OPEN JOINT STOCK COMPANY
VSMPO-AVISMA CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS

PREPARED IN ACCORDANCE WITH ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA

AS AT AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

(WITH REPORT OF INDEPENDENT AUDITORS)

CONTENTS | **PAGES**

ZAO PricewaterhouseCoopers Audit
Kosmodamianskaya nab. 52/5
115054 Moscow
Russian Federation
Telephone +7 (495) 967 6000
Facsimile +7 (495) 967 6001
www.pwc.ru

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and shareholders of OJSC VSMPO-AVISMA Corporation

We have audited the accompanying consolidated balance sheets of OJSC VSMPO-AVISMA Corporation and its subsidiaries (the “Group”) as at December 31, 2006 and 2005, and the related consolidated statements of income and comprehensive income, of cash flows and of changes in stockholders’ equity for the years then ended. These consolidated financial statements are the responsibility of the Group’s Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of Uniti LLC, an equity method investee. As disclosed in Note 5 to the accompanying consolidated financial statements, as at December 31, 2006 and 2005, the carrying value of the Group’s investment in Uniti LLC was US$ 18,035 thousand and US$ 11,971 thousand, respectively, and the Group’s share in earnings of the investee for the years then ended was US$ 14,833 thousand and US$ 8,260 thousand, respectively. The financial statements of Uniti LLC were audited by other auditors whose report has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Uniti LLC, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 statements presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Group as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the financial statements, the Company changed its method of accounting for defined benefit pension plans on Decmber 31, 2006, upon adoption of the recognition and related disclosure provisions of SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R).*

ZAO PricewaterhouseCoopers Audit

Moscow, Russian Federation

28 December 2007

(In thousands of US dollars)

	Note	December 31, 2006	December 31, 2005
ASSETS			
Current assets			
Cash and cash equivalents	4	42,632	29,349
Restricted cash	4	2,248	2,477
Short-term investments		2,459	1,397
Short-term loans – related parties	21	-	986
Trade accounts receivable, net of provision of US$ 23,567 (December 31, 2005: US$ 3,736)		129,108	96,631
Trade accounts receivable – related parties	21	8,689	6,157
Advances, net of provision of US$ 165 (December 31, 2005: US$ 538)		39,756	27,190
Taxes and other receivables	6	118,521	71,689
Inventories, net	7	422,687	311,343
Deferred income taxes	14	11,726	2,873
Other current assets		7,064	6,856
Total current assets		**784,890**	**556,948**
Non-current assets			
Property, plant and equipment, net	8	519,493	370,927
Intangible assets, net		1,808	1,776
Goodwill	19	60,733	57,551
Investments	5	19,987	13,603
Other non-current assets		423	759
Total non-current assets		**602,444**	**444,616**
Total assets		**1,387,334**	**1,001,564**
LIABILITIES, STOCKHOLDERS' EQUITY AND MINORITY INTERESTS			
Current liabilities			
Borrowings from third parties	9	168,395	133,924
Trade accounts payable		66,052	65,453
Trade accounts payable – related parties	21	145	51
Income and other taxes payable	10	44,116	41,784
Restructured taxes, current portion	12	1,931	1,446
Other current liabilities	11	73,907	40,761
Defined benefit pension plan	13	4,164	2,015
Dividends payable	15	75	68
Total current liabilities		**358,785**	**285,502**
Non-current liabilities			
Long-term borrowings from third parties	9	67,218	4,286
Long-term borrowings from related parties	21	-	2,494
Restructured taxes	12	4,133	7,708
Defined benefit pension plan	13	38,462	16,781
Other non-current liabilities		4,244	6,579
Deferred revenue		-	18
Deferred income taxes	14	35,005	33,751
Total non-current liabilities		**149,062**	**71,617**
Total liabilities		**507,847**	**357,119**
Minority interests	18	567	614
Commitments and contingencies	23	-	**-**
Stockholders' equity			
Share capital	15	5,149	5,149
Capital surplus	15	158,054	158,054
Accumulated other comprehensive income	16	59,004	11,768
Retained earnings		656,713	468,860
Total stockholders' equity		**878,920**	**643,831**
Total liabilities, stockholders' equity and minority interests		**1,387,334**	**1,001,564**

The accompanying notes are an integral part of these consolidated financial statements.

(In thousands of US dollars, except for earnings per share amounts)

	Note	Year ended December 31, 2006	Year ended December 31, 2005
Sales revenue			
Sales of titanium products		754,972	489,550
Sales of titanium products - related parties	21	83,720	51,165
Sales of aluminium products		29,281	20,520
Sales of magnesium and alloys		10,045	44,107
Sales of ferrotitanium		70,285	73,767
Other revenue		54,917	49,082
Total revenue		**1,003,220**	**728,191**
Production costs		(491,862)	(380,869)
Depreciation and amortization		(33,227)	(31,369)
		(525,089)	**(412,238)**
Gross profit		**478,131**	**315,953**
Taxes other than on income		(16,119)	(21,756)
Provision for taxes other than on income		4,376	(23,030)
Selling, general and administrative expenses	17	(140,216)	(117,085)
Consulting expenses – related parties	21	-	(4,921)
Commission expenses – related parties	21	(1,145)	(570)
Management services – related parties	21	-	(1,668)
Social expenses		(21,935)	(13,824)
Impairment of goodwill		(2,108)	-
Loss on disposal of interest in subsidiary		-	(148)
Loss on disposal of property, plant and equipment		(4,103)	(2,935)
Gain from investments		-	58
Total other operating expenses		**(181,250)**	**(185,879)**
Operating income		**296,881**	**130,074**
Interest expense		(13,357)	(4,841)
Foreign exchange loss		(6,211)	(3,290)
Income before income tax expense and minority interest		**277,313**	**121,943**
Income taxes	14	(88,113)	(50,324)
Income before minority interest		**189,200**	**71,619**
Minority interest		(24)	(5,266)
Share in earnings of joint venture	5	14,833	8,260
Net income		**204,009**	**74,613**
Other comprehensive income:			
Incremental effect of applying FAS 158		(18,904)	-
Net change in unrealized gain on a change in valuation of investments		-	114
Translation adjustment		66,140	(14,850)
Comprehensive income		**251,245**	**59,877**
Net income per share (US dollars)			
basic and diluted	15	17.6945	6.8955

The accompanying notes are an integral part of these consolidated financial statements.

(In thousands of US dollars)

	Note	Year ended December 31, 2006	Year ended December 31, 2005
Net income		**204,009**	**74,613**
Adjustments to reconcile net income to cash generated from operations:			
Depreciation and amortization		33,227	32,083
Loss on disposal of property, plant and equipment		4,103	2,935
Loss on disposal of interest in subsidiary		-	148
Loss on impairment of goodwill	19	2,108	-
Share in earnings of joint venture	5	(14,833)	(8,260)
Deferred tax benefit	14	(9,465)	(17,985)
Other non-cash movements		(790)	968
Bad debts	17	18,843	5,543
Inventory provisions	17	6,303	167
Cash distributions received from joint venture	5	7,354	-
Change in restricted cash balance		444	(154)
Minority interests		24	5,266
Changes in operating assets and liabilities, excluding cash and debt:			
Trade accounts receivable		(42,478)	(25,645)
Advances		(9,309)	(3,443)
Taxes and other receivables		(38,896)	(9,886)
Inventories		(86,074)	(101,092)
Other current and non-current assets		810	(805)
Trade accounts payable and accrued expenses		(5,235)	14,718
Income and other taxes payable		(1,509)	28,581
Repayment of restructured tax liabilities		(3,818)	(732)
Other current liabilities		25,554	11,398
Accrued pension cost		3,076	3,424
Net cash generated by operating activities		**93,448**	**11,842**
Investing activities			
Capital expenditures		(147,652)	(78,537)
Loans repaid by related parties		-	1,021
Loans advanced to third parties		-	(832)
Disposal of a share in subsidiary		-	326
Disposal of non-current assets held for sale		-	29,489
Proceeds from sales of investments in affiliated and non-marketable securities		1,249	-
Acquisition of subsidiaries net of cash acquired	18	-	(8,990)
Net cash used in investing activities		**(146,403)**	**(57,523)**
Financing activities			
Net proceeds from short-term borrowings – third parties		14,133	44,467
Proceeds from long-term borrowings – related parties		-	1,247
Proceeds from long-term borrowings – third parties		74,340	3,703
Repayment of long-term borrowings – third parties		(9,234)	-
Dividends paid to minority shareholders of subsidiary		-	(1,823)
Dividends paid	15	(16,065)	(10,996)
Net cash generated by financing activities		**63,174**	**36,598**
Effect of exchange rate changes on cash and cash equivalents		3,064	697
Net change in cash and cash equivalents		**13,283**	**(8,386)**
Cash and cash equivalents at December 31, 2005 and 2004	**4**	**29,349**	**37,735**
Cash and cash equivalents at December 31, 2006 and 2005	**4**	**42,632**	**29,349**
Supplemental cash flow information:			
Interest paid, net of amounts capitalized		18,698	6,238
Income taxes paid		118,496	57,647

The accompanying notes are an integral part of these consolidated financial statements.

(In thousands of US dollars)

	Notes	Share capital	Capital surplus	Treasury stock	Accumulated other comprehensive income	Retained earnings	Total stock-holders' equity
Balance at December 31, 2004		**5,118**	**4,014**	**(74)**	**26,504**	**405,423**	**440,985**
Stock issue	15	31	154,040		-	-	154,071
Retirement of treasury stock	15	-	-	74	-	(74)	-
Net income		-	-	-	-	74,613	74,613
Other comprehensive income:							
Net change in unrealized gain on a change in valuation of investments		-	-	-	114	-	114
Translation adjustment		-	-	-	(14,850)	-	(14,850)
Comprehensive income							**59,877**
Dividends to stockholders	15	-	-	-	-	(11,102)	(11,102)
Balance at December 31, 2005		**5,149**	**158,054**	**-**	**11,768**	**468,860**	**643,831**
Net income		-	-	-	-	204,009	204,009
Other comprehensive income:							
Incremental effect of applying FAS 158	3	-	-	-	(18,904)	-	(18,904)
Translation adjustment		-	-	-	66,140	-	66,140
Comprehensive income							**251,245**
Dividends to stockholders	15	-	-	-	-	(16,156)	(16,156)
Balance at December 31, 2006		**5,149**	**158,054**	**-**	**59,004**	**656,713**	**878,920**

The accompanying notes are an integral part of these consolidated financial statements.

1 NATURE OF OPERATIONS

Open joint stock company "VSMPO-AVISMA Corporation" ("VSMPO-AVISMA" or the "Company") and its subsidiaries (collectively the "Group") is one of the world's leading titanium producers. The Company was originally established as a state owned enterprise in 1933 in the Moscow region and re-allocated to Verkhnya Salda (Sverdlovsk region) in 1941. The Company was privatized in the form of a joint stock company in 1992 and registered as an open joint stock company "Verkhnesaldinskoye Metallurgicheskoe Proizvodstvennoe Obyedinenie" ("VSMPO") in accordance with the Law on Joint Stock Companies of the Russian Federation.

In 1998 VSMPO acquired controlling interest in an open joint stock company "Avisma" ("Avisma"). In January 2005 VSMPO was renamed to open joint stock company "VSMPO-AVISMA Corporation". In July 2005 following the acquisition of outstanding minority interest (Note 18) and a legal reorganization, in the form of accession of Avisma into VSMPO, VSMPO and Avisma formed one legal entity. As a result of this reorganization, AVISMA branch was established.

In September 2006, federal state unitary enterprise Rosoboronexport acquired control of 65.8% outstanding stock in VSMPO-AVISMA, and in November 2006 a new Board of Directors with VSMPO-AVISMA was elected.

The Company's main operations are on VSMPO production site located in Verkhnya Salda (Sverdlovsk region) of the Russian Federation and are subject to the legislative requirements of both the Russian Federation and the Sverdlovsk regional authorities. The Company's main products are titanium melted and mill products and forgings for aerospace, industrial and other applications. It also produces ferrotitanium, aluminium extrusions and specialty steel mill products and forgings. These products are sold both in the Russian Federation and abroad.

Avisma branch's main operations are in Berezniki (Perm region) of the Russian Federation and are subject to the legislative requirements of both the Russian Federation and the Perm regional authorities. Avisma's main products are titanium sponge and primary magnesium.

In November 2005 the Company acquired all the outstanding shares of the Swedish company "Carl.Edblom.titan AB", which held a controlling interest in closed joint-stock company "Plant SETAB Nikopol", a Ukrainian company engaged in production and sale of seamless titanium pipes (Note 18).

VSMPO-AVISMA and its subsidiaries form a vertically integrated operation.

2 BASIS OF PREPARATION

(a) Statement of compliance

The Group maintains its accounting records in accordance with the legislative requirements of the country of incorporation of each of the Group's company. The accompanying financial statements have been prepared from those accounting records and adjusted as necessary to comply, in all material respects, with the requirements of accounting principles generally accepted in the United States of America ("US GAAP").

b) Functional and presentation currency

In accordance with the laws of the Russian Federation the accounting records of the Company are maintained and the Company's statutory financial statements for its stockholders are prepared in Russian roubles ("rouble").

The functional currency of the Company and its trading subsidiaries is considered to be the rouble. The functional currency of Ukrainian "Plant SETAB Nikopol" company is the US Dollar. The accompanying financial statements have been prepared using the US Dollar ("US$") as the Group's reporting currency, utilizing period-end exchange rates for assets and liabilities, period weighted average exchange rates for consolidated income statements accounts and historic rates for equity accounts in accordance with the provisions of SFAS No. 52, Foreign currency translation. As a result of these translation procedures, a cumulative translation adjustment of US$ 77,314 and US$ 11,174 as at December 31, 2006 and 2005, respectively, which accounts for such gains and losses, was recorded directly in stockholders equity (Note 16).

The Central Bank of the Russian Federation's closing rates of exchange at December 31, 2006 and 2005 were US$1 to 26.3311 roubles and US$1 to 28.7825 roubles, respectively. The annual weighted average exchange rates were 27.1852 and 28.2864 roubles to US$1 for each of the years ended December 31, 2006 and 2005, respectively.

(c) Consolidation principles

These consolidated financial statements include all majority-owned and controlled subsidiaries of the Group. All significant intercompany accounts and transactions have been eliminated.

3 SIGNIFICANT ACCOUNTING POLICIES

The following significant accounting policies have been applied in the preparation of the consolidated financial statements. These accounting policies have been consistently applied by the Group from one reporting period to another with the exception of newly adopted accounting pronouncements.

(a) Use of estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of financial statements, and revenue and expenses during the periods reported.

Estimates are used when accounting for certain items such as contingent liabilities, allowances for doubtful accounts; employee compensation programs; depreciation and amortization of property, plant and equipment and intangible assets; impairment of long-lived assets; asset retirement obligations; inventory values; valuations of investments and determining when investment impairments are other than temporary; assets and liabilities assumed in a purchase business combinations and deferred taxes, including valuation allowances. Estimates are based on historical experience, where applicable, and other assumptions that management believes are reasonable under the circumstances. Actual results may differ from those estimates under different assumptions or conditions.

(b) Cash and cash equivalents

Cash and cash equivalents comprise cash balances, cash on current accounts with banks, bank deposits and other highly liquid investments with original maturity of 90 days or less, that are readily convertible to known amount of cash.

(c) Restricted cash

Restricted cash comprise funds legally or contractually restricted as to withdrawal.

(d) Accounts receivable

Accounts receivable are stated at cost less an allowance for doubtful debts. Management quantifies this allowance, based on current information regarding the customer's ability to repay their obligations. Amounts previously written off which are subsequently collected are recognized as income.

(e) Value added tax (VAT)

Output VAT related to sales of goods and services rendered is payable to the tax authorities upon the collection of receivables from customers. Input VAT is reclaimable against sales VAT upon payment for purchases. The input VAT paid in respect of capital expenditures is reclaimable upon the commissioning of the respective capital assets into operations. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales / purchases of goods and services rendered / used which have not been settled at the balance sheet date (VAT deferred) is recognized in the balance sheet on a gross basis and disclosed separately as a current asset and liability. Where an allowance has been made for doubtful debts, a loss is recorded for the gross amount of the debtor, including VAT. The related VAT liability is maintained until the debtor is written off for tax purposes.

Subsequent to the year end the VAT accounting policy was revised. Output value added tax related to sales of goods (work performance, services provision) is payable to tax authorities upon delivery of the goods (work, services) or property rights to customers. Input VAT on goods and services purchased (received) is generally recoverable against output VAT. VAT related to sales and purchases / services provision and receipt which has not been settled at the balance sheet date (VAT deferred) is recognized in the balance sheet on a gross basis and disclosed separately within current assets or current liabilities. Where a doubtful debt provision has been made, a loss is recorded for the gross amount of the debt, including VAT.

(f) Inventories

Inventories are carried at the lower of acquisition cost or market value. Inventories are released to production or written off otherwise at average cost. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads.

A provision for obsolescence is calculated based on an analysis of slow-moving and obsolete inventories. Such items are provided for in full.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Investments in marketable debt and equity securities

Marketable debt and equity securities consist of investments in corporate debt and equity securities where the Group does not exert control or significant influence over the investee. The Group classifies marketable debt and equity securities into three categories: trading, held to maturity and available for sale. The specific identification methods are used for determining the cost basis of all such securities.

Trading securities

Trading securities are bought and held principally for the purpose of selling them in the near term. Trading securities are carried on the consolidated balance sheet at their estimated fair values. Unrealized gains and losses arising on trading securities held are included in the statement of income and comprehensive income.

Held-to-maturity securities

Held-to-maturity securities are those debt securities, which the Group has the ability and intent to hold until maturity. Such securities are recorded at amortized cost.

Premiums and discounts are amortized and recorded in the consolidated statement of income and comprehensive income over the life of the related held-to-maturity securities, as an adjustment to yield using the effective interest method.

Available-for-sale securities

All marketable securities not included in trading or held to maturity categories are classified as available for sale.

Available-for-sale investments are carried at fair value. Unrealized gains and losses arising on securities held, net of the related tax effect, are excluded from earnings and reported as a separate component of accumulated other comprehensive income in the stockholders' equity until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis.

(h) Investments in associates and non-marketable securities

Investments in associates

Associates are those enterprises in which the Group has significant influence, but does not have control over the financial and operating policies. Investments in associates are accounted for by the equity method of accounting. The consolidated financial statements include the Group's share of reported associates' earnings from the date when significant influence effectively commences until the date when significant influence effectively ceases to exist.

Investments in non-marketable securities

Investments in non-marketable securities where the Group does not exercise control or significant influence over the investee are carried at cost less provisions for anything other than temporary diminution in value. Provisions are recorded for the investments in securities of the companies which are experiencing significant financial difficulties for which recovery is not expected within a reasonable period in the future, or are under bankruptcy proceedings.

(i) Property, plant and equipment

Owned assets

Property, plant and equipment are stated at acquisition cost less accumulated depreciation and impairment losses. Assets under construction and equipment awaiting installation are included in property, plant and equipment, accounted for at historical cost and are not depreciated until commissioned into operation.

Subsequent expenditures

Expenditures incurred to replace a component of an item of property, plant and equipment that is accounted for separately, are capitalized with the carrying amount of the component subject to depreciation. Other subsequent expenditures are capitalized only when they increase the future economic benefits embodied in an item of property, plant and equipment. All other expenditures are recognized as expenses in the consolidated statement of income as incurred.

Capitalized interest

Interest is capitalized if related to the construction or acquisition of major qualifying assets. The capitalized interest is recorded as part of the asset to which it relates, and is depreciated over the asset's useful life.

(in thousands of US$, except where indicated)

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Property, plant and equipment (continued)

Depreciation

Depreciation is charged on a straight-line basis over the estimated useful lives of individual assets. Subsequent capitalized expenditures are depreciated on a straight-line basis over the estimated remaining useful life of the individual assets. Depreciation is charged from the time an asset is put into operation. Depreciation is not charged on assets to be disposed or land. The range of estimated useful lives is as follows:

Buildings and constructions	25 - 40 years
Plant and equipment	15 years
Vehicles	10 years
Infrastructure	20 years
Other	5 years

(j) Goodwill and intangible assets

Goodwill represents the excess of purchase price over fair value of net assets acquired in a business combination. Under SFAS No. 142, *Goodwill and Other Intangible Assets*, ("SFAS No. 142") goodwill and intangible assets with indefinite useful lives are subject to an impairment test at least annually and on an interim basis when an event occurs or circumstances change between annual tests that would, more likely than not, result in impairment.

Under SFAS No. 142, goodwill is assessed for impairment by using the fair value based method. The Group determines fair value by utilizing discounted cash flows. The impairment test required by SFAS No. 142 includes a two-step approach. Under the first step, companies must compare fair value of a "reporting unit" to its carrying value. A reporting unit is the level at which goodwill impairment is measured and it is defined as an operating segment or one level below it if certain conditions are met. If the fair value of the reporting unit is less than its carrying value, step two is required to determine if goodwill is impaired.

Under step two, the amount of goodwill impairment is measured by the amount, if any, that the reporting unit's goodwill carrying value exceeds its "implied" fair value of goodwill. The implied fair value of goodwill is determined by deducting the fair value of all tangible and intangible net assets of the reporting unit (both recognized and unrecognized) from the fair value of the reporting unit (as determined in the first step).

The Group performs the required annual goodwill impairment test at the end of each calendar year.

The excess of the fair value of net assets acquired over purchase cost is determined as negative goodwill, and is allocated to the acquired non-current assets, except for deferred taxes, if any, until they are reduced to zero.

Intangible assets that have limited useful lives are amortized on a straight-line basis over the shorter of their useful or legal lives.

(k) Impairment of long-lived assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset to the future undiscounted cash flows expected to be generated by the asset. If the carrying amount of the assets is determined to be not recoverable, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value, generally determined by reference to the discounted future cash flows. Assets available for sale that meet certain criteria are measured at the lower of their carrying amount or fair value less cost to sell.

(l) Pensions and other post retirement benefits

The Group follows the Pension and Social Insurance legislation of the Russian Federation, which requires contributions to the Russian Federation Pension Fund by the employer calculated as a percentage of current gross salaries. These contributions are expensed as incurred. The Group also maintains defined benefit pensions and other post employment benefits (such as additional material support to its former employees, lump-sum payments upon death or retirement, jubilee benefits). The program is unfunded: the company pays benefits on a pay-as-you-go basis. The pension accounting costs are assessed using the projected unit credit method. Under this method, the cost of providing pensions is charged to the income statement, so as to attribute the total pension cost over the service lives of employees in accordance with the benefit formula of the plan. Actuarial gains and losses are amortised over the average remaining working lives of the employees, to the extent to which these exceed 10% of the greater of projected benefit obligation and plan assets. The Group also maintains a non-contributory defined benefit plan for its full-time employees. The pensions earned as well as the interest on the projected benefit obligations are accrued in accordance with FAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Income taxes

Income taxes are accounted for under the asset and liability method. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements' carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in the years in which these temporary differences are expected to reverse. The Group provides valuation allowances for deferred tax assets which are unlikely to be realized.

(n) Asset retirement obligations

A liability for an asset retirement obligation is recorded at fair value in the period in which it is incurred. When the liability is initially recorded, a corresponding cost is capitalized by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the estimated useful life of the related asset. The Group bears asset retirement obligations in respect of its main production facilities. These obligations have indeterminate settlement dates since the Group currently plans to operate such assets in perpetuity.

(o) Borrowings

Borrowings are recognized initially at cost, net of any discounts or premiums. Debt issue costs are deferred and amortized over the period of the borrowing as an adjustment to yield using the effective interest rate method. Subsequent to initial recognition, borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in the consolidated statement of income and comprehensive income, as expense over the period of the borrowings using the effective interest method.

(p) Commitments and contingencies

Contingent liabilities, including environmental remediation costs, arising from claims, assessments, litigation, fines, penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated.

(q) Segment reporting

The Group conducts its operations within one business segment: production of titanium sponge and manufacturing of titanium products. This is based on the way management assesses operating performance and makes operating and investing decisions. All the principal production and manufacturing units are located in the Russian Federation.

In 2006, the Group's exports in monetary terms were 79% (2005: 84%) of the total sales.

(r) Dividends

Dividends are recognized as a liability in the period in which they are declared. Dividends on VSMPO's ordinary shares, if declared, are payable in roubles.

(s) Revenue Recognition

Revenue from the sale of goods is recognized in the consolidated statement of income and comprehensive income when there is a firm arrangement, the price is fixed or determinable, delivery has occurred and collectibility is reasonably assured.

(t) Comprehensive income

Comprehensive income includes all changes in equity for a period from non-owner sources.

(u) Environmental charges

Expenditures for current operations are expensed or capitalised, as appropriate. Expenditures relating to existing conditions caused by past operations, and which do not contribute to future revenues, are expensed. Liabilities are recorded when remedial efforts are probable and the costs can be reasonably estimated. The liability may include non discounted costs such as site investigations, consultant fees, feasibility studies, outside contractor and monitoring expenses. Estimates are not reduced by potential claims for recovery unless recovery is probable.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

(v) Financial instruments

The fair value of financial instruments is determined with reference to various market information and other valuation methods as considered appropriate. However, judgment is necessarily required to interpret market data to determine the estimated fair value. The carrying values of cash and cash equivalents, trade accounts receivable, trade accounts payable and income and other taxes payable approximate their fair values because of the short maturities of these instruments. Marketable securities are carried at fair values in the consolidated balance sheets. Fair values of long-term borrowings from third parties and restructured taxes approximate their carrying values as these instruments bear interest at rates which are commensurate with market interest rates available for debt with similar characteristics. Management believes that it is not practicable to estimate fair value of related party receivables and payables.

(w) Interest

Interest income is recognized in the consolidated statement of income and comprehensive income as earned. All interest and other costs incurred in connection with borrowings are expensed as incurred as part of interest expense, except for interest capitalized as part of the cost of qualifying long-lived assets.

(x) New accounting pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("SFAS No. 157"). This Statement defines fair value, establishes a framework for measuring fair value under other accounting pronouncements that permit or require fair value measurements, changes the methods used to measure fair value and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Group is currently evaluating the potential impact, if any, that the adoption of FAS 157 will have on its consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* ("SFAS No. 159"). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 will become effective for the Group on January 1, 2008.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective in fiscal years beginning after December 15, 2006. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption, with the cumulative effect adjustment reported as an adjustment to the opening balance of retained earnings. The Group is currently evaluating the potential impact, if any, that the adoption of FIN 48 will have on its consolidated financial statements.

In April 2006, the FASB issued FSP FIN 46(R)-6, *Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)* ("FSP FIN 46(R)6"). FSP FIN 46(R)−6 addresses whether certain arrangements associated with variable interest entities should be treated as variable interests or considered as creators of variability, and indicates that the variability to be considered shall be based on an analysis of the design of the entity. FSP FIN 46(R)−6 is required to be applied prospectively to all entities with which the Group first becomes involved and to all entities previously required to be analyzed under FIN 46(R) upon the occurrence of certain events, beginning the first day of the first reporting period after June 15, 2006. Early application is permitted for periods for which financial statements have not yet been issued. Retrospective application to the date of the initial application of FIN 46(R) is permitted but not required, however, if elected, it must be completed no later than the end of the first annual reporting period after July 15, 2006. The Group is currently evaluating the potential impact, if any, that the adoption of FSP FIN 46(R)−6 will have on its consolidated financial statements

(in thousands of US$, except where indicated)

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

(y) Accounting changes recently adopted

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* an amendment of FASB Statements No. 87, 88, 106, and 132(R) ("SFAS No. 158"). This Statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity. This Statement also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions, and enhances disclosures in respect of defined benefit postretirement plans. Recognition and related disclosure provisions of SFAS No. 158 become effective for the Group as of December 31, 2006, while the measurement date provisions shall apply as of December 31, 2008. The impact of the adoption of SFAS No. 158 was as follows:

Incremental effect of applying SFAS 158 on individual line items in the Consolidated Balance Sheets at December 31, 2006 (rounded)	Before Application of Statement 158	Incremental Effect of Adopting FAS 158	After Application of Statement 158
Liability for pension benefits	(30,004)	(12,622)	(42,626)
Intangible asset	6,282	(6,282)	-
Accumulated other comprehensive income – Pension	-	18,904	18,904

In March 2005, the FASB issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations.* The Interpretation requires entities to record a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The term "conditional asset retirement obligation" refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The Intepretation became effective for the Group as of December 31, 2005. The adoption of this Interpretation did not have a material impact on Group's consolidated financial statements.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, *Inventory Costs*, an Amendment of ARB No. 43, Chapter 4, which is effective for the Group starting January 1, 2006. The Statement amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4*, Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and spoilage. In addition, the standard requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of this Statement did not have a material impact on Group's consolidated financial statements.

(z) Reclassifications

Certain amounts in previously issued consolidated financial statements have been reclassified to conform to the current year presentation. Such reclassifications have no impact on net income or stockholders' equity.

(in thousands of US$, except where indicated)

4 CASH AND CASH EQUIVALENTS

	31 December 2006	31 December 2005
Cash at bank, US Dollars	11,533	14,838
Cash at bank – Russian roubles	13,233	2,966
Cash at bank - Euro, Swiss francs, Pound Sterling	17,722	2,680
Cash on hand	30	5,698
Short-term bank deposits	93	3,009
Other cash equivalents	21	158
Total cash and cash equivalents	**42,632**	**29,349**
Restricted cash	**2,248**	**2,477**

Restricted cash as at December 31, 2006 and 2005 is represented by the certificate of deposit in the amount of US$ 2,248 and US$ 2,165, respectively. The certificate of deposit was pledged as collateral for the issued letter of credit in the amount of US$ 2,100 which matures on 30 April 2007. As of 31 December 2005, the remaining restricted cash of US$ 312 represented a security deposit for the bank guarantee.

5 INVESTMENTS

	31 December 2006	31 December 2005
Joint venture – Uniti LLC	18,035	11,971
Other investments	1,952	1,632
Total investments	**19,987**	**13,603**

On April 29, 2003, the Group entered into an agreement with Allegheny Technologies Incorporated to form a joint venture to engage in the marketing and sale of titanium products and conversion services. The joint venture is organized in the form of Uniti LLC, a company registered in the United States of America. The Group owns a 50% interest in the joint venture and accounts for this interest under the equity method.

In accordance with the agreement, any income or loss earned/incurred by the joint venture is allocated in proportion to the percentage of goods and services provided by the Group and included in Uniti LLC's sales. Such percentage is calculated as a share of each participant included in cost of goods sold by Uniti for the reviewed quarter. Therefore 42.1% and 45.9% of the profit earned by the joint venture were allocated to the Group in 2006 and 2005, respectively.

The following information is a summary of the Uniti balance sheet as of December 31, 2006 and 2005:

	31 December 2006	31 December 2005
Current assets	55,609	39,729
Property and equipment, net	140	192
Other assets	69	35
Total assets	**55,818**	**39,956**
Current liabilities	14,441	9,257
Total liabilities	**14,441**	**9,257**
Equity	**41,377**	**30,699**

The total revenue and net profit of Uniti for the year ended December 31, 2006 and 2005 were US$ 206,327 and US$ 29,332 and US$ 112,812 and US$ 24,125, respectively. The Group's share in Uniti's earnings of US$ 14,833 and US$ 8,260 for the years ended December 31, 2006 and 2005, respectively, was included in the consolidated income statement as a separate item after Income before minority interest.

In 2006 and 2005, the Group's sales to Uniti were US$ 83,720 and US$ 51,165, respectively.

In 2006, the Group received US$ 7,354 of stockholder distributions from Uniti in cash. In January 2007, the Group received an additional distribution of US$ 1,415. In 2005, Uniti did not authorize or pay any distributions to stockholders.

(in thousands of US$, except where indicated)

6 TAXES AND OTHER RECEIVABLES

	December 31, 2006	December 31, 2005
VAT recoverable	87,809	62,938
Prepaid taxes	20,783	2,780
Prepaid custom duties	942	623
Other non-trade receivables	8,987	5,348
Total taxes and other receivables	**118,521**	**71,689**

7 INVENTORIES, NET

	December 31, 2006	December 31, 2005
Raw materials	150,680	86,748
Work in progress	89,921	87,000
Finished products	198,419	148,042
Less: Provision for obsolescence	(16,333)	(10,447)
Total inventory, net	**422,687**	**311,343**

Inventory with a carrying value of US$ 13,041 and US$ 23,992 as of December 31, 2006 and 2005, respectively, was pledged as collateral for certain borrowings of the Group (Note 9).

8 PROPERTY, PLANT AND EQUIPMENT, NET

	December 31, 2006	December 31, 2005
Land	3,727	3,395
Buildings & Constructions	161,326	137,189
Machinery & Equipment	325,634	229,213
Vehicles	15,005	11,868
Transfer devices	24,184	21,251
Other	52,089	38,656
Less: accumulated depreciation	(190,318)	(149,494)
Net book value	391,647	292,078
Construction in progress	80,228	56,269
Advances for construction	47,618	22,580
Total property, plant and equipment, net	**519,493**	**370,927**

Carrying and pledge values of property, plant and equipment subject to lien under loan agreements comprise US$ 50,892 and US$ 53,701 as of December 31, 2006, respectively (US$ 49,826 and US$ 49,626 as of December 31, 2005) (Note 9).

9 SHORT AND LONG-TERM BORROWINGS

	Currency	December 31, 2006	December 31, 2005
SHORT-TERM BORROWINGS			
Bank loans			
International Moscow Bank; interest of LIBOR + from 2.2% to 3.0% (Note a)	(1)	74,300	55,743
Wachovia Capital Finance Corporation; interest from 7.073% to 8.250% (Note c)	(1)	36,853	18,564
Calion Rusbank; interest of LIBOR + 1.25% (Note b)	(1)	13,894	25,000
Raiffeisenbank; interest of LIBOR + from 2.15% to 3.0% (Note d)	(1)	27,480	-
Raiffeisenbank; interest of LIBOR + from 2.3% to 3.0% (Note d)	(2)	11,437	-
Kredit-Dnepr (Note e)		3,935	-
Prominvestbank; interest from 13.0% to 20.0%	(1)	-	562
Prominvestbank; interest from 13.0% to 20.0%	(4)	-	1,707
Vneshtorgbank; interest of 10.0%	(2)	-	4,202
Vneshtorgbank; interest from 7.3% to 8.0%	(1)	-	19,500
Citibank; interest of LIBOR + 3.0%	(1)	-	8,620
Other		496	26
Total short-term borrowings from third parties		**168,395**	**133,924**

(in thousands of US$, except where indicated)

9 SHORT AND LONG-TERM BORROWINGS (continued)

	Currency	December 31, 2006	December 31, 2005
LONG-TERM BORROWINGS			
Bank loans			
International Moscow Bank; interest of LIBOR + 2.2 to 6.0% (Note a)	(1)	42,043	4,000
RaiffeisenBank; interest of LIBOR + from 2.15% to 3.0% (Note d)	(1)	25,070	-
Prominvestbank; interest from 13.0% to 20.0%	(1)	-	286
Other		105	-
Total long-term borrowings from third parties		**67,218**	**4,286**

All interest rates are on a per annum basis.

(1) US$ denominated loans;

(2) Russian rouble denominated loans;

(3) EURO denominated loans;

(4) Other currencies denominated loans.

Details of significant secured loan balances are summarised below:

(a) International Moscow Bank

The loans are collateralized by the pledge of inventory (Note 7) and property, plant and equipment (Note 8). Under the terms of the agreements the Group is also required to maintain a required level of cash flows through the accounts opened with the bank.

The loans contain certain restrictive covenants in relation to the sale of assets, pledges of property, total amount of borrowings, change of controlling stockholders, changes in the Group's management, default on liabilities to third parties (including the bank), bankruptcy and other.

The bank is authorized by the Group to direct debiting the bank accounts opened by the Group with the bank for the purpose of loan settlement.

The long-term loans mature in September, 2009.

(b) Calion Rusbank

Under the terms of the agreements the Group is required to maintain a required level of cash flows through the accounts opened with the bank. The loans contain certain restrictive covenants in relation to sale of assets, pledges of property, export contracts, change of management structure and controlling stockholders, reorganisation, default on tax and other liabilities, bankruptcy and other.

The bank is authorized by the Group to direct debiting of the bank accounts opened by the Group with the bank for the purpose of loan settlement.

(c) Wachovia Capital Finance Corporation

On January 14, 2005 VSMPO Tirus US, a subsidiary, entered into a Loan and Security Agreement with Wachovia Capital Finance Corporation with a term ending three years from that date. The agreement as initially executed enabled VSMPO Tirus US to borrow up to US$ 25 million in revolving loans, with up to US$ 10 million of this amount in the form of letter of credit accommodations. On December 29, 2005 the agreement was amended to permit up to US$ 50 million in revolving loans. The amount available in revolving loans is limited to the lesser of US$ 50 million or the sum of stated percentages of eligible accounts receivable, finished goods inventory, material in process and scrap. Revolving loans are either designated as Prime Rate Loans or Eurodollar Rate Loans. Borrowings under the agreement are collateralised by a security interest in all the assets of VSMPO Tirus US.

The agreement contains certain restrictive covenants that, among other things, limit or restrict the ability of VSMPO Tirus US to incur debt, incur liens, make investments, pay dividends or redeem common stock; and requires compliance with a minimum tangible net worth covenant. VSMPO Tirus US is also required to maintain a lockbox arrangement whereby daily net cash receipts are used to reduce outstanding borrowings. Accordingly, outstanding loan balances are classified as a current liability. The interest on Prime Rate Loans is payable at the Prime Rate. Interest on Eurodollar Rate Loans is payable at a rate equal to the Adjusted Eurodollar Rate plus 1.75% per annum. As of December 31, 2006 and 2005, four Eurodollar Rate Loans were outstanding, totaling US$ 30 million and US$ 15 million, respectively, with interest rates ranging from 7.073% to 7.126%, and one Prime Rate loan was outstanding in the amount of US$ 6,853 and US$ 3,564. As of December 31, 2006 and 2005, US$ 1,200 and US$ 900, respectively, was outstanding in letter of credit accommodations.

(in thousands of US$, except where indicated)

9 SHORT AND LONG-TERM BORROWINGS (continued)

(d) Raiffeisenbank

Under the terms of the agreements the Group is required to maintain a required level of cash flows through the accounts opened with the bank.

The long-term loan matures in November, 2008.

(e) Kredit-Dnepr

The loans are collateralized by the pledge of inventory (Note 7).

10 INCOME AND OTHER TAXES PAYABLE

	December 31, 2006	December 31, 2005
Deferred VAT	311	1,187
Income tax	8,392	8,523
Property tax	1,076	873
Other taxes	4,023	2,069
Provision for taxes and duties (Note 22)	30,314	29,132
Income and other taxes	**44,116**	**41,784**

11 OTHER CURRENT LIABILITIES

	December 31, 2006	December 31, 2005
Advances received	53,238	22,533
Payroll and social tax payable	10,848	8,516
Promissory notes	-	279
Antidumping duties (Note 22)	-	2,139
Other payables	9,821	7,294
Total current liabilities	**73,907**	**40,761**

12 RESTRUCTURED TAXES

Prior to January 1, 2002 the Company had been granted a 10-year restructuring of its tax liability (including fines and delayed interest) from the tax authorities. This tax liability is to be settled by equal quarterly instalments by December 31, 2011. The Company's entitlement to tax restructuring is conditional on timely payment of both the current and restructured taxes (inclusive of interest). If the tax liability is settled ahead of schedule, the Company receives a right to partial or full forgiveness of the related fines and delayed interest. In 2006 the Company paid US$ 1,622 (2005: US$ 584) of restructured tax liability thus settling the original tax liability on profit taxes in full and applied to the tax authorities for a partial or full forgiveness of the respective fines and delayed interest.

The Company was granted the permission for forgiveness in June 2007 (Note 24) so it released the respective obligation for fines and delayed interests relating to profit tax as of December 31, 2006.

13 PENSION OBLIGATIONS

The post employment and post retirement program of the Group consists of lump-sum benefits, an occupational pension plan and additional benefits provided by the Group to its retired employees. Most of the pension benefits are dependent on participants' past service. The lump sum benefits are based on the monthly base wage and are further dependent on a participant's past service at retirement. There were 21,386 employees participating in some part of the post employment and post retirement program of the Group, 10,507 pensioners and 2,303 retired former employees, who received additional benefits from the Group as at December 31, 2006 (as at December 31, 2005: 21,498 employees,10,633 pensioners and no assessment for additional support benefits).

The defined benefit pension plan provides old age retirement pension and disability pension. At AVISMA employees are also provided with a death-in-service and jubilee benefit in the form of fixed monetary amounts.
The Group does not provide any defined contribution pension arrangements.

The last independent actuarial valuation of pension and other post employment and post retirement benefits for the purpose of US GAAP was performed in September 2007, with valuation date of December 31, 2006.

The valuation was performed using the Projected Unit Method with a discount rate of 6.6% (2005: 7%).

(in thousands of US$, except where indicated)

13 PENSION OBLIGATIONS (continued)

	2006	2005
Change in projected benefit obligations		
Projected Benefit Obligation (opening balance)	29,740	24,073
Service cost	1,818	1,414
Interest cost	2,145	2,121
Actuarial loss	2,157	2,940
Amendments	5,358	900
Benefits paid	(1,666)	(672)
Translation adjustment	3,074	(1,036)
Projected Benefit Obligation (closing balance)	**42,626**	**29,740**
Components of net periodic benefit costs		
Service cost	1,818	1,414
Interest cost	2,145	2,121
Amortization of prior service cost	681	566
Recognised actuarial gain/loss	103	-
Net periodic benefit costs	**4,747**	**4,101**
Funded status at year end		
Funded status	**42,626**	**29,740**
Unrecognized actuarial loss	(6,435)	(3,961)
Unrecognized prior service cost	(12,469)	(6,983)
Net amount recognised prior to adoption of FAS 158	**23,722**	**18,796**
Information for pension plans with an accumulated benefit obligation in excess of plan assets		
Projected benefit obligation (PBO)	42,626	29,740
Accumulated benefit obligation (ABO)	30,004	18,796
Fair value of plan assets	-	-
Amounts recognised in the statement of financial position consist of:		
Accrued benefit liability	30,004	18,796
Intangible asset	(6,282)	-
Accumulated other comprehensive income (AOCI)	-	-
Net amount recognised prior to adoption of FAS 158	**23,722**	**18,796**

	2006
Non-current assets	-
Current liabilities	4,164
Non-current liabilities	38,462
Net amount recognised following adoption of FAS 158	**42,626**

Amounts recognised in accumulated other comprehensive income consist of:	**2006**
Net loss	6,435
Prior service cost	12,469
	18,904

The amounts in other comprehensive income expected to be recognised in net periodic benefit cost for the year ending December 31, 2007:	**2007**
Net loss	217
Prior service cost	1,256
	1,473

(in thousands of US$, except where indicated)

13 PENSION OBLIGATIONS (continued)

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Pension benefits
2007	4,178
2008	2,317
2009	2,734
2010	2,886
2011	3,076
Years 2012-2016	17,090

Weighted-average assumptions used to determine benefit obligations at December 31	2006	2005
Discount rate	6.60%	7.00%
Salary and benefit basis increase	9.20%	8.15%
Pension in pay	5.00%	5.00%
Staff turnover	up to age 49: 5% p.a. from age 50:0% p.a.	up to age 49: 5% p.a. from age 50:0% p.a.
Mortality	Russian population 1998	Russian population 1998

Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31	2006	2005
Discount rate	7.00%	9.18%
Salary and benefit basis increase	8.15%	9.18%
Pension in pay	5.00%	6.00%
Staff turnover	up to age 49: 5% p.a. from age 50:0% p.a.	up to age 49: 5% p.a. from age 50:0% p.a.
Mortality	Russian population 1998	Russian population 1998

14 INCOME TAXES

	Year ended December 31, 2006	Year ended December 31, 2005
Current tax expense	97,578	68,309
Deferred tax benefit	(9,465)	(17,985)
Total income tax expense	**88,113**	**50,324**

The Group calculates deferred income taxes in accordance with SFAS No.109, *Accounting for Income Taxes*, applying specific provisions for foreign companies using the US$ as the reporting currency.

Deferred income tax balances were classified in the consolidated balance sheets as follows:

	December 31, 2006	December 31, 2005
Current deferred tax asset	11,726	2,873
Total deferred tax asset	**11,726**	**2,873**
Non-current deferred tax liability	(35,005)	(33,751)
Total deferred tax liability	**(35,005)**	**(33,751)**
Net deferred tax liability	**(23,279)**	**(30,878)**

Presented below is a reconciliation between total income tax expense and theoretical income tax expense determined by applying the Russian statutory income tax rate to income before income taxes and minority interest:

	Year ended December 31, 2006	Year ended December 31, 2005
Income before income taxes and minority interest	277,313	121,943
Theoretical tax charge at statutory rate of 24%	66,555	29,266
Increase in income tax resulting from:		
Effects of different tax rates	12,256	6,648
Non-deductible expenses and non-taxable income	9,302	14,410
Total income tax expense	**88,113**	**50,324**

(in thousands of US$, except where indicated)

14 INCOME TAXES (continued)

Deferred tax assets/(liabilities) comprised differences arising between the carrying values and tax bases of the following assets and liabilities:

	December 31, 2006	December 31, 2005
Deferred income tax assets:		
Inventory	2,254	1,462
Accounts receivable	8,482	677
Accounts payables and accruals	3,775	6,146
Total gross deferred income tax assets	**14,511**	**8,285**
Deferred income tax liabilities:		
Property, plant and equipment	(35,002)	(33,751)
Intangible assets	(84)	
Inventory	-	(282)
Accounts receivable	-	(4,475)
Other assets	(128)	-
Unrealized gain on a change in valuation of investments	(210)	(193)
Accounts payables and accruals	(2,363)	(462)
Total gross deferred income tax liabilities	**(37,787)**	**(39,163)**
Net deferred tax liability	**(23,276)**	**(30,878)**

The amount of foreign retained earnings deemed permanently reinvested was US$ 90,270 and US$ 37,523 at December 31, 2006 and December 31, 2005, respectively. At December 31, 2006 the amount of unrecognized deferred tax liability for temporary differences related to investments in foreign subsidiaries that are essentially permanent in duration was determined as US$ 13,980 (December 31, 2005: US$ 5,629).

15 SHARE CAPITAL

The share capital of VSMPO inclues the following:

	Authorized and issued common shares December 31, 2006	Par value per common share December 31, 2006	Authorized and issued common shares December 31, 2005	Par value per nominal share December 31, 2005
VSMPO	11,529,538	1 rouble	11,529,538	1 rouble

On July 1, 2005 the legal reorganization of VSMPO and Avisma (Note 1), its subsidiary, was carried out in the form of the accession of Avisma to the Company by issuance of the Company's common stock in exchange for a minority stake in Avisma. In particular, in 2005 the Company issued 904,908 common shares, which were exchanged for a minority stake in Avisma in the proportion of 2 to 1 for common stock and 1 to 1 for preferred stock. Minority shareholders, who voted against the reorganization or did not participate in the exchange, sold to Avisma 1,053 common shares and 2,671 preferred shares for roubles 4,253.92 per common share and roubles 2,137.92 per preferred share.

At December 31, 2004 the Group had 970 shares of VSMPO with a value of US$ 74 in treasury. In 2005 these shares were retired. In accordance with Russian legislation treasury stock should be sold or retired with one year from the date of purchase.

Each share of common stock entitles the holder to participate in shareholders' meetings, receive dividends and in the event of liquidation, receive its share of distributable reserves to the extent available.

Basic net income per share of common stock is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the reporting period, after giving retroactive effect to any stock splits.The average shares outstanding for purposes of basic and diluted earnings per share information were 11,529,538 and 10,820,487 for the years ended December 31, 2006 and 2005, respectively.

The Company does not have potentially dilutive shares outstanding.

In 2005 VSMPO declared the potential issue of 2,500,000 privileged shares with par value of 1 Russian rouble per share. No privileged shares were issued.

(in thousands of US$, except where indicated)

15 SHARE CAPITAL (continued)

Reserves available for distribution to shareholders are based on the statutory accounting reports of the Company as a stand-alone entity, which are prepared in accordance with Regulations on Accounting and Reporting of the Russian Federations and which differ significantly from U.S. GAAP. Russian legislation identifies the basis of distribution as net income. For 2005, the current year statutory accumulated retained earnings of the company that is available for distribution according to provisions of the Russian legislation was as of December 31, 2006 and 2005 US$ 518,279 and US$ 285,717 respectively at the exchange rate effective on December 31, 2006 and 2005 respectively. However, current legislation and other statutory regulations dealing with distribution rights are open to legal interpretation, consequently, actual distributable reserves may differ from the amount disclosed.

In June 2006 annual general shareholders' meeting declared dividends for the year ended December 31, 2005 of 37,88 Russian roubles per share for the total of US$ 16,156.

In June 2005 the Company declared dividends for the year ended December 31, 2004 of 29 Russian roubles per share for the total of US$ 11,102. The amount of dividends to be paid on 31 December 2006 was US$ 75 (31 December 2005: US$ 68).

16 STRUCTURE OF ACCUMULATED OTHER COMPREHENSIVE INCOME

	Year ended December 31, 2006	Year ended December 31, 2005
Cumulative translation adjustment	77,314	11,174
Net unrealized gain on a change in valuation of investments	594	594
Incremental effect of applying FAS 158	(18,904)	-
Total accumulated other comprehensive income	**59,004**	**11,768**

17 SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended December 31, 2006	Year ended December 31, 2005
Personnel costs	44,813	46,729
Selling expenses	19,042	15,207
Bad debt expense	18,843	5,543
VAT expenses	7,335	16,114
Provision for inventory obsolescence	6,303	167
Energy and utilities	4,768	2,656
Insurance	4,438	5,012
Pension obligations provision	3,117	3,464
Materials	1,523	2,132
Consulting expenses	670	3,404
Research and development expenses	566	1,278
Other	28,798	15,379
Total selling, general and administrative expenses	**140,216**	**117,085**

18 BUSINESS COMBINATIONS AND MINORITY INTEREST

In 2005 the Company effected a legal reorganization in the form of the accession of Avisma to VSMPO by issuance of the Company's common stock in exchange for 43.03% minority stake in Avisma (Note 15). The fair value of the net assets acquired comprised US$ 98,298 as of the acquisition date. The related goodwill amounted to US$ 55,774. The cost of the acquisition amounted to US$ 154,071 based on estimated fair value of the shares issued reflecting value per share issued of US$ 0.172.

In November 2005 OAO "Corporation VSMPO-AVISMA" acquired 100.0% of the outstanding shares of the Swedish company "Carl.Edblom.titan AB", which held a controlling interest of 50.1% in Closed Joint-Stock Company "Plant SETAB Nikopol", a Ukrainian company engaged in production and sale of seamless titanium tubes, for a cash consideration of US$ 9,000. The fair value of the net assets acquired comprised US$ 7,000 as of the acquisition date. The related goodwill amounted to US$ 2,000. This acquisition was made consistent with Group's vertical integration strategy, aiming for increasing production volumes of high-value-added products. The acquired company was consolidated by the Group for the first time as at the effective date of obtaining control, which management considers to be November 2006. Pro forma results of operations for the years ended December 31, 2005 and December 31, 2004 as if the business combination had been completed at the beginning of each period is as follows: pro forma revenue - US$ 732,559 (unaudited) and US$ 528,167 (unaudited), net income - US$ 70,528 (unaudited) and US$ 45,803 (unaudited), respectively.

(in thousands of US$, except where indicated)

18 BUSINESS COMBINATIONS AND MINORITY INTEREST (continued)

The following table summarizes the assigned values of assets acquired and liabilities assumed in this business combination, determined in accordance with SFAS No. 141. The fair values of property, plant and equipment were established by independent appraiser:

Current assets	7,871
Property, plant and equipment	13,054
Other non-current assets	375
Goodwill	2,000
Total assets acquired	23,300
Current liabilities	(10,910)
Deferred income tax liability	(2,368)
Non-current liabilities	(583)
Total liabilities assumed	(13,861)
Minority interest	(439)
Net assets acquired	9,000
Less: cash acquired	(10)
Net assets acquired, net of cash acquired	**8,990**

19 GOODWILL

Balance as at December 31, 2004	**-**
Acquired through business combinations (Note 18)	57,774
Cumulative translation adjustment	(223)
Balance as at December 31, 2005	**57,551**
Impairment of goodwill previously acquired	(2,108)
Cumulative translation adjustment	5,290
Balance as at December 31, 2006	**60,733**

As at December 31, 2006, the Group assessed the goodwill acquired in business combinations (Note 18) for impairment. As a result of this assessment, the impairment loss was recognized on full goodwill previously assigned to Swedish company “Carl.Edblom.titan AB” and its subsidiaries (“reporting unit”). Major factors for impairment loss were changes in economic environment, influencing the actual and projected performance of the reporting unit. The fair value of the reporting unit was determined based on present value method.

20 SALE OF PRODUCTS BELONGING TO THIRD PARTIES

In 2004, the Group sold US$ 27,214 of products belonging to third parties. As a result, the Group has an obligation to settle in respect of these products. Accordingly, no profit margin was recognized on such sales and a liability equal to the fair value of the products was recorded in the consolidated financial statements. The liability will be marked-to-market until the Group finally settles its liability in respect of these products. The respective liability as at December 31, 2006 amounted to US$ 18,978 (2005: US$ 32,016). Upon settlement of its liability in respect of the products, the Group recognizes a profit margin equal to the difference between the fair value and the cost of such products to the Group.

21 RELATED PARTY TRANSACTIONS

Related party transactions are disclosed on the face of each primary consolidated financial statement. Such transactions primarily comprise transactions with parties related to the stockholders and transactions with Uniti LLC (Note 5).

Balance sheet captions and statement of income and comprehensive income captions with the parties related to the stockholders for the years ended December 31, 2006 and 2005 comprised of the following:

Balance sheet captions:

	December 31, 2006	**December 31, 2005**
Short-term loans (Note a)	-	986
Total receivables from related parties		**986**
Long-term loans (Note d)	-	(2,494)
Total payables to related parties	**-**	**(2,494)**

Profit and Loss account and comprehensive income statement captions:

	Year ended December 31, 2006	**Year ended December 31, 2005**
Consulting fees (Note b)	-	(4,921)
Management services (Note c)	-	(1,668)

(in thousands of US$, except where indicated)

21 RELATED PARTY TRANSACTIONS (continued)

(a) Short-term loans

In 2005 the unsecured loan was advanced to related parties at 4% p.a. This loan was repaid in 2006.

(b) Consulting fees

Consulting services provided to the Group by related parties in 2005 were fully paid before December 31, 2005.

(c) Management services

Management services were provided to the Group by related parties in respect of a foreign subsidiary and were fully paid before December 31, 2005.

(d) Long-term loans

In 2004 the Group received a non-interest bearing and unsecured loan from related parties repayable in 2006 that was fully repaid before December 31, 2006.

Transactions and balances with Uniti LLC (Note 5) for the years ended December 31, 2006 and 2005 were as follows:

Balance sheet captions:

	December 31, 2006	December 31, 2005
Trade accounts receivable	8,689	6,157
Trade accounts payable	(145)	(51)
Net balance receivable	**8,544**	**6,106**

Profit and loss account and comprehensive income statement captions:

	Year ended December 31, 2006	Year ended December 31, 2005
Sales of titanium products	83,720	51,165
Commission expenses	(1,145)	(570)

22 RISKS AND UNCERTAINTIES

Operating environment. The Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

Whilst there have been improvements in the economic trends, the future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory, and political developments.

Convertibility of Russian rouble The future dynamics of RR to US$ exchange rate will affect the rouble carrying amount of the Group's assets and liabilities denominated in US dollars. This dynamics may also affect the Group's ability to sell assets presented in this consolidated financial statements in US dollars. Accordingly, any translation of Rouble amounts to US$ should not be construed as a representation that such Rouble amounts have been, could be, or will in the future be converted into US$ at the exchange rate shown or at any other exchange rate.

Commercial risks

(i) Foreign exchange risk. The Group minimizes its sales risks by having a wide range of geographical zones for sales, which allow the Group to respond quickly to unexpected changes in the situation on one or more sales markets on the basis of an analysis of the existing and prospective markets.

No individual customer comprised more than 10% of the Group's sales during 2006 and 2005. Management does not believe that the Group is reliant on any particular customer.

The volume of export sales outside the Russian Federation in money terms for years ended December 31, 2006 and 2005 amounts to 79% and 84% of the total amount of the Group's sold products, respectively.

The Group relies on export sales to generate foreign currency earnings. As the Group exports a significant portion of its production, it is exposed to foreign currency risk as well as global economic and political risks.

(in thousands of US$, except where indicated)

22 RISKS AND UNCERTAINTIES

Due to its foreign currency denominated assets and liabilities, the Group is subject to the risk arising from foreign exchange rate fluctuations. The net foreign currency position as at December 31, 2006 is as follows:

	US$	Euro	Other currencies
Cash and cash equivalents	11,551	16,173	1,549
Accounts receivable	72,406	48,741	10,785
Accounts payable and other liabilities	(25,564)	(6,074)	(8,945)
Short-term borrowings	(92,982)	(2)	(3,876)
Long-term borrowings	(67,218)	-	-

(ii) Interest rate risk. The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest-bearing short and long-term borrowings. The interest rates on borrowings are disclosed in Note 9. The Group has no significant interest-bearing assets, other than disclosed in Note 4.

23 COMMITMENTS AND CONTINGENCIES

Capital commitments. The Group is engaged in construction and equipment renovation programs. The investment programs are subject to periodic reviews and actual construction costs may vary from these estimates for many reasons including, but not limited to, general business conditions; environmental regulations; exchange rate fluctuations; the cost and efficiency of labor resources, equipment and materials; and the availability and cost of capital. At December 31, 2006 capital commitments amount to US$ 32,988 (December 31, 2005: US$ 23,616).

Taxation. The Group's principal operations are in Russia. Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant local, regional and federal authorities. Notably recent developments in the Russian environment suggest that the authorities in this country are becoming more active in seeking to enforce, through the Russian court system, interpretations of tax legislation, in particular in relation to the use of certain commercial trading structures, which may be selective for particular tax payers and different to the authorities' previous interpretations or practices. Different and selective interpretations of tax regulations by various government authorities and inconsistent enforcement create further uncertainties in the taxation environment in the Russian Federation.

Tax declarations, together with related documentation, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Fiscal periods remain open to review by the authorities for three calendar years preceding the year of review (one year in the case of customs reviews). Under certain circumstances reviews may cover longer periods. In addition, in some instances, new tax regulations effectively have been given retroactive effect. Additional taxes, penalties and interest which may be material to the financial position of the taxpayers may be assessed in the Russian Federation as a result of such reviews.

As at December 31, 2006 and 2005 management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these consolidated financial statements (Note 10). The management has assessed, based on their interpretation of the relevant legislation, that the other than remote tax exposures approximating US$ 5,847 (December 31, 2005: US$ 8,195) exist which the Group believes are not likely to materialize as liabilities. Management will continue to monitor the situation as legislation and practice evolve in the jurisdictions in which the Group operates.

Non-cancelable lease. VSMPO Tirus US leases warehouse and office facilities and certain equipment under non-cancelable operating leases. The following is a schedule of minimum rental payments required under these leases as of December 31, 2006 and 2005:

	Year ended December 31, 2006	Year ended December 31, 2005
2006	-	782
2007	595	568
2008	400	381
2009	210	200
2010	103	94
2011	6	-

The rental expense amounted to US$ 841 and US$ 810 for the years ended December 31, 2006 and 2005, respectively.

23 COMMITMENTS AND CONTINGENCIES (continued)

Environmental contingencies. The Group and its predecessor entities have operated in the Russian Federation for many years. Governmental authorities are continually considering environmental regulations and their enforcement and the Group periodically evaluates its obligations related thereto. As obligations are determined, they are recognized immediately. The outcome of environmental liabilities under proposed or any future legislation, or as a result of stricter enforcement of existing legislation, cannot reasonably be estimated. Under current levels of enforcement of existing legislation, management believes there are no probable liabilities, which will have a materially adverse effect on the financial position or the operating results of the Group.

Legal contingencies. The Group is the named defendant in a number of lawsuits as well as a named party in other proceedings arising in the ordinary course of business. While the outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a materially adverse effect on the financial position or the operating results of the Group.

Antidumping. In 2003 the U.S. Department of Commerce began an investigation of VSMPO Tirus US and Avisma in connection with an antidumping claim against pure and alloy magnesium from Russia. In 2004, VSMPO Tirus US and its legal counsel devoted substantial attention to defending the Group's interest in this case. The case initially resulted in a preliminary determination by the U.S. Department of Commerce of a 10.62% penalty on the cost of magnesium imports starting from October 1, 2004. In March 2005 the U.S. Department of Commerce issued its final determination in this matter which provisionally resulted in a higher rate of 21.71%. The increased penalty rate associated with this determination, however, had no impact on duties paid on imports prior to April 2005. This determination require VSMPO Tirus US to maintain a dumping duty bond or make cash deposits of estimated dumping duties at the time magnesium is imported into the United States. During 2006 and 2005 dumping duties of US$ 5,917 and US$ 3,469, respectively, were charged to cost of goods sold. As of December 31, 2006 and 2005, accrued liabilities included US$ 2,139 for amounts charged against dumping duty bond. From October 1, 2004 through December 31, 2006, charges against dumping duty bond and cash deposits totaled US$ 10,232.

In September 2007 U.S. Department of Commerce published final results of the investigation in respect of dumping duties of magnesium exports from Russia and determined them at the level of 0,41% starting from the investigation commencement date (October 2004) to filing date (March 2006) (Note 24). Accordingly, the Group recognized the related income on partial duty relief in 2006.

24 SUBSEQUENT EVENTS

In July 2007 the Group set up a new subsidiary Tirus International SA (Lausanne, Switzerland). The establishment of the company is aimed to ensure operational coordination of activities of foreign trading companies of the Group in global markets.

In August 2007 the Group announced the establishment of a joint venture with Boeing - CJSC Ural Boeing Manufacturing (UBM). JV UBM will perform mechanical conversion of titanium stampings to be used in the manufacture of Boeing 787 Dreamliner. Initially the companies announced their plans to set up a joint venture in April 2006, when a relevant memorandum of intentions was signed. Joint venture Ural Boeing Manufacturing is set up in Verkhnaya Salda (Sverdlovsk region).

In October 2007 the Group acquired a 33% stake in LLC "Mining Company Uralskoye zoloto" holding a license for geological survey, exploration and production of molybdenum ore in Yuzhno-Shameiskoye field. The Group's stake in the Charter capital of the mining company is associated with systematic implementation of steps to put in place a reliable delivery system of raw materials and supplies to achieve the key strategic objectives of the corporation regarding the increase of the production of titanium products for major aircraft manufacturers.

In June 2007 the annual general shareholders' meeting declared dividends for the year ended December 31, 2006 in the amount of RR 50.83 per share to the total amount of US$ 22,674.

On December 20, 2007, Uniti authorized the payment of distributions to the shareholders. The amount paid to Tirus US on December 21 was $US 2,127.

On September 11, 2007, U.S. Department of Commerce set the final dumping duty of magnesium exports from the Group to US at the level of 0.41% for the period of October 2004 to March 2006. (Note 23).

In June 2007 authorised tax authorities confirmed the right of the Group for a partial forgiveness of penalties and fines on restructured tax obligations (Note 12).

In June 2007 the Group issued a guarantee on a loan to a related party in the amount of US$ 45 million for three years. Under the contract the Group shall be jointly liable to a creditor and in case of the performance of obligations for the debtor it fully acquires the rights of the creditor to the debtor. The objective of issuing original loan was acquisition of companies – beneficiary owners of shares in the Group by the debtor.