| | <u>100%</u> | <u>100%</u> |

5. Administrative expenses

| <i>In thousands of US dollars</i> | 9 months ended 30 September 2004 | 3 months ended 30 September 2004 (Unaudited) | 12 months ended 31 December 2003 |
|-----------------------------------|---|---|---|
| Wages, salaries and related taxes | 34,032 | 11,637 | 41,148 |
| Depreciation | 4,671 | 1,382 | 5,431 |
| Insurance | 3,782 | 926 | 5,875 |
| Taxes other than income tax | 2,930 | 958 | 6,438 |
| Materials | 1,551 | 520 | 2,062 |
| Bank charges | 1,506 | 462 | 2,763 |
| Consulting | 1,049 | 111 | 2,584 |
| Travel expenses | 1,346 | 482 | 1,880 |
| Amortisation of intangibles | 179 | (12) | 265 |
| Penalties | 38 | 15 | 531 |
| Other administrative expenses | 10,716 | 6,453 | 9,830 |
| | <u>61,800</u> | <u>22,934</u> | <u>78,807</u> |

6. Other operating (income)/expenses

| <i>In thousands of US dollars</i> | 9 months ended 30 September 2004 | 3 months ended 30 September 2004 (Unaudited) | 12 months ended 31 December 2003 |
|--|---|---|---|
| Net gain on sale of investments | (1,395) | (642) | (282) |
| (Decrease)/Increase in accounts receivable provision | (7,108) | (165) | 2,311 |
| Decrease in provision for inventories | (7,146) | (615) | (897) |
| Net gain on disposal of property, plant and equipment | (1,470) | (792) | (404) |
| Net loss/(gain) on disposal of other assets | 719 | 704 | (17) |
| Increase in provision for onerous contracts | 34 | 1,064 | 1,001 |
| Increase/(Decrease) in provision for warranty expenses | 3,150 | 247 | (1,877) |
| Revaluation of property, plant and equipment | (3,462) | (3,462) | - |
| Other operating expenses | 3,462 | 3,443 | 1,426 |
| | <u>(13,216)</u> | <u>(218)</u> | <u>1,261</u> |

7. Personnel expenses

| <i>In thousands of US dollars</i> | 9 months ended 30 September 2004 | 3 months ended 30 September 2004 (Unaudited) | 12 months ended 31 December 2003 |
|--|---|---|---|
| Wages, salaries and related taxes included in: | | | |
| cost of sales | 44,836 | 16,688 | 45,459 |
| distribution costs | 5,327 | 1,819 | 3,175 |
| administrative expenses | 34,032 | 11,637 | 41,148 |
| | <u>84,195</u> | <u>30,144</u> | <u>89,782</u> |

The average number of employees during the 9 months ended 30 September 2004 was 14,133 (12 months ended 31 December 2003: 14,575).

8. Net financing expenses

| <i>In thousands of US dollars</i> | 9 months ended 30 September 2004 | 3 months ended 30 September 2004 (Unaudited) | 12 months ended 31 December 2003 |
|--|---|---|---|
| Interest expense | 21,080 | 8,808 | 24,203 |
| Interest income | (5,870) | (640) | (6,372) |
| Net foreign exchange gain | (192) | 268 | (2,141) |
| Bank guarantees expenses | 4,125 | 1,764 | 2,587 |
| Impairment loss on assets available for sale | 7,209 | 7,273 | 588 |
| | <u>26,352</u> | <u>17,473</u> | <u>18,865</u> |

9. Income tax expense

| <i>In thousands of US dollars</i> | 9 months ended 30 September 2004 | 3 months ended 30 September 2004 (Unaudited) | 12 months ended 31 December 2003 |
|---|---|---|---|
| <i>Current tax expense</i> | | | |
| Current year expense | 15,882 | 15,501 | 2,987 |
| Under/(over) provided in prior years | 2,167 | 2,167 | - |
| | <u>18,049</u> | <u>17,668</u> | <u>2,987</u> |
| <i>Deferred tax expense</i> | | | |
| Origination and reversal of temporary differences | (6,830) | (10,183) | 3,410 |
| | <u>(6,830)</u> | <u>(10,183)</u> | <u>3,410</u> |
| | <u>11,219</u> | <u>7,485</u> | <u>6,397</u> |

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

Reconciliation of effective tax rate

| <i>In thousands of US dollars</i> | 9 months ended 30 September 2004 | 3 months ended 30 September 2004 (Unaudited) | 12 months ended 31 December 2003 |
|--------------------------------------|---|---|---|
| Profit before tax | <u>19,056</u> | <u>7,255</u> | <u>10,913</u> |
| Income tax using corporate tax rate | 24% 4,573 | 24% 1,741 | 24% 2,619 |
| Non-deductible expenses | 31% 5,894 | 61% 4,405 | 36% 3,979 |
| Non-taxable income | 0% (4) | 8% 583 | (11%) (1,286) |
| Effect of tax losses utilized | (7%) (1,411) | (19%) (1,411) | 10% 1,085 |
| Under/(over) provided in prior years | 11% 2,167 | 30% 2,167 | - |
| | <u>59% 11,219</u> | <u>104% 7,485</u> | <u>59% 6,397</u> |

10. Construction contracts

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

| <i>In thousands of US dollars</i> | 9 months ended 30 September 2004 | 12 months ended 31 December 2003 |
|-----------------------------------|---|---|
| Contract revenue | 262,326 | 138,785 |
| Contract costs | (173,020) | (79,999) |
| Gross margin | <u>89,306</u> | <u>58,786</u> |

11. Restatement of the opening retained earnings

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

12. Property, plant and equipment

| <i>In thousands of US dollars</i> | Land and Buildings | Machinery and equipment | Transpor- tation equipment | Other | Assets under construction | Total |
|---|-----------------------------------|--|---|--------------|--------------------------------------|--------------|
| Cost | | | | | | |
| Balance at 1 January 2004 | 330,428 | 680,795 | 15,157 | 30,437 | 10,266 | 1,067,083 |
| Translation effect | 2,504 | 5,522 | (166) | 92 | 884 | 8,837 |
| Additions | 472 | 13,472 | 477 | 3,267 | 19,815 | 37,502 |
| Transfers | 1,688 | 3,092 | 134 | 562 | (5,478) | . |
| Disposals | (112) | (1,432) | (969) | (207) | (943) | (3,663) |
| Balance at 30 September 2004 | 334,981 | 701,450 | 14,632 | 34,152 | 24,544 | 1,109,761 |
| Depreciation | | | | | | |
| Balance at 1 January 2004 | (264,580) | (555,502) | (12,193) | (16,566) | - | (848,841) |
| Translation effect | (2,169) | (4,441) | (186) | 37 | - | (6,759) |
| Charge for the period | (1,265) | (11,490) | (566) | (2,618) | - | (15,939) |
| Revaluation of property, plant and equipment | 3,462 | . | . | . | - | 3,462 |
| Disposals | 82 | 1,038 | 944 | 442 | - | 2,512 |
| Balance at 30 September 2004 | (264,467) | (570,395) | (12,001) | (18,702) | - | (865,565) |
| Carrying amount | | | | | | |
| At 1 January 2004 | 65,848 | 125,293 | 2,964 | 13,871 | 10,266 | 218,242 |
| At 30 September 2004 | 70,514 | 131,055 | 2,632 | 15,451 | 24,544 | 244,196 |

Borrowing costs

Borrowing costs of USD 115 thousand were capitalised during the 9 months ended 30 September 2004 as part of the cost of qualifying assets (12 months ended 31 December 2003: USD 1,348 thousand).

Leased machinery

The Group leases production equipment under a number of finance lease agreements. As at 30 September 2004 the net carrying amount of leased machinery and equipment was USD 11,949 thousand (31 December 2003: USD 6,845 thousand).

13. Intangible assets

| <i>In thousands of US dollars</i> | Development costs | Other intangible assets | Total |
|-----------------------------------|--------------------------|--------------------------------|--------------|
| Cost | | | |
| Balance at 1 January 2004 | 7,671 | 7,922 | 15,593 |
| Translation effect | 36 | (58) | (22) |
| Additions | 2,019 | 1,432 | 3,451 |
| Disposals | (3) | (89) | (92) |
| Balance at 30 September 2004 | 9,723 | 9,207 | 18,930 |
| Amortisation | | | |
| Balance at 1 January 2004 | (92) | (1,085) | (1,177) |
| Translation effect | - | 114 | 114 |
| Amortisation for the year | (100) | (254) | (354) |
| Disposals | 1 | 76 | 77 |
| Balance at 30 September 2004 | (191) | (1,149) | (1,340) |
| Carrying amount | | | |
| As at 1 January 2004 | 7,579 | 6,837 | 14,416 |
| As at 30 September 2004 | 9,532 | 8,058 | 17,590 |

14. Investments in associates

The Group has the following investments in associates:

| | Country of incorporation | Ownership | | Voting interest | |
|-------------------------------|---------------------------------|--------------------------|-------------------------|--------------------------|-------------------------|
| | | 30 September 2004 | 31 December 2003 | 30 September 2004 | 31 December 2003 |
| ZAO Interplast | Russia | 50% | 50% | 50% | 50% |
| OAO Kaluzhsky Turbinnyi Zavod | Russia | - | 20% | - | 26% |
| NPO CKTI | Russia | 35% | 35% | 35% | 35% |

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|-----------------------------------|--------------------------|-------------------------|
| ZAO Interplast | 83 | 73 |
| OAO Kaluzhsky Turbinnyi Zavod | - | 5,396 |
| NPO CKTI | 5,608 | 5,449 |
| | <u>5,691</u> | <u>10,918</u> |

As at 30 September 2004 the investment in NPO CKTI includes goodwill of USD 3,956 thousand (31 December 2003: USD 3,924 thousand).

14. Investments in associates continued

OAO Obyedinennie Mashinostroitelnye Zavody (“OMZ”)

During the 9 months ended 30 September 2004 the Group purchased a 7% interest in OAO Obyedinennie Mashinostroitelnye Zavody (“OMZ”) for USD 42,739 thousand. The purpose of the acquisition of shares represented part of the process to merge OMZ and the Group, which was expected to ultimately result in the Group being the acquirer of OMZ. Management of the Group were appointed to key managerial positions of OMZ enabling the Group to exercise significant influence over OMZ’s financial and operating policy decisions. In July 2004 the planned merger of the Group and OMZ was terminated, the investment in OMZ was sold for its carrying value and management of the Group resigned from their managerial positions of OMZ.

15. Other investments

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|---------------------------------------|------------------------------|-----------------------------|
| <i>Non-current investments</i> | | |
| Equity securities available-for-sale | 6,625 | 11,615 |
| Debt securities held to maturity | 8 | 5,184 |
| Loans given | 7 | 1,122 |
| | <u>6,640</u> | <u>17,921</u> |
| <i>Current investments</i> | | |
| Debt securities held to maturity | 1,319 | 11,608 |
| Equity securities available-for-sale | 407 | 2,180 |
| Loans given | 2,254 | 775 |
| | <u>3,980</u> | <u>14,563</u> |

16. Other non-current receivables

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|-----------------------------------|------------------------------|-----------------------------|
| Trade accounts receivable | 20,156 | 35,232 |
| Notes receivable | 770 | 1,059 |
| Other non-current receivables | 5 | - |
| Less provision for doubtful debts | - | (4,400) |
| | <u>20,931</u> | <u>31,891</u> |

At 30 September 2004 trade accounts receivable included contractual retention amounts billed to customers amounting to USD 12,807 thousand (31 December 2003: USD 27,857 thousand). Retentions in the amount of USD 1,329 thousand were considered to be doubtful and were provided for in full as at 31 December 2003; at 30 September 2004 no retention amounts were considered doubtful.

17. Inventories

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|-------------------------------------|------------------------------|-----------------------------|
| Work in progress | 31,827 | 36,128 |
| Raw materials and consumables | 40,103 | 41,879 |
| Finished goods and goods for resale | 24,853 | 32,376 |
| Supplies | 4,273 | 2,116 |
| Other inventories | 542 | 2,631 |
| | <u>101,598</u> | <u>115,130</u> |

18. Trade receivables, current

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|---|------------------------------|-----------------------------|
| Trade accounts receivable | 51,193 | 64,063 |
| Notes receivable | 1,292 | 1,094 |
| Less provision for doubtful debts | (3,969) | (8,271) |
| | <u>48,516</u> | <u>56,886</u> |
| Costs and earnings in excess of billings on uncompleted contracts | 209,255 | 122,167 |
| Advance payments received related to uncompleted contracts | (137,196) | (121,506) |
| | <u>72,059</u> | <u>661</u> |
| | <u>120,575</u> | <u>57,547</u> |

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

19. Other receivables

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|-----------------------------------|------------------------------|-----------------------------|
| Prepayments | 73,541 | 72,529 |
| VAT receivable | 34,548 | 33,579 |
| Deferred expenses | 38,794 | 22,238 |
| Restricted cash | 5,223 | 5,223 |
| Income tax receivable | 129 | 3,921 |
| Receivables from employees | 948 | 931 |
| Other receivables | 10,351 | 9,292 |
| | <u>163,534</u> | <u>147,713</u> |

20. Cash and cash equivalents

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

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|---|------------------------------|-----------------------------|
| Rouble bank accounts | 13,532 | 14,575 |
| Foreign currency bank accounts | 3,786 | 4,896 |
| Other rouble denominated cash equivalents | 533 | 3,856 |
| Foreign currency bank deposits | 583 | 297 |
| Rouble bank deposits | 25,129 | 42,349 |
| | <u>43,563</u> | <u>65,973</u> |

21. Equity

Share capital and share premium

| <i>In shares</i> | Ordinary shares | | Non-redeemable preference shares | |
|-----------------------------|------------------------------|-----------------------------|---|-----------------------------|
| | 30 September 2004 | 31 December 2003 | 30 September 2004 | 31 December 2003 |
| On issue at opening balance | 5,362,500,000 | 31,500 | 1,050,000,000 | 10,500 |
| Issuance | 811,462,708 | 22,125 | - | - |
| Repurchased | (3,050,000) | - | (3,974,000) | - |
| Effect of split of shares | - | 5,362,446,375 | - | 1,049,989,500 |
| On issue at closing balance | <u>6,170,912,708</u> | <u>5,362,500,000</u> | <u>1,046,026,000</u> | <u>1,050,000,000</u> |

Share capital

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

Additional paid-in capital

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

Translation reserve

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

Dividends

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

21. Equity continued

Dividends payable are limited to the maximum retained earnings of the Group as determined in accordance with the legislation of the Russian Federation. As at the balance sheet date reserves available for distribution in accordance with Russian legislation amounted to USD 117,588 thousand.

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

Voting rights of shareholders

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

Issuance of shares

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

22. Loans and borrowings

| <i>In thousands of US dollars</i> | Effective interest rate | 30 Sep 2004 | Effective interest rate | 31 Dec 2003 |
|---|--|--------------------|--|--------------------|
| <i>Current loans and borrowings</i> | | | | |
| Secured loans: - RUR, fixed | 10% | 38,867 | 11% | 70,676 |
| - USD, fixed & variable | 9% | 820 | 10% | 25,571 |
| - EURO, fixed & variable | 8% | 2,792 | 12% | 22,493 |
| Current portion of secured loans: | | | | |
| - RUR, fixed | - | - | 9% | 1,413 |
| - USD, variable | 5% | 36,955 | - | - |
| - EURO, fixed | 7% | 2,342 | 11% | 552 |
| Current portion of Loan from Ministry of Finance, USD | 3% | 483 | - | - |
| Unsecured loans: - RUR, fixed | 10% | 2,553 | 6% | 6,165 |
| - USD, fixed | 9% | 29,954 | 7% | 70,339 |
| Current portion of finance lease liabilities | 30% | 5,667 | 27% | 2,809 |
| | | 120,433 | | 200,018 |
| <i>Non-current loans and borrowings</i> | | | | |
| Secured loans: - RUR, fixed | 11% | 37,585 | 11% | 1,055 |
| - USD, fixed & variable | 7% | 37,414 | 5% | 14,291 |
| - EURO, fixed | 7% | 5,336 | 11% | 1,104 |
| - CHF, variable | 6% | 556 | 6% | 561 |
| Unsecured loans: - RUR, fixed | 14% | 1,653 | 0% | 1,518 |
| - USD, variable | 6% | 15,000 | - | - |
| Loan from Ministry of Finance, USD | 3% | 10,760 | 0% | 11,243 |
| Non-current finance lease liabilities | 30% | 2,024 | 27% | 2,138 |
| | | 110,328 | | 31,910 |

22. Loans and borrowings continued

Non-current debt repayment schedule

Presented below is the debt repayment schedule for non-current debts outstanding at 30 September 2004 (other than finance lease liabilities (see below)).

| <i>In thousands of US dollars</i> | Total | Less than 1 year | 1-2 years | 2-3 years | 3-4 years | 4-5 years | More than 5 years |
|------------------------------------|----------------|-------------------------|------------------|------------------|------------------|------------------|--------------------------|
| Secured bank loans | | | | | | | |
| - RUR, fixed | 37,585 | - | 37,585 | - | - | - | - |
| - USD, fixed | 74,369 | 36,955 | 18,381 | 12,116 | 6,917 | - | - |
| - EUR, fixed | 7,678 | 2,342 | 2,342 | 1,583 | 823 | 588 | - |
| - CHF, fixed | 556 | - | 556 | - | - | - | - |
| Unsecured loans | | | | | | | |
| - RUR, fixed | 1,653 | - | - | - | 967 | - | 686 |
| - USD, fixed | 15,000 | - | 15,000 | - | - | - | - |
| Loan from Ministry of Finance, USD | 11,243 | 483 | 731 | 989 | 1,248 | 1,518 | 6,274 |
| | <u>148,084</u> | <u>39,780</u> | <u>74,595</u> | <u>14,688</u> | <u>9,955</u> | <u>2,106</u> | <u>6,960</u> |

During the 9 months ended 30 September 2004 the Group obtained a loan of USD 35,000 thousand from the EBRD which was still outstanding as at the balance sheet date. Covenants to the loan agreement require the Group to maintain certain financial ratios, limit capital expenditure, and restrict the amount of outstanding payables related to the acquisition of fixed assets. The Group is restricted from performing mergers, acquisitions, reorganizations and consolidations without the prior written consent of the EBRD.

Finance lease liabilities repayment schedule

Finance lease liabilities are payable as follows:

| <i>In thousands of US dollars</i> | 2004 | | | 2003 | | |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | Payments | Interest | Principal | Payments | Interest | Principal |
| Less than one year | 7,292 | 1,625 | 5,667 | 3,807 | 998 | 2,809 |
| Between one and five years | 2,416 | 392 | 2,024 | 2,538 | 400 | 2,138 |
| | <u>9,708</u> | <u>2,017</u> | <u>7,691</u> | <u>6,345</u> | <u>1,398</u> | <u>4,947</u> |

23. Pledges provided by the Group

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

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|--|------------------------------|-----------------------------|
| Property, plant and equipment | 67,215 | 81,777 |
| Inventories and costs and earnings in excess of billings on uncompleted contracts | 107,342 | 93,607 |
| Notes receivable, current | - | 690 |
| Notes receivable, non-current and available for sale | 37,047 | 15,782 |
| Debt securities held to maturity, current | - | 2,784 |
| Cash and cash equivalents | 9,092 | 3,291 |
| Revenue from planned supply of equipment in the future | 33,244 | 49,245 |
| | <u>253,940</u> | <u>247,176</u> |

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

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|--|------------------------------|-----------------------------|
| <i>Current loans and borrowings</i> | | |
| Pledges provided for the debt of the Group | 99,322 | 147,365 |
| Pledges provided for the debt of third parties | - | 515 |
| <i>Non-current loans and borrowings</i> | | |
| Pledges provided for the debt of the Group | 148,328 | 83,350 |
| Pledges provided for the debt of third parties | 6,290 | 15,946 |
| | <u>253,940</u> | <u>247,176</u> |

24. Deferred tax liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

| | Assets | | Liabilities | | Net | |
|---|----------------|----------------|----------------|----------------|----------------|----------------|
| | 30 Sep 2004 | 31 Dec 2003 | 30 Sep 2004 | 31 Dec 2003 | 30 Sep 2004 | 31 Dec 2003 |
| <i>In thousands of US dollars</i> | | | | | | |
| Cash and cash equivalents | - | (311) | 2 | - | 2 | (311) |
| Property, plant and equipment | - | - | 24,838 | 23,239 | 24,838 | 23,239 |
| Intangible assets | - | - | 1,611 | 1,373 | 1,611 | 1,373 |
| Other investments | (2,155) | (893) | - | 1,316 | (2,155) | 423 |
| Inventories | (39,535) | (17,000) | 19,948 | 11,650 | (19,587) | (5,350) |
| Trade and other accounts receivable | (18,806) | (10,235) | 56,926 | 37,076 | 38,120 | 26,841 |
| Trade and other accounts payable | (6,445) | (3,632) | 4,863 | 4,850 | (1,582) | 1,218 |
| Loans and borrowings | (1,714) | (1,986) | - | 471 | (1,714) | (1,515) |
| Tax value of loss carry-forwards recognised | - | - | - | - | - | - |
| Tax (assets)/liabilities | (68,655) | (34,057) | 108,188 | 79,975 | 39,533 | 45,918 |

25. Trade and other payables

| | 30 September 2004 | 31 December 2003 |
|-------------------------------------|----------------------|---------------------|
| <i>In thousands of US dollars</i> | | |
| Advances from customers | 88,141 | 106,137 |
| Trade accounts payable | 71,612 | 44,517 |
| Income tax payable | 16,477 | 2,884 |
| Other taxes payable | 9,892 | 15,161 |
| Employee related liabilities | 9,821 | 8,033 |
| Provision for warranties | 4,626 | 1,497 |
| Deferred income | 1,597 | 129 |
| Current portion of government grant | 1,261 | 726 |
| Contract related reserves | 1,174 | 1,131 |
| Interest payable | 608 | 428 |
| Accrued liabilities | 320 | 356 |
| Other current liabilities | 10,563 | 16,748 |
| | 216,092 | 197,747 |

26. Other non-current liabilities

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|-----------------------------------|------------------------------|-----------------------------|
| Trade accounts payable | 24,692 | 26,396 |
| Other non-current liabilities | - | 659 |
| Government grant | 7,565 | 4,358 |
| | <u>32,257</u> | <u>31,413</u> |

The Company was awarded a government grant of USD 15,278 thousand for the development of technology to produce gas-steam turbines. As at the balance sheet date the Company had received USD 8,824 thousand of the government grant and recorded it as deferred income in other non current liabilities. The amount of deferred income will be amortised over the same period as the related development costs will be amortised.

27. Financial instruments

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

Credit risk

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

As of the balance sheet date the Group had USD 112,658 thousand of notes and trades receivable from one significant customer (31 December 2003: USD 124,819 thousand). The recoverability of these receivables is secured by a guarantee of the Indian Government.

Interest rate risk

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

Foreign currency risk

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

Fair value

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

28. Related party transactions

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

| <i>In thousands of US dollars</i> | Sales | | | Purchases | | | Interest expense | | |
|--|-------------------------|-------------------------|--------------------------|-------------------------|-------------------------|--------------------------|-------------------------|-------------------------|--------------------------|
| | 9mths 30 Sep 2004 | 3mths 30 Sep 2004 | 12mths 31 Dec 2003 | 9mths 30 Sep 2004 | 3mths 30 Sep 2004 | 12mths 31 Dec 2003 | 9mths 30 Sep 2004 | 3mths 30 Sep 2004 | 12mths 31 Dec 2003 |
| OAo Kalugskiy Turbinny Zavod | 1,47 | 36 | 1,142 | - | - | - | - | - | - |
| OAo Rosbank | | - | - | - | - | - | 1,066 | 108 | 1,736 |
| Elaine Ventures Inc | | - | 16,332 | - | - | - | - | - | - |
| Brightwood Ventures Limited | | - | - | - | - | 5,138 | - | - | 848 |
| Midway Management Ltd and Kestrel Ventures Inc | 4,88 | 4,888 | - | - | - | - | - | - | - |
| Other related parties | 1 | 5 | 12,532 | 487 | 351 | - | - | - | - |

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

| <i>In thousands of US dollars</i> | Receivable | | Payable | |
|---|----------------|----------------|----------------|----------------|
| | 30 Sep 2004 | 31 Dec 2003 | 30 Sep 2004 | 31 Dec 2003 |
| OAo Kalugskiy Turbinny Zavod – advances, current | 415 | 2,393 | 79 | 105 |
| OAo Kalugskiy Turbinny Zavod – creditors | - | - | 182 | 77 |
| OAo Kalugskiy Turbinny Zavod – debtors | 13,489 | 5,612 | - | - |
| OAo Kalugskiy Turbinny Zavod – loans given, current | 458 | 202 | - | - |
| RB Leasing – advances | - | - | - | 5,376 |
| Burbot Limited – debtors | - | 19 | - | - |
| NPO CKTI – debtors | 146 | - | - | - |
| NPO CKTI – creditors | - | - | 36 | 70 |
| ZAO Interplast – debtors | 62 | 7 | - | - |
| ZAO Interplast – creditors | - | - | 79 | 33 |
| OAo Rosbank – promissory notes | - | 6,304 | - | - |
| OAo Rosbank – loans received | - | - | - | 10,000 |
| OAo Rosbank – creditors | - | - | 30 | - |

28. Related party transactions continued

The nature of the related party relationships are as follows:

Burbott Limited

Burbott Limited is the principal shareholder of the Group.

OAO Kalugskiy Turbinny Zavod

During the 9 months to 30 September 2004 the Group sold its interest in OAO Kaluzhsky Turbinny Zavod to Midway Management Limited and Kestrel Ventures Inc. Previously the investment was recognized as an associate of the Group.

NPO CKTI

NPO CKTI is an associate of the Group.

OAO Rosbank

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

Elaine Ventures Inc

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

Brightwood Ventures Limited ("BVL")

In 2003 the Group acquired an 18% interest in the share capital of NPO CKTI from BVL. The entity is under the control of the majority shareholder of the Group. As at 30 September 2004 the Group owned a 35% investment in NPO CKTI.

RB Leasing

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

Midway Management Limited ("MML") and Kestrel Ventures Inc ("KVI")

MML and KVI are the companies under the control of the majority shareholder of the Group. During the 9 months ended 30 September 2004 the Group sold shares in OAO Kaluzhsky Turbinny Zavod to these companies for an amount equal to its carrying value.

Other related parties

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

Financial guarantees provided to related parties

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

29. Subsidiary Companies

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

| Significant subsidiaries | Country of incorporation | Ownership interest | Ownership interest |
|---------------------------------------|--------------------------|--------------------|--------------------|
| | | % | % |
| | | 30 September 2004 | 31 December 2003 |
| OAo Leningradskiy Metalicheskiy Zavod | Russia | branch | 100.00% |
| OAo Electrosila | Russia | branch | 100.00% |
| OAo Zavod Turbinich Lopatok | Russia | branch | 100.00% |
| OOO Reostat | Russia | 100.00% | 100.00% |
| ZAO Gazovie Turbini | Russia | 100.00% | 100.00% |
| ZAO LMZ Invest | Russia | 100.00% | 100.00% |
| ZAO LMZ Engineering | Russia | 100.00% | 100.00% |
| LMZ Energy Limited | Ireland | 100.00% | 100.00% |
| OOO Interturbo | Russia | 55.12% | 55.12% |
| OAo SK Selecta | Russia | 96.43% | 96.43% |
| Energomachimpex Czech Republic | Czech Republic | 80.00% | 80.00% |
| EMEC LTDa Columbia | Columbia | 99.99% | 99.99% |
| Energomach Handels GMBH | Germany | 100.00% | 100.00% |

30. Commitments

(i) Capital commitments

The Group is committed to capital expenditure of approximately USD 14,523 thousand (31 December 2003: USD 20,258).

(ii) Social commitments

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

31. Contingencies

(i) Financial Guarantees

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

| <i>In thousands of US dollars</i> | 30 September 2004 | 31 December 2003 |
|---------------------------------------|-------------------|------------------|
| Maturity in one year or more | | |
| Third party suppliers | 704,872 | 28,034 |
| Maturity in less than one year | | |
| Third party suppliers | 5,892 | 5,408 |
| OAo Kalugskiy Turbinii Zavod | 3,765 | - |
| | 714,529 | 33,442 |

30. Contingencies continued

During the 9 months ended 30 September 2004 the Group was a co-signatory to a guarantee of USD 682,381 thousand given by a consortium of companies (including the Group) against a loan obtained by CIISA. CIISA is an entity that is constructing a power station in Mexico in which the Group holds a 19% interest and participates in the construction. The Group's maximum exposure under this guarantee is estimated to be the equivalent 19% interest in the project, USD 129,614 thousand.

The Group's contingent maximum exposure to credit losses in the event of non-performance by all other parties to these financial guarantees would amount to the total contractual amount of the guarantee stipulated above. Assets of the Group were also pledged against certain of the third party supplier guarantees (Note 22).

(ii) Contingencies

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

(iii) Insurance

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

(iv) Litigation

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

(v) Taxation contingencies

The taxation system in the Russian Federation is relatively new and is characterised by numerous taxes and frequently changing legislation, which is often unclear, contradictory, and subject to interpretation. Often, differing interpretations exist among the numerous taxation authorities and jurisdictions. Taxes are subject to review and investigation by a number of authorities, who are enabled by law to impose severe fines, penalties and interest charges.

These facts may create tax risks in Russia substantially more significant than in other countries. Management believes that it has adequately provided for all tax liabilities based on its interpretation of the tax legislation. However, the relevant authorities may have differing interpretations and the effects could be significant.

30. Contingencies continued

(vi) Environmental liabilities

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

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