Open Joint Stock Company Power Machines and Subsidiaries

Consolidated Financial Statements

for the year ended 31 December 2005

Contents

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Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheet of Open Joint Stock Company Power Machines (the "Company") and its subsidiaries (the "Group") as at 31 December 2005 and the related consolidated statements of income, changes in equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we 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.

The Group has suspended work on a construction contract because the customer has not been able to obtain certain government approvals required in relation to financing. Management believes that the work undertaken on this contract can be used on other contracts if the customer is ultimately unable to obtain the required approvals. In the circumstances, we believe that the amounts recoverable on this contract, stated at USD 6,894 thousand, should be stated at the lower of cost and net realizable value. Management has not made an estimate of the net realizable value of such asset. The effects of this departure from International Financial Reporting Standards, if any, on amounts recoverable on contracts, loss before tax, taxation and retained earnings as at and for the year ended 31 December 2005 have not been determined.

There are indications that the recoverable amount of property, plant and equipment and intangible assets might be lower than their carrying amounts stated at USD 237,348 thousand and USD 27,670 thousand, respectively. International Financial Reporting Standard IAS 36 *Impairment of Assets* requires that where such indications exist, management makes a formal estimate of the recoverable amount. No such estimate has been made. The effects of this departure from International Financial Reporting Standards, if any, on the carrying amounts of property, plant, equipment and intangible assets, loss before tax, taxation and retained earnings as at and for the year ended 31 December 2005 have not been determined.

As described in note 33(a), the Group has not recorded a provision for projected losses on a construction contract. Management is in the process of negotiating an increase in the price of this contract in respect of which losses of USD 7,480 thousand are currently projected; management believes that a price increase will be agreed such that losses on this contract will not be incurred. Provision for foreseeable losses on individual contracts is required by International Accounting Standard IAS 11 *Construction Contracts*. Had such losses been provided for, provision for onerous contracts would have increased by USD 7,011 thousand (31 December 2004: USD 3,091 thousand), deferred expenses would have decreased by USD 469 thousand (31 December 2004: USD 2,855 thousand), loss before tax would have increased by USD 1,534 thousand (31 December 2004: USD 5,946 thousand), taxation benefit would have increased by USD 368 thousand (31 December 2004: USD 1,427 thousand) and retained earnings would have decreased by USD 5,685 thousand (31 December 2004: USD 4,519 thousand).

As described in note 22, at 31 December 2005 the Group had breached certain covenants in several of its loan agreements; as a consequence, the loans are payable on demand. The Group has not classified such loans as current liabilities as required by International Financial Reporting Standards IAS 1 *Presentation of Financial Statements*. Had such loans been classified as current liabilities, current liabilities would have increased by

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USD 88,314 (31 December 2004: USD 56,408) with a corresponding decrease in non-current liabilities.

The Group has not disclosed the name of its ultimate controlling party as at 31 December 2005 and 31 December 2004, which is required by International Financial Reporting Standard IAS 24 *Related Party Disclosures.*

In our opinion, except for (a) any effects of the matters described in paragraphs three and four above, (b) the effects of the matters described in paragraphs five and six above and (c) the omission of the information described in the preceding paragraph, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2005, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

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25 June 2006

Consolidated income statement

In thousands of US dollars	Note	2005	2004 (Restated)
Revenues	5	667,173	661,967
Cost of sales		(504,803)	(476,970)
Gross profit		162,370	184,997
Distribution expenses		(73,934)	(47,608)
Administrative expenses	6	(96,675)	(93,254)
Other operating income	7	7,760	14,169
Other operating expenses	7	(6,084)	(3,689)
Profit from operations		(6,563)	54,615
Financial income	9	6,711	14,090
Financial expenses	9	(46,975)	(44,811)
Income from associates		9	29
(Loss)/profit before tax		(46,818)	23,923
Income tax benefit/(expense)	10	6,295	(13,709)
Net (loss)/profit for the year		(40,523)	10,214
Attributable to:			
Shareholders of the Company		(40,526)	10,015
Minority interest		3	199
		(40,523)	10,214
Basic (loss)/earnings per share	28	(0.0062) USD	0.0017 USD
Diluted (loss)/earnings per share	28	(0.0062) USD	0.0014 USD

The consolidated financial statements were approved on 25 June 2006 and signed by:

I.P. Klochko
Chief Executive Officer

T.A. Borodina
Chief Accountant

The consolidated income statement is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 9 to 39.

Consolidated balance sheet

In thousands of US dollars	Note	2005	2004 (Restated)
Assets			
Property, plant and equipment	12	237,348	250,061
Intangible assets	13	27,670	27,201
Investments in associates	14	4,114	5,991
Other investments	15	4,333	6,842
Notes receivable available-for-sale		-	75,073
Other non-current receivables	16	26,821	26,771
Total non-current assets		300,286	391,939
Inventories	17	91,557	87,495
Income tax receivable		68	33
Trade receivables	18	119,396	124,358
Other receivables	19	167,009	174,295
Notes receivable available-for-sale		-	14,810
Other investments	15	3,071	2,173
Cash and cash equivalents	20	34,483	12,933
Total current assets		415,584	416,097
Total assets		715,870	808,036
Equity	21		
Ordinary shares		10,563	8,382
Preference shares		-	2,181
Additional paid-in capital		125,280	125,280
Foreign currency translation reserve		25,893	36,493
Retained earnings		102,455	142,981
Total equity attributable to shareholders of the Company		264,191	315,317
Minority interest		985	1,415
Total equity		265,176	316,732
Liabilities			
Loans and borrowings	22	119,145	133,033
Deferred tax liabilities	24	7,239	35,750
Other non-current liabilities	27	33,252	33,239
Total non-current liabilities		159,636	202,022
Loans and borrowings	22	117,206	104,163
Income tax payable		3,260	22,981
Trade and other payables	25	155,907	157,319
Provisions	26	14,685	4,819
Total current liabilities		291,058	289,282
Total liabilities		450,694	491,304
Total equity and liabilities		715,870	808,036

The consolidated balance sheet is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 9 to 39.

Consolidated statement of cash flows

In thousands of US dollars	2005	2004 (Restated)
Operating activities		
Net (loss)/profit for the year	(40,523)	10,214
Adjustments for:		
Depreciation and amortisation	31,584	25,247
Loss/(gain) on disposal of property plant and equipment	1,859	(5,717)
Loss on disposal of intangible assets	909	26
Gain on disposal of investments	(2,192)	(516)
Loss/(gain) on disposal of subsidiaries	1,555	(2,826)
Impairment of investments available for sale	2,277	11,275
Income from associates	(9)	(29)
Interest income	(6,711)	(9,971)
Interest expense	27,931	26,845
Income tax benefit/(expense)	(6,295)	13,709
Unrealised foreign exchange gains/(losses)	587	(6,643)
Operating profit before changes in working capital and provisions	10,972	61,614
(Increase)/decrease in inventories	(7,332)	33,427
Decrease/(increase) in trade and other receivables	61,746	(56,916)
(Decrease)/increase in trade and other payables	(45,150)	(45,554)
Cash flows from/(utilised by) operations before income taxes and interest paid	20,236	(7,429)
Interest paid	(27,173)	(26,719)
Income tax paid	(40,654)	(3,641)
Cash flows utilised by operating activities	(47,591)	(37,789)
Investing activities		
Proceeds from disposal of property, plant and equipment	2,473	8,329
Interest received	6,711	9,971
Acquisition of property, plant and equipment and intangible assets	(34,944)	(49,655)
Acquisition of investments in associates	-	(10,368)
Disposal of subsidiaries, net of cash disposed of	(83)	-
Sales of investments in associates	-	15,240
Proceeds from disposal of notes available for sale	88,175	-
Loans to third and related parties	1,012	829
Acquisition of other investments	1,946	13,440
Cash flows from/(utilised by) investing activities	65,290	(12,214)
Financing activities		
Proceeds from borrowings	487,894	524,745
Repayments of borrowings	(483,932)	(529,754)
Sale of treasury shares	-	28
Cash flows from/(utilised by) financing activities	3,962	(4,981)
Net increase/(decrease) in cash and cash equivalents	21,661	(54,984)
Cash and cash equivalents at the beginning of year	12,933	65,973
Effect of exchange rate fluctuations	(111)	1,944
Cash and cash equivalents at the end of year	34,483	12,933

The consolidated statement of cash flows is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 9 to 39.

Consolidated statement of changes in equity

In thousands of US dollars	Attributable to shareholders of the Company							Minority interest	Total equity
	Ordinary shares	Preference shares	Additional paid-in capital	Treasury shares	Translation reserve	Retained earnings	Total		
Balance at 1 January 2004	7,789	2,181	125,873	(27)	18,132	132,966	286,914	1,284	288,198
Net profit	-	-	-	-	-	10,015	10,015	199	10,214
Currency translation differences	-	-	-	-	18,361	-	18,361	(68)	18,293
Total recognised income and expenses							28,376	131	28,507
Shares issued	593	-	(593)	-	-	-	-	-	-
Sale of treasury shares	-	-	-	27	-	-	27	-	27
Balance at 31 December 2004	8,382	2,181	125,280	-	36,493	142,981	315,317	1,415	316,732
Net loss	-	-	-	-	-	(40,526)	(40,526)	3	(40,523)
Currency translation differences	-	-	-	-	(10,600)	-	(10,600)	(49)	(10,649)
Total recognised income and expenses							(51,126)	(46)	(51,172)
Conversion of preference shares	2,181	(2,181)	-	-	-	-	-	-	-
Disposal of subsidiary	-	-	-	-	-	-	-	(384)	(384)
Balance at 31 December 2005	10,563	-	125,280	-	25,893	102,455	264,191	985	265,176

The consolidated statement of changes in equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 9 to 39.

Notes to the consolidated financial statements

1. Background

(a) Organisation and operations

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

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

(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 consolidated 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

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

(b) Basis of measurement

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

(c) Functional and presentation currency

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

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

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

(d) Use of estimates

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

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

- Note 3(r)(ii) – accounting for construction contracts
- Note 17 – provision for obsolete inventory.
- Note 26 – provision for warranties and onerous contracts
- Note 33(a) – contingencies related to construction contracts

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 except for the changes in accounting policy described in note 3(v) .

(a) Subsidiaries

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

(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 accounted 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 its interest in the associate, that interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associate.

(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 currencies

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

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

(e) Property, plant and equipment

(i) Owned assets

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

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

(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 3 (k)).

(iii) Subsequent expenditure

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

(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.

The estimated useful lives are as follows:

■ buildings	50-90 years
■ machinery and equipment	15-30 years
■ transportation equipment	5-18 years
■ other property and equipment	4-28 years

(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 and which have finite useful lives, are stated at cost less accumulated amortisation (refer below) and impairment losses (refer accounting policy 3 (k)). Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

(iii) ***Amortisation***

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

The estimated useful lives are as follows:

- development costs — 7 years
- other intangible assets — 2-10 years

(g) Investments

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

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

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

The fair value of investments available-for-sale is their quoted bid price at the balance sheet date. Investments in equity securities that are not quoted on a stock exchange, and where fair value cannot be estimated on a reasonable basis by other means, are stated at cost less impairment losses.

(h) Trade and other receivables

Trade and other receivables are stated at amortised cost less impairment losses (refer accounting policy 3 (k)) except for receivables available for sale that are stated at fair value.

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

Amqunts recoverable on contracts are stated at cost plus profit recognized to date (see accounting policy 3(r)) less a provision for foreseeable losses and less progress billings. Cost includes all expenditure related directly to specific projects and an allocation of fixed and variable overheads incurred in the Group's contract activities based on normal operating capacity.

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

(j) Cash and cash equivalents

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

(k) Impairment

The carrying amounts of the Group's assets, other than inventories (refer accounting policy 3 (i)) and deferred tax assets (refer accounting policy 3 (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 held-to-maturity investments and receivables is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. Receivables with a short duration are not discounted.

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

(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.

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.

(l) Share capital

(i) Preference share capital

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

(ii) Repurchase of share capital (treasury shares)

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

(iii) 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 makes contributions for the benefit of employees to Russia's State Pension Fund. These contributions 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 grants are recognised in the balance sheet initially as deferred income when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as revenue in the income statement on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are recognised in the income statement as other operating income on a systematic basis over the useful life of the asset.

(r) Revenue

(i) Goods sold and services rendered

Revenue from sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Revenue from services rendered is recognised in the income statement in proportion to the stage of completion of the transaction to the balance sheet date. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due, associated costs or the possible return of goods also continuing management involvement with the goods.

(ii) Construction contracts

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

(iii) Rental income

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

(s) Expenses

(i) Agents' fees

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

(ii) 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.

(iii) Social costs

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

(iv) Financial income and expenses

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

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

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

(t) Income tax

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

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

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

(u) Segment reporting

The Group manufactures energy generating equipment, buys energy generating equipment from subcontractors and sells both types of energy generating equipment to final customers or intermediaries under the same contracts within the framework of turn-key projects. The revenues, results and assets attributable to these activities, which have similar risks and returns, comprise substantially all of the

Group's revenues, results and assets. Therefore no separate information in respect of business segments is presented.

The Group's manufacturing operations are all based in Russia and, accordingly, no geographical segment information is presented.

(v) Changes in accounting policy

During the current year, the Group changed a number of its accounting policies as a result of new or revised Standards that are effective for periods beginning on or after 1 January 2005.

The following changes in presentation result from revised IAS 1 *Presentation of Financial Statements*:

- In the income statement, the minority interests share in the results of subsidiaries is no longer added or subtracted in arriving at the Group's net profit/(loss) for the period. Instead it is presented as an allocation of the Group's net profit/(loss) for the period.
- In the balance sheet, minority interests are presented as a separate component of equity rather than being presented between equity and liabilities. As a result, the statement of changes in equity shows the movement in minority interests during the period.

Comparatives were restated to reflect these changes.

(w) Changes in classification

During the current year, the Group modified the classification of certain balance sheet and income statement items. Comparatives were reclassified for consistency which resulted in the following reclassifications of comparative information:

- A portion of deferred expenses amounting to USD 825 thousand was reclassified to intangible assets. Such reclassification better reflects the nature of these balances.
- A portion of advances from customers amounting to USD 61,591 thousand was reclassified to progress billings on long-term contracts. Previously, the advances were recorded in liabilities as the contracts under which the advances were received were thought not to be long-term contracts.
- Movements in provisions for inventories and onerous contracts were reclassified from other operating income and expenses into cost of sales. Such reclassification better reflects the nature of these expenses.

(x) New Standards and Interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are not yet effective and have not been applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group's operations. The Group plans to adopt these pronouncements when they become effective.

IFRS 7 *Financial Instruments: Disclosures*, which is effective for annual periods beginning on or after 1 January 2007. The Standard will require increased disclosure in respect of the Group's financial instruments.

Amendment to IAS 1 *Presentation of Financial Statements – Capital Disclosures*, which is effective for annual periods beginning on or after 1 January 2007. The Standard will require increased disclosure in respect of the Company's capital.

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – The Fair Value Option*, which is effective for annual periods beginning on or after 1 January 2006. The amendment restricts the designation of financial instruments as "at fair value through profit or loss".

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 4 *Insurance Contracts – Financial Guarantee Contracts*, which is effective for annual periods beginning on or after 1

January 2006. The amendment requires guarantees that are not insurance contracts to be measured at fair value upon initial recognition.

IFRIC 4 *Determining whether an Arrangement contains a Lease*, which is effective for annual periods beginning on or after 1 January 2006. The Interpretation requires certain arrangements to be accounted for as a lease even if they are not in the legal form of a lease.

4. Formation and disposal of subsidiaries

In May 2005, the Group disposed of its investment in Energomachimpex. This subsidiary contributed USD 1,877 thousand to the net loss for the year, including a loss on disposal of USD 1,555 thousand.

The disposal of the subsidiary had the following effect on the Group's assets and liabilities at the date of disposal:

In thousands of US dollars	**Carrying amount at date of disposal**
Non-current assets	
Property, plant and equipment	9
Intangible assets	2
Current assets	
Investments	96
Inventories	571
Trade and other receivables	3,018
Cash and cash equivalents	181
Current liabilities	
Trade and other payables	1,924
Net identifiable assets and liabilities	1,953
Minority interest	390
Net identifiable assets and liabilities disposed	1,563
Consideration received	98
Cash disposed of	(181)
Net cash outflow	(83)

During the year ended 31 December 2005, one of the Group's subsidiaries, ZAO LMZ Invest, ceased trading and the Group established a new subsidiary, Power Machines de Mexico, to service contacts in Mexico.

5. Revenues

In thousands of US dollars	**2005**	**2004**
Energy generating and other equipment	642,606	625,630
Sales of spare parts	24,567	36,337
	667,173	661,967

6. Administrative expenses

In thousands of US dollars	2005	2004
Wages, salaries and related taxes	46,767	46,684
Depreciation	7,659	6,232
Insurance	5,314	5,455
Taxes other than income tax	5,016	4,451
Social costs	4,584	4,077
Amortisation of intangibles	4,340	255
Bank charges	2,480	3,928
Materials	1,829	1,763
Consulting	1,527	2,640
Travel expenses	1,479	2,699
Penalties	44	913
Other administrative expenses	15,636	14,157
	96,675	93,254

7. Other operating income and expenses

In thousands of US dollars	2005	2004 (Restated)
Other operating income		
Gain on disposal of investments	2,192	516
Gain on disposal of other assets	1,727	2,248
Amortisation of government grants	946	-
Decrease in accounts receivable provision	556	2,862
Gain on disposal of property, plant and equipment	-	5,717
Gain on disposal of subsidiary	-	2,826
Other operating income	2,339	-
	7,760	14,169
Other operating expenses		
Loss on disposal of property, plant and equipment	1,859	-
Increase in provision for warranty expenses	1,761	2,564
Loss on disposal of subsidiary	1,555	-
Loss on disposal of intangible assets	909	26
Other operating expenses	-	1,099
	6,084	3,689

8. Personnel expenses

In thousands of US dollars	2005	2004
Wages, salaries and related taxes included in:		
cost of sales	72,674	60,059
distribution costs	7,605	7,141
administrative expenses	46,767	46,684
	127,046	113,884

The average number of employees during the year ended 31 December 2005 was 13,840 (year ended 31 December 2004: 13,828).

9. Financial income and expenses

In thousands of US dollars	2005	2004
Financial income		
Interest income	6,711	9,971
Foreign exchange gain	-	4,119
	6,711	14,090
Financial expenses		
Interest expense	27,931	26,845
Bank guarantee expenses	9,028	6,691
Loss on disposal of notes receivable	7,266	-
Impairment loss on investments available for sale	2,277	11,275
Foreign exchange loss	473	-
	46,975	44,811

10. Income tax expense

In thousands of US dollars	2005	2004
Current tax expense		
Current year	10,339	24,661
Under-provided in prior years	11,656	2,139
	21,995	26,800
Deferred tax expense		
Origination and reversal of temporary differences	(16,634)	(13,091)
Over-provided in prior years	(11,656)	-
	(28,290)	(13,091)
	(6,295)	13,709

The Group's applicable tax rate is the corporate income tax rate of 24% (2004: 24%)

Reconciliation of effective tax rate

In thousands of US dollars	2005		2004	
(Loss)/profit before tax	(46,818)		23,923	
Income tax using corporate tax rate	(11,236)	24%	5,742	24%
Non-deductible expenses	5,083	(11%)	7,249	30%
Non-taxable income	(142)	0%	-	-
Effect of tax losses utilized	-	-	(1,421)	(6%)
Under-provided in prior years	-	-	2,139	9%
	(6,295)	13%	13,709	57%

During 2005, the Group reassessed the way it accounted for long-term contracts for tax purposes. This resulted in USD 11,656 thousand being transferred from deferred to current tax in the current year.

11. Construction contracts

The revenues and gross margin recognized on construction contracts during the year amounted to:

In thousands of US dollars	2005	2004
Contract revenues	466,967	385,524
Contract costs	(344,407)	(263,864)
(Increase)/decrease in provision for onerous contracts	(17,035)	610
Gross profit	105,525	122,270

12. Property, plant and equipment

In thousands of US dollars	Land and buildings	Machinery and equipment	Transportation equipment	Other	Assets under construction	Total
Cost/deemed cost						
At 1 January 2004	330,271	680,805	15,081	30,719	10,132	1,067,008
Additions	1,340	27,233	849	4,225	10,366	44,013
Transfers	1,976	3,777	134	760	(6,647)	-
Disposals	(1,099)	(3,225)	(1,146)	(596)	(1,398)	(7,464)
Translation adjustments	20,389	42,920	920	2,058	712	66,999
At 31 December 2004	352,877	751,510	15,838	37,166	13,165	1,170,556
Additions	2,297	7,098	943	3,496	13,712	27,546
Transfers	533	4,424	236	1 344	(6,537)	-
Disposals	(3,864)	(16,694)	(820)	(1,650)	(1,415)	(24,443)
Translation adjustments	(12,736)	(26,902)	(503)	(1,418)	(865)	(42,424)
At 31 December 2005	339,107	719,436	15,694	38,938	18,060	1,131,235
Depreciation and impairment losses						
At 1 January 2004	(264,578)	(555,507)	(12,109)	(16,566)	-	(848,760)
Charge for the year	(1,868)	(16,986)	(1,024)	(3,810)	-	(23,688)
Disposals	923	2,217	991	721	-	4,852
Translation adjustments	(16,301)	(34,716)	(745)	(1,137)	-	(52,899)
At 31 December 2004	(281,824)	(604,992)	(12,887)	(20,792)	-	(920,495)
Charge for the year	(2,043)	(19,471)	(983)	(4,043)	-	(26,540)
Disposals	3,297	15,425	800	589	-	20,111
Translation adjustments	10,086	21,727	485	739	-	33,037
At 31 December 2005	(270,484)	(587,311)	(12,585)	(23,507)	-	(893,887)
Net book value						
At 1 January 2004	65,693	125,298	2,972	14,153	10,132	218,248
At 31 December 2004	71,053	146,518	2,951	16,374	13,165	250,061
At 31 December 2005	68,623	132,125	3,109	15,431	18,060	237,348

Leased machinery

The Group leases production equipment under a number of finance lease agreements. As at 31 December 2005 the net book value of leased machinery and equipment was USD 8,286 thousand (31 December 2004: USD 12,095 thousand).

13. Intangible assets

In thousands of US dollars	Development projects Completed	Development projects In process	Other intangible assets	Total
Cost				
At 1 January 2004	648	11,188	4,332	16,168
Additions	1,614	8,860	1,183	11,657
Transfers	162	(326)	164	-
Transfer from deferred expenses	-	-	583	583
Disposals	(149)	-	(164)	(313)
Translation adjustments	102	1,016	310	1,428
At 31 December 2004	2,377	20,738	6,408	29,523
Additions	4,403	1,257	1,738	7,398
Transfers	14,907	(14,988)	81	-
Disposals	(32)	(528)	(703)	(1,263)
Translation adjustments	(87)	(744)	(230)	(1,061)
At 31 December 2005	21,568	5,735	7,294	34,597
Amortisation				
At 1 January 2004	(92)	-	(1,081)	(1,173)
Amortisation for the year	(969)	-	(590)	(1,559)
Transfer from deferred expenses	-	-	242	242
Disposals	136	-	151	287
Translation adjustments	(37)	-	(82)	(119)
At 31 December 2004	(962)	-	(1,360)	(2,322)
Amortisation for the year	(2,646)	-	(2,398)	(5,044)
Disposals	13	-	341	354
Translation adjustments	34	-	51	85
At 31 December 2005	(3,561)	-	(3,366)	(6,927)
Net book value				
At 1 January 2004	556	11,188	3,251	14,995
At 31 December 2004	1,415	20,738	5,048	27,201
At 31 December 2005	18,007	5,735	3,928	27,670

14. Investments in associates

The Group has the following investments in associates:

	Country of incorporation	Ownership 31 December 2005	Ownership 31 December 2004	Voting interest 31 December 2005	Voting interest 31 December 2004
ZAO Interplast	Russia	50%	50%	50%	50%
NPO CKTI	Russia	35%	35%	35%	35%

In thousands of US dollars	**2005**	**2004**
ZAO Interplast	84	88
NPO CKTI	4,030	5,903
	4,114	5,991

15. Other investments

In thousands of US dollars	**2005**	**2004**
Non-current investments		
Available-for-sale investments	4,326	6,812
Debt securities held to maturity	-	23
Loans	7	7
	4,333	6,842
Current investments		
Debt securities held to maturity	2,962	808
Available-for-sale investments	-	220
Loans	109	1,145
	3,071	2,173

Available-for-sale investments, stated at cost, comprise unquoted equity securities in the banking industry. There is no market for these investments and there have not been any recent transactions that provide evidence of fair value. In addition, discounted cash flow techniques yield a wide range of fair values due to the uncertainty of future cash flows in this industry. However, management performed a review of the recoverable amount of these investments and believes it unlikely that the fair value would differ significantly from the carrying amount.

16. Other non-current receivables

In thousands of US dollars	**2005**	**2004**
Trade accounts receivable	26,580	26,055
Notes receivable	241	716
	26,821	26,771

At 31 December 2005 trade accounts receivable included contractual retention amounts billed to customers amounting to USD 11,518 thousand (31 December 2004: USD 11,649 thousand).

17. Inventories

In thousands of US dollars	2005	2004
Raw materials and consumables	42,888	44,203
Work in progress	30,010	35,478
Finished goods and goods for resale	27,587	25,176
Supplies	6,407	4,914
Other inventories	777	571
	107,669	110,342
Provision for obsolete inventory	(16,112)	(22,847)
	91,557	87,495

During the year ended 31 December 2005, the Group reduced the provision for slow-moving inventories by USD 8,388 thousand. The reduction resulted, in part, from the availability of better information about the ageing of inventories from the Group's new inventory management system.

18. Trade receivables

In thousands of US dollars	2005	2004 (Restated)
Trade accounts receivable	108,048	77,031
Notes receivable	287	603
	108,335	77,634
Less provision for doubtful debts	(1,022)	(2,608)
	107,313	75,026
Costs and profit recognised to date less progress billings	284,515	246,443
Advance payments received	(272,432)	(197,111)
	12,083	49,332
	119,396	124,358

At 31 December 2005 trade accounts receivable included contractual retention amounts billed to customers amounting to USD 915 thousand (31 December 2004: USD 744 thousand).

19. Other receivables

In thousands of US dollars	2005	2004 (Restated)
Prepayments	65,197	75,651
VAT receivable	53,632	43,302
Deferred expenses	38,406	36,645
Restricted cash	1,218	2,386
Receivables from employees	1,486	812
Other receivables	7,070	15,499
	167,009	174,295

20. Cash and cash equivalents

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

In thousands of US dollars	2005	2004
Rouble bank deposits	10,364	263
Foreign currency bank accounts	8,984	6,263
Rouble bank accounts	7,487	5,604
Foreign currency bank deposits	7,040	-
Other rouble denominated cash equivalents	608	803
	34,483	12,933

21. Equity

(a) *Share capital*

Number of shares	Ordinary shares		Non-redeemable preference shares	
	2005	2004	2005	2004
On issue at beginning of year	6,170,912,708	5,362,500,000	1,046,026,000	1,050,000,000
Issuance	-	811,462,708	-	-
Repurchased	-	(3,050,000)	-	(3,974,000)
Conversion	1,046,026,000	-	(1,046,026,000)	-
On issue at end of year	7,216,938,708	6,170,912,708	-	1,046,026,000

As at the balance sheet date, the authorised share capital comprised 9,359,450,000 ordinary shares (31 December 2004: 9,359,450,000) of which 7,216,938,708 ordinary shares (31 December 2004: 6,170,912,708 ordinary shares and 1,046,026,000 preference shares) were issued and fully paid. All shares have a par value of RUR 0.01 (31 December 2004: RUR 0.01). Preference shareholders participate in the Company's residual assets only to the extent of 110% of the nominal value of the preference shares. In August 2005, 1,046,026,000 preference shares were converted into 1,046,026,000 ordinary shares.

(b) *Additional paid-in capital*

Contributions to additional paid-in capital arose in connection with the formation of the Group in 2002 and 2003 and principally represent the excess of fair value of the companies acquired by the Group from entities under common control over the price paid.

(c) *Foreign currency translation reserve*

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

(d) *Dividends*

Dividends payable are limited to the retained earnings of the Company as determined in accordance with the legislation of the Russian Federation. As at the balance sheet date, reserves available for distribution in accordance with Russian legislation amounted to USD 182,224 thousand.

As disclosed in note 22, certain of the Group's loan agreements currently prevent the Company from paying dividends.

(e) Voting rights of shareholders

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

22. Loans and borrowings

In thousands of US dollars	2005	2004
Non-current		
Secured bank loans	73,566	89,021
Unsecured bank facility	35,000	30,004
Unsecured loans with other companies	2,818	1,740
Secured loan From the Ministry of Finance	7,279	10,029
Finance lease liability	482	2,239
	119,145	133,033
Current		
Current portion of secured bank loans	79,033	79,270
Unsecured bank facility	35,034	19,951
Current portion secured loan from the Ministry of Finance	989	731
Current portion of finance lease liability	2,150	4,211
	117,206	104,163

Finance lease liabilities are payable as follows:

In thousands of US dollars

	2005			2004		
	Payments	Interest	Principal	Payments	Interest	Principal
Less than one year	2,481	331	2,150	5,420	1,209	4,211
Between one and five years	522	40	482	2,692	453	2,239
	3,003	371	2,632	8,112	1,662	6,450

During the year ended 31 December 2004, the Group obtained a loan from the European Bank for Reconstruction and Development ("EBRD"). The outstanding balance as at the balance sheet date is USD 58,362 thousand. Covenants in the loan agreement require the Group to maintain certain financial ratios, limit capital expenditure, and restrict the amount of outstanding payables related to the acquisition of fixed assets. The Group may not undertake mergers, acquisitions, reorganizations and consolidations without the prior written consent of EBRD. As at 31 December 2005, the Group had not complied with three of the financial ratios required by the covenants.

During the year ended 31 December 2004, the Group obtained a loan from HSBC. The outstanding balance as at the balance sheet date is USD 15,000 thousand. Covenants in the loan agreement require the Group to maintain certain financial ratios; the covenants also restrict the Group from obtaining a new secured loan which requires pledges in an amount exceeding the level of pledged assets as at the date of obtaining the loan from HSBC. The covenants in the loan agreement restrict the Group from making dividend payments during the period of the loan. As at 31 December 2005, the Group had not complied with three of the financial ratios required by the covenants.

During the year ended 31 December 2005, the Group obtained a loan from Donau-Bank AG. The outstanding balance as at the balance sheet date is USD 35,000 thousand. Covenants in the loan agreement require the Group to maintain certain financial ratios. As at 31 December 2005, the Group had not complied with two of the financial ratios required by the covenants.

Management believes that there is a low probability that the banks will demand early repayment of the loans solely because of the breach of covenants. Nevertheless, management plans to negotiate with the banks amendments to existing agreements. The loans have been classified either as current or non-current based on repayment terms in the loan agreements.

23. Pledges provided by the Group

The following assets have been pledged to secure Group borrowings:

In thousands of US dollars	**2005**	**2004**
Property, plant and equipment	42,209	41,325
Inventories and costs and profits recognized to date in excess of progress billings	147,128	113,023
Notes receivable, non-current and available for sale	-	43,569
Cash and cash equivalents	3,486	2,865
Revenue from planned supply of equipment in the future	59,024	59,708
	251,847	260,490

Assets pledged to secure borrowings are as follows:

In thousands of US dollars	**2005**	**2004**
Current loans and borrowings		
Pledges in connection with Group borrowings	124,152	84,960
Pledges in connection with subcontractors' borrowings	6,385	-
Non-current loans and borrowings		
Pledges in connection with Group borrowings	121,310	168,907
Pledges in connection with subcontractors' borrowings	-	6,623
	251,847	260,490

24. Deferred tax liabilities

Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets			Liabilities			Net		
In thousands of US dollars	31 Dec 2005	31 Dec 2004	31 Dec 2003	31 Dec 2005	31 Dec 2004	31 Dec 2003	31 Dec 2005	31 Dec 2004	31 Dec 2003
Cash and cash equivalents	(257)	(16)	(311)	-	-	-	(257)	(16)	(311)
Property, plant and equipment	-	-		22,025	24,039	23.239	22,025	24,039	23.239
Intangible assets	-	-		2,917	2.682	1,373	2,917	2.682	1,373
Other investments	(3,556)	(3,326)	(893)	-	-	1,316	(3,556)	(3,326)	423
Inventories	(5,715)	(28,706)	(17,000)	-	-	11.650	(5,715)	(28,706)	(5.350)
Trade and other accounts receivable	-	-	(10,235)	317	41,515	37.076	317	41,515	26.841
Trade and other accounts payable	(5,806)	-	(3,632)	-	852	4,850	(5,806)	852	1,218
Provisions	(2,926)						(2,926)		
Loans and borrowings	-	(1,290)	(1,986)	240	-	471	240	(1,290)	(1,515)
Tax (assets)/liabilities	(18,260)	(33,338)	(34,057)	25,499	69,088	79,975	7,239	35,750	45,918

During the year USD (28,290) thousand (2004: USD (13,091) thousand) of the movement in the deferred tax liability was recognized in the income statement, and USD (221) thousand (2004: USD 2,923 thousand) relating to foreign exchange differences was recognized in equity.

25. Trade and other payables

In thousands of US dollars	2005	2004 (Restated)
Advances from customers	41,968	46,128
Trade accounts payable	83,981	72,084
Other taxes payable	9,262	15,032
Employees-related liabilities	11,216	11,826
Deferred income	65	125
Interest payable	1,310	586
Accrued liabilities	266	183
Other current liabilities	7,839	11,355
	155,907	157,319

26. Provisions

In thousands of US dollars	Provision for warranties	Provision for onerous contracts	Total
Balance at 1 January 2005	4,252	567	4,819
Provisions made during the year	1,761	17,035	18,796
Provisions used during the year	(3,399)	(5,182)	(8,581)
Translation differences	(124)	(225)	(349)
Balance at 31 December 2005	2 490	12,195	14,685

Provision for warranties
The Group gives warranties on certain products and undertakes to repair or replace items that fail to perform satisfactorily. A provision of USD 2,490 thousand has been recognized at 31 December 2005 (31 December 2004: USD 4,252 thousand) for expected warranty claims based on past experience of the level of repairs and returns.

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

27. Other non-current liabilities

In thousands of US dollars	**2005**	**2004**
Trade accounts payable	20,285	22,436
Government grant	12,967	10,803
	33,252	33,239

The Group was awarded a government grant of USD 13,913 thousand for the development of technology to produce gas-steam turbines. As at the balance sheet date, the Group had received a grant of USD 13,913 thousand of which USD 946 thousand was recognized in the income and the balance as deferred income in other non-current liabilities. The amount of deferred income is amortised over the same period as the related development costs are amortised.

28. (Loss)/earnings per share

(a) Basic (loss)/earnings per share
Basic (loss)/earnings per share is calculated by dividing the (loss)/profit attributable to the shareholders of the Company by the weighted average number of ordinary shares outstanding during the year. The following is a reconciliation of the weighted average number of ordinary shares:

In number of shares	**2005**	**2004**
Ordinary shares in issue at 1 January	6,170,912,708	5,362,500,000
Effect of ordinary shares issued in January 2004	-	811,462,708
Effect of ordinary shares repurchased in January 2004	-	(3,050,000)
Effect of conversion of preference shares in August 2005	348,675,333	-
Weighted average number of ordinary shares for the year	6,519,588,041	6,170,912,708

(b) Diluted (loss)/earnings per share
Diluted (loss)/earnings per share is calculated by dividing the (loss)/profit attributable to the shareholders of the Company by the weighted average number of ordinary and convertible preference shares outstanding during the year. The following is a reconciliation of the weighted average number of ordinary shares (diluted):

In number of shares	**2005**	**2004**
Weighted average number of ordinary shares for the year'	6,519,588,041	6,170,912,708
Dilutive effect of preference shares in issue	697,350,667	1,046,026,000
Weighted average number of ordinary and preference shares for the year	7,216,938,708	7,216,938,708

29. 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.

(a) *Credit risk*

Financial instruments that potentially subject the Group to significant credit risk consist primarily of accounts receivable. Credit evaluations are performed for all banks in which the Group holds deposits, and all customers requiring credit over a certain amount. The Group's policy is to obtain collateral in respect of financial assets in 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.

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

(b) *Interest rate risk*

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

The following table shows the period in which interest-bearing financial liabilities reprice.

2005 '000 USD	Average interest rate Contract	Effective	0-6 mths	6-12 mths	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	Over 5 yrs	Total
Liabilities										
Secured bank loans:										
RUR*	9,4%	9,56%	(2)	(35,790)	-	-	-	-	-	(35,792)
EUR*	7,9%	7,83%	(944)	(10,428)	(1,329)	(1,215)	(1,102)	-	-	(15,018)
USD	LIBOR+ 2,95% to 4,5%	6,95%	(101,790)	-	-	-	-	-	-	(101,790)
Secured Loan from Ministry of Finance										
USD*	3,0%	9,89%	-	(989)	(1,168)	(1,328)	(1,473)	(1,601)	(1,709)	(8,268)
Unsecured bank loans:										
USD	LIBOR+ 2,5% to 3,75%	7,10%	(70,034)	-	-	-	-	-	-	(70,034)
Unsecured loans with other companies										
RUR*	0,0%	13,00%	-	-	(1,656)	-	(1,161)	-	-	(2,817)
Finance lease liabilities – RUR*	28,9%	28,93%	-	(2,150)	(482)	-	-	-	-	(2,632)
			(172,770)	(49,357)	(4,635)	(2,543)	(3,736)	(1,601)	(1,709)	(236,351)

*Fixed rate debt does not reprice until contractual maturity

*Fixed rate debt does not reprice until contractual maturity

2004 '000 USD	Average interest rate Contract	Effective	0-6 mths	6-12 mths	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	Over 5 yrs	Total
Assets										
Notes receivable available-for-sale										
USD*	8,5%	5,3%	7,405	7,136	13,379	12,054	10,830	9,967	29,112	89,883
Liabilities										
Secured bank loans:										
RUR*	10,5%	10,50%	(1,025)	(39,279)	(18,469)	-	-	-	-	(58,773)
USD*	11,0%	11,00%	(132)	(135)	-	-	-	-	-	(267)
EUR*	7,1%	7,13%	(1,084)	(1,042)	(2,127)	(1,525)	(1,394)	(1,264)	-	(8,436)
USD	LIBOR+ 2,5% to 6,2%	6,47%	(100,333)	-	-	-	-	-	-	(100,333)
EUR	EURIBOR+4%	6,10%	(314)	-	-	-	-	-	-	(314)
CHF	LIBOR+ 5,5%	6,26%	(618)	-	-	-	-	-	-	(618)
Unsecured bank loans:										
USD*	8,5%	8,50%	(4,955)	-	-	-	-	-	-	(4,955)
USD	LIBOR+ 3,5%	5,81%	(45,000)	-	-	-	-	-	-	(45,000)
Loan from Ministry of Finance	3,0%	3,00%	(731)	-	(989)	(1,248)	(1,518)	(1,799)	(4,475)	(10,760)
Unsecured loans with other companies										
RUR*	0,0%	14,00%	-	-	(1,085)	-	(655)	-	-	(1,740)
Finance lease liabilities – RUR*	30,3%	30,26%	(4,211)		(2,239)	-	-	-	-	(6,450)
			(150,998)	(33,320)	(11,530)	9,281	7,263	6,904	24,637	(147,763)

The following table shows the contractual maturities of variable rate interest-bearing financial assets and liabilities. For fixed rate interest-bearing financial assets and liabilities the contractual rate is consistent with the repricing shown in the above table.

2005 **'000 USD**	**0-6 mths**	**6-12 mths**	**1-2 yrs**	**2-3 yrs**	**3-4 yrs**	**4-5 yrs**	**Over 5 yrs**	**Total**
Secured bank loans:								
USD	(24,523)	(7,346)	(50,195)	(8,369)	(5,048)	(5,048)	(1,260)	(101,789)
Unsecured bank loans:								
USD	(35,034)	-	(17,501)	(17,500)	-	-	-	(70,035)
	(59,557)	(7,346)	(67,696)	(25,869)	(5,048)	(5,048)	(1,260)	(171,824)

(c) ***Foreign currency risk***

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

(d) ***Fair value***

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

Trade and other receivables and payables. For receivables and payables with a maturity of less than twelve months fair value is not materially different from the carrying amount because the effect of the time value of money is not material. For other receivables and payables, expected future principal and interest cash flows were discounted at rates of between 8.33% and 14.83%.

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

30. Related party transactions

(a) ***Control relationships***

The Company's parent company is Burbot Limited. Burbot Limited does not prepare consolidated financial statements. 1,804,234,678 ordinary shares of the Company owned by Burbot Limited were pledged by Burbot Limited as a security for the EBRD loan to the Group. In addition, the Group has a controlling relationship with all of its subsidiaries (see note 31 for a list of significant subsidiaries).

(b) ***Transactions with management***

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

In thousands of US dollars	**2005**	**2004**
Salaries and bonuses	3,904	3,538
Termination benefits	238	-
	4,142	3,538

(c) ***Transactions with other related parties***

In thousands of US dollars	**2005**	**2004**
Sales of goods		
Entities with significant influence	1,019	-
	1,019	-

In thousands of US dollars	**2005**	**2004**
Services provided		
Entities with significant influence	348	-
Associates	24	1,999
Fellow subsidiaries	-	4,888
	372	6,887

In thousands of US dollars	2005	2004
Trade and other receivables		
Entities with significant influence	1,362	-
Associates	-	212
	1,362	212

In thousands of US dollars	2005	2004
Prepayments given		
Entities with significant influence	651	-
Associates	257	10,611
	908	10,611

In thousands of US dollars	2005	2004
Purchases of goods		
Entities with significant influence	1,354	-
	1,354	-

In thousands of US dollars	2005	2004
Purchases of services		
Associates	596	488
Fellow subsidiaries	11	1,070
	607	1,558

In thousands of US dollars	2005	2004
Trade and other payables		
Entities with significant influence	383	-
Associates	130	42
	513	42

In thousands of US dollars	2005	2004
Prepayments received		
Entities with significant influence	8,037	-
Fellow subsidiaries	-	1,707
	8,037	1,707

In thousands of US dollars	2005	2004
Loans given		
Associates	-	426
	-	426

(d) Financial guarantees provided to related parties

Details of financial guarantees provided to related parties are disclosed in note 33(b).

31. Subsidiary companies

The Company's principal subsidiaries are as follows:

Significant subsidiaries	Country of incorporation	Ownership interest % 2005	Ownership interest % 2004
OOO Reostat	Russia	100.00%	100.00%
ZAO Gazovie Turbini	Russia	100.00%	100.00%
ZAO LMZ Invest (note 4)	Russia	-	100.00%
LMZ Energy Limited	Ireland	100.00%	100.00%
OOO Interturbo	Russia	55.12%	55.12%
OAO SK Selecta	Russia	80.36%	80.36%
Energomachimpex (note 4)	Czech Republic	-	80.00%
EMEC LTDa Columbia	Columbia	99.99%	99.99%
Energomach Handels GMBH	Germany	100.00%	100.00%
Power Machines de Mexico (note 4)	Mexico	99.90%	-

32. Commitments

(a) *Capital commitments*

At 31 December 2005, the Group was committed to capital expenditure (property, plant and equipment) of approximately USD 5,300 thousand (31 December 2004: USD 8,101 thousand).

(b) *Social commitments*

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

33. Contingencies

(a) *Construction contracts*

Management is in the process of negotiating an increase in the price of one of its construction contracts. The customer has agreed, in principle, to negotiate an increase in the price of the contract. Management believes it is probable that the contract price will be increased such that losses on this contract will not be incurred. Accordingly, no provision for such losses has been made at 31 December 2005. If the contract price is not increased, losses of USD 7,480 thousand will be incurred on this contract.

The Group has suspended work on one of its construction contracts because the customer has not been able to obtain certain government approvals required in relation to financing. Revenue for this contract has been recognized using the stage of completion method. Management believes that the work undertaken for this contract can be used on other contracts if the customer is unable to obtain the required approvals. The profit recognized to 31 December 2005 on this contract amounted to USD 3,828 thousand.

The Group has recognized revenue for one of its construction contracts based on a price that includes an incentive payment that, in accordance with the original contract, is required to be withheld by the Ministry of Finance of Russia. Although confirmation has been received from the Ministry of Finance that the incentive payment will not be withheld but paid to the Group, the relevant agreement has not yet been signed. Management believes that the agreement will be signed.

(b) *Financial guarantees*

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

In thousands of US dollars	2005	2004
Maturity in one year or more		
Third party suppliers	698,039	697,727
Maturity in less than one year		
Third party suppliers	8,154	43,339
Associate	-	3,964
	706,193	745,030

During the year ended 31 December 2005, the Group was a co-signatory to a guarantee of USD 682,381 thousand given by a consortium of companies (including the Group) against a loan obtained by CIISA. CIISA is an entity that is constructing a power station in Mexico in which the Group holds a 19% interest and participates in the construction. The Group's exposure under this guarantee is estimated to be the equivalent 19% interest in the project, USD 129,614 thousand.

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

(c) *Insurance*

The insurance industry in the Russian Federation is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have full coverage for its plant facilities, third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group operations.

(d) *Litigation*

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

(e) *Taxation contingencies*

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

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

(f) *Environmental liabilities*

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

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