OJSC Cherkizovo Group

Independent Auditors' Report

Consolidated Financial Statements
Years Ended 31 December 2006 and 2005

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Statement of management's responsibilities for the preparation and approval of the consolidated financial statements

For the years ended 31 December 2006 and 2005

The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on page 3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of OJSC Cherkizovo Group (the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group at 31 December 2006 and 2005 and the results of its operations, cash flows and changes in shareholders' equity and comprehensive income for the years then ended, in compliance with accounting standards generally accepted in the United States of America ("US GAAP").

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

- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and fairly represent the most likely outcome of uncertainties;
- Stating whether US GAAP has been followed, subject to any material departures disclosed and explained in the consolidated financial statements, and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial statement of the Group comply with US GAAP;
- Maintaining statutory accounting records in compliance with local legislation and accounting standards in the respective jurisdictions in which the Group operates;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group, and
- Preventing and detecting fraud and other irregularities.

The Consolidated financial statements for the year ended 31 December 2006 and 2005 were approved on 16 April 2007 by:

Mr. Sergei I. Mikhailov
Chief Executive Officer

Ms. Ludmila I. Mikhailova
Chief Financial Officer

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Independent auditors' report

To the Shareholders of OJSC Cherkizovo Group:

We have audited the accompanying consolidated balance sheets of OJSC Cherkizovo Group and its subsidiaries (hereinafter referred to as "the Group") as of 31 December 2006 and 2005 and the related consolidated statements of income, cash flows and changes in shareholders' equity and comprehensive income (hereinafter referred to as "the Financial Statements") for the years then ended. The Financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on the Financial Statements based on our audits.

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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 of the Financial Statements, the Group did not maintain historical cost records for property, plant and equipment acquired prior to 31 December 2001. On 31 December 2001, the Group established the carrying value of such assets based on the estimated fair values at such date. In our opinion, accounting principles generally accepted in the United States of America require that property, plant and equipment be stated at historical cost. The information needed to quantify the effects of these items on the financial position, results of operations, and cash flows of the Group is not reasonably determinable from the accounts and records.

In our opinion, except for the effects of including property, plant and equipment based on fair values as described in the preceding paragraph, the Financial Statements referred to above present fairly, in all material respects, the consolidated financial position of the Group as of 31 December 2006 and 2005 and the consolidated results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche CIS

16 April 2007

Consolidated balance sheets

As of 31 December 2006 and 2005

	Notes	2006 US$000	2005 US$000
Assets			
Current assets:			
Cash and cash equivalents	3	106 988	5 191
Trade receivables, net of allowance for doubtful accounts of $2 208 and of $3 023 as of 31 December 2006 and 2005, respectively		62 783	31 758
Advances paid, net of allowance for doubtful accounts of $320 and of $735 as of 31 December 2006 and 2005, respectively		17 851	8 505
Inventory	4	89 116	55 783
Short-term loans receivable		2 628	2 743
Deferred tax assets	18	4 672	3 656
Other receivables, net of allowance for doubtful accounts of $208 and of $522 as of 31 December 2006 and 2005, respectively		9 216	4 844
Other current assets	5	27 837	26 296
Total current assets of continuing operations		**321 091**	**138 776**
Current assets of discontinued operations		–	2 231
Total current assets		**321 091**	**141 007**
Non-current assets:			
Property, plant and equipment, net	6	353 505	249 983
Goodwill	7	9 538	8 725
Other intangible assets, net	7	17 993	13 969
Loans to affiliated companies		1 553	8
Deferred tax assets	18	1 927	388
Long-term notes receivable	8	6 904	–
VAT receivable		13 353	8 108
Total long-term assets of continuing operations		**404 773**	**281 181**
Long-term assets of discontinued operations		–	1 624
Total non-current assets		**404 773**	**282 805**
Total assets		**725 864**	**423 812**

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

Consolidated balance sheets continued

As of 31 December 2006 and 2005

	Notes	2006 US$000	2005 US$000
Liabilities and shareholders' equity			
Current liabilities:			
Trade accounts payable		37 523	47 218
Short-term loans and current portion of finance leases	9	104 005	90 641
Tax related payables	10	8 134	13 574
Deferred tax liabilities	18	46	–
Payroll related liability		10 015	7 541
Advances received		1 965	2 071
Payables for non-current assets		2 831	10 395
Interest payable		2 316	3 339
Other payables		5 761	4 233
Total current liabilities of continuing operations		**172 596**	**179 012**
Current liabilities of discontinued operations		–	2 133
Total current liabilities		**172 596**	**181 145**
Non-current liabilities:			
Long-term notes payable		190	3 559
Long-term loans and finance leases	9	262 466	140 311
Tax related payables	10	50	46
Deferred tax liabilities	18	19 843	19 402
Long-term payables to shareholders	21	1 133	1 115
Other non-current liabilities		11	40
Total non-current liability of continuing operations		**283 693**	**164 473**
Total non-current liabilities of discontinued operations		–	812
Total non-current liabilities		**283 693**	**165 285**
Commitments and contingencies	24	342	326
Minority interest		18 882	14 548
Equity:			
Share capital	11	14	12
Additional paid-in capital	11	209 861	63 614
Other accumulated comprehensive loss	11	(934)	(13 114)
Retained earnings		41 410	11 996
Total equity		**250 351**	**62 508**
Total liabilities and equity		**725 864**	**423 812**

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

Consolidated income statements

For the years ended 31 December 2006 and 2005

	Notes	2006 US$000	2005 US$000
Sales	12	629 985	544 897
Cost of sales	13	(480 935)	(420 037)
Gross profit		**149 050**	**124 860**
Selling, general and administrative expenses	14	(98 349)	(80 187)
Other operating expenses	15	(1 717)	(1 104)
Operating income		**48 984**	**43 569**
Other income (expense), net	16	6 488	(1 301)
Interest expense, net	17	(17 538)	(15 605)
Income from continuing operations before income tax, minority interest and extraordinary item		**37 934**	**26 663**
Income tax	18	(2 419)	(7 973)
Minority interest		(2 319)	(1 387)
Income from continuing operations before extraordinary item		**33 196**	**17 303**
Loss from discontinued operations, net of income tax (expense) benefit of $(96) and $32, respectively	23	(199)	(306)
Loss on disposal of discontinued operations, net of income tax expense of $(25)		(2 813)	–
Extraordinary gain on purchase of interests in consolidating entities, net of income tax		–	79
Net income		**30 184**	**17 076**
Weighted average number of shares outstanding		368 783	328 216

	US$	US$
Earnings per share – basic and diluted (Note 2):		
Income from continuing operations before extraordinary item	90.02	52.72
Loss from discontinued operations	(0.54)	(0.93)
Loss on disposal of discontinued operations	(7.63)	–
Extraordinary gain	–	0.24
Net income	81.85	52.03

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

Consolidated cash flow statements

For the years ended 31 December 2006 and 2005

	2006 US$000	2005 US$000
Cash flows (used in) from operating activities:		
Income from continuing operations before extraordinary item	33 196	17 303
Adjustments to reconcile income from continuing operations before extraordinary item to net cash from (used in) operating activities:		
Amortisation of discount on loans from third parties	18	129
Depreciation	24 524	20 162
Bad debt recovery	(206)	(359)
Gain from debt forgiveness	(801)	(982)
Loss on disposal of property, plant and equipment	1 717	637
Minority interest	2 319	1 387
Foreign exchange (gain) loss	(4 567)	2 219
Deferred tax benefit	(4 284)	(1 893)
Other adjustments	(185)	(179)
Changes in operating assets and liabilities		
Increase in inventories, other than livestock	(13 311)	(6 758)
Increase in trade receivables	(27 441)	(25 632)
Increase in livestock	(13 818)	(5 875)
Increase in other assets	(9 926)	(18 821)
(Decrease) increase in trade accounts payable	(14 867)	16 894
(Decrease) increase in taxes payable	(6 598)	7 027
Decrease in VAT for property, plant and equipment	(4 351)	–
Increase in other current payables	5 438	8 315
Net cash (used in) from operating activities associated with continuing operations	**(33 143)**	**13 574**
Cash flows (used in) from discontinued operating activities:		
Loss from discontinued operations	(199)	(306)
Adjustments to reconcile loss from discontinued operations to net cash (used in) from operating activities associated with discontinued operations:		
Minority interest in net losses of discontinued operations	(29)	46
Deferred tax expense (benefit)	121	(54)
Loss (gain) on disposal of property, plant and equipment	8	(24)
Net change in operating assets and liabilities	(1 945)	1 012
Net cash (used in) from operating activities associated with discontinued operations	**(2 044)**	**674**
Total net cash (used in) from operating activities	**(35 187)**	**14 248**
Cash flows used in investing activities:		
Purchases of property, plant and equipment	(112 895)	(76 496)
Proceeds from sale of property, plant and equipment	337	1 469
Acquisition of minority interest in consolidating entities	(137)	(291)
Proceeds from sale of consolidating entities, net of cash disposed	47	–
Purchases of notes receivable	(6 690)	–
Proceeds from sale of investments	184	–
Long term loans granted	(4 874)	–
Repayment on long-term loans granted	2 508	–
Acquisition of subsidiaries, net of cash acquired	–	56
Short-term loans granted	(3 662)	(6 382)
Repayments on short term loans	3 186	10 998
Net cash used in investing activities associated with continuing operations	**(121 996)**	**(70 646)**

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

Consolidated cash flow statements continued

For the years ended 31 December 2006 and 2005

	2006 US$000	2005 US$000
Cash flows used in discontinued operations' investing activities:		
Purchases of property, plant and equipment	(180)	(504)
Proceeds from sale of property, plant and equipment	10	75
Net cash used in investing activities associated with discontinued operations	**(170)**	**(429)**
Total net cash used in investing activities	**(122 166)**	**(71 075)**
Cash flows from financing activities:		
Proceeds from long-term loans	187 793	69 929
Repayment of long-term loans	(79 955)	(23 142)
Proceeds from long-term loans from related parties	163	28
Repayment of long-term loans from related parties	(1 870)	(450)
Repayment of notes payable	(2 482)	–
Proceeds from short-term loans	289 901	118 083
Repayment of short-term loans	(281 858)	(100 566)
Proceeds from shares issued	146 249	–
Cash distributed to shareholders	(951)	(4 823)
Net cash from financing activities associated with continuing operations	**256 990**	**59 059**
Cash flows (used in) from discontinued operations' financing activities:		
Repayment of long-term loans to related parties	–	(40)
Proceeds from short-term loans	–	852
Repayment of short-term loans	(782)	(32)
Net cash (used in) from financing activities associated with discontinued operations	**(782)**	**780**
Total net cash from financing activities	**256 208**	**59 839**
Total net cash from operating, investing and financing activities	**98 855**	**3 012**
Impact of exchange rate difference on cash and cash equivalents	2 933	(216)
Net increase in cash and cash equivalents	101 788	2 796
Cash and cash equivalents associated with continuing operations, at the beginning of the year	**5 191**	**2 403**
Cash and cash equivalents associated with discontinued operations, at beginning of the year	**9**	**1**
Cash and cash equivalents associated with continuing operations, at end of the year	**106 988**	**5 191**
Cash and cash equivalents associated with discontinued operations, at end of the year	**–**	**9**
Supplemental Information:		
Income taxes paid	5 407	9 350
Interest paid	33 890	15 853
Property, plant and equipment acquired on credit	1 237	1 637
Repayment of loan with notes receivable	1 529	–

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

Consolidated statements of changes in shareholders' equity and comprehensive income

For the years ended 31 December 2006 and 2005

	Share capital US$000	Additional paid-in capital US$000	Retained earnings US$000	Other accumulated compre-hensive loss US$000	Total share holders' equity US$000	Total compre-hensive income US$000
Balances at 1 January 2005	**11**	**37 461**	**5 841**	**(10 465)**	**32 848**	
Net income for the year	–	–	17 076	–	17 076	17 076
Shares issued in exchange for minority interest	1	26 153	–	–	26 154	
Distributions to owners (Note 11)	–	–	(1 841)	–	(1 841)	
Net distribution to shareholders through spin-off	–	–	(9 080)	–	(9 080)	
Translation loss	–	–	–	(2 649)	(2 649)	(2 649)
Balances at 31 December 2005	**12**	**63 614**	**11 996**	**(13 114)**	**62 508**	
For the year ended 31 December 2005						**14 427**
Balances at 1 January 2006	**12**	**63 614**	**11 996**	**(13 114)**	**62 508**	
Net income for the year	–	–	30 184	–	30 184	30 184
New share issue	2	146 247	–	–	146 249	
Distributions to owners (Note 11)	–	–	(770)	–	(770)	
Translation gain	–	–	–	12 180	12 180	12 180
Balances at 31 December 2006	**14**	**209 861**	**41 410**	**(934)**	**250 351**	
For the year ended 31 December 2006						**42 364**

No dividends were declared or paid for the years ended 31 December 2006 and 2005.

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

1 Business and environment

Business

Incorporation and history

OJSC Cherkizovo Group and subsidiaries (further "the Group") trace their origins back to the transformation of a formerly state owned enterprise, Cherkizovsky Meat Processing Plant (Moscow), into a limited liability partnership and subsequent privatisation in the early 1990's. At the moment of privatisation, one individual became the majority shareholder in the enterprise. Over the next decade, this individual continued to acquire other meat processing and agricultural entities in the Russian Federation registering shareholding amounts personally as well as in the name of other immediate family members or friends of the family, (collectively "the Control Group"). As the Group evolved with continuing acquisitions, two distinctive operating structures emerged made up of meat processing (APK Cherkizovsky) and agricultural entities (APK Mikhailovsky). The structure of the Group is presented in Note 23.

The business of the Group

Cherkizovo Group is a holding company which was formed in 2005 as a combination of two separate groups of companies – Cherkizovsky agro-industrial group and Mikhailovsky agro-industrial group. Cherkizovo is a leading Russian vertically integrated agro-industrial company. Its operations spread over a full production cycle from feed production and breeding to meat processing and distribution. The operational facilities of the Group include 8 meat processing plants, 4 pig production complexes, 2 poultry production complexes as well as one combined fodder production plant. It also operates two trading houses with subsidiaries in 13 major Russian cities.

The Group's geographical landscape covers Moscow and the Moscow region, the regions of Saint Petersburg, Penza, Lipetsk, Vologorod, Belgorod, Ulianovsk, Rostov, Tver, Chelyabinsk, Tambov, Voronezh, Krasnodar, Ufa, Saratov, Samara, Ekaterinburgh, Perm and Kazan. The Group is well represented in the European part of Russia through its own distribution network; the logistical reach of this network is further aided by its own fleet of over 870 trucks.

The Group owns locally recognised brands which include «Черкизовский» (Cherkizovsky), "Петелинка" (Petelinka) and «Империя вкуса» (Imperia vkusa).

At 31 December 2006 and 2005, the number of staff employed by the Group was 12 511 and 12 066, respectively.

Environment

General

The principal business activities of the Group are within the Russian Federation. The Russian Federation's legal system and legislation are in a development stage. Weaknesses in the legal system could affect the Group's ability to enforce its rights, or to defend itself against claims by others.

Recently, the Russian Federation's economy has experienced positive trends, such as an increase in the gross domestic product, a relatively stable national currency, strong domestic demand, rising real wages and a reduced rate of inflation. However, the Group's assets and operations could be at risk should are any adverse changes materialise in the political and business environment.

1 Business and environment continued

Currency exchange and control
Foreign currencies, in particular the US dollar, play a significant role in the underlying economics of many business transactions in Russia. The following table summarizes the exchange rates of the rouble to 1 US dollar at 31 December 2006 and 2005.

	Exchange rate
31 December 2005	28.7825
31 December 2006	26.3311

Management has not entered into any transactions designed to hedge against foreign currency risk. The Group's future operating cash flows will be generated in Russian roubles. Future movements in the exchange rate between the rouble and the US dollar will affect the carrying value of the Group's rouble denominated monetary assets and liabilities and the US dollar amounts of revenues and expenses. Such changes may also affect the Group's ability to realize assets as represented in terms of US dollars in the accompanying consolidated financial statements.

Interest rates
The APK Cherkizovsky sub-group's principal interest rate risks relate to the fact that interest rates on certain loans are fixed at 3% for Euro loans and in the range of 4% to 16.5% for rouble loans. Management has not entered into any transactions designed to hedge against such interest rate risks.

The APK Mikhailovsky sub-group's principal interest rate risks relate to the fact that interest rates on certain loans are fixed at 0% to 16% for rouble loans. Management has not entered into transactions designed to hedge against interest rate risk.

Liquidity and financial resources
At 31 December 2006 the Group had positive working capital of $148 495 compared to a negative working capital of $40 138 at 31 December 2005. The increase in working capital arose mainly from the issuance of new shares and long-term debt, which lead to a large increase in cash balances, as well as repayment of current obligations. Note 9 contains additional information relating to debt structure, liquidity and refinancing.

2 Summary of significant accounting policies

Accounting principles
The Group's companies maintain their accounting books and records in Russian roubles in accordance with Russian statutory accounting regulations. The accompanying consolidated financial statements have been prepared in order to present the consolidated financial position and consolidated results of operations and cash flows of the Group in accordance with accounting principles generally accepted in the United States of America ("US GAAP") and expressed in terms of US dollars (paragraph "Translation Methodology" below). The accompanying consolidated financial statements differ from the financial statements prepared for statutory purposes in Russia in that they reflect certain adjustments that are appropriate to present the financial position, results of operations and cash flows in accordance with US GAAP.

Basis of consolidation of subsidiaries
The consolidated financial statements of the Group include companies controlled by the Control Group through direct and indirect ownership of the majority of the voting interests as described in Note 23 Acquisitions, divestitures, investments in affiliates.

Beginning 1 January 2005, the Group amended its consolidation policy to include any variable interest entities where management determined the Group to be the primary beneficiary. As of 31 December 2006, management believes that no variable interest entities exist where the Group is the primary beneficiary.

2 Summary of significant accounting policies continued

The purchase method of accounting is used for acquired businesses. Companies acquired or disposed of during the year are included in the consolidated financial statements from the date of acquisition or to the date of disposal.

All significant inter-company balances and transactions are eliminated on consolidation.

Investments in certain companies that are not material to the consolidated financial position and results of operations are stated at cost or excluded from the consolidated financial statements.

Fiscal year

The Group's fiscal year end is the last day of each calendar year.

Translation methodology

The Group follows a translation policy in accordance with SFAS No. 52, "Foreign Currency Translation" and has determined the rouble to be its functional currency.

The Group determined the U.S. Dollar to be its reporting currency and translates its functional currency financial statements into U.S. Dollars. Assets and liabilities are translated at year-end exchange rates, equity, other than retained earnings, at the rate effective on the later of 1 January 2003 (date of change in functional currency due to cessation of hyperinflation) or the date when the transaction occurred, while income and expense items are translated at average rates of exchange prevailing during the year. The resulting translation adjustment is recorded as a separate component of other comprehensive income (loss).

Management estimates

The preparation of the consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The principal management estimates underlying these financial statements include estimation of discounted future cash flows used in assessing the existence of impairment of goodwill, allowances for bad debts, valuation allowances for deferred tax assets and valuation of intangible assets determined to have an indefinite life.

Reclassifications

Certain comparative information, presented in the consolidated financial statements for the year ended 31 December 2005, has been reclassified in order to achieve comparability with the presentation used in the consolidated financial statements for the year ended 31 December 2006. The most significant reclassifications relate to the discontinued operations of the Group which were sold in 2006 and where financial position and results of operations have been separately disclosed as of and for the years ended 31 December 2006 and 2005.

Cash and cash equivalents

Cash and cash equivalents represent cash on hand and in bank accounts and short-term investments having original maturities of less than three months.

Accounts receivable and allowance for doubtful accounts

Accounts receivable are stated at their net realizable value, which approximates their fair value.

Group companies provide an allowance for doubtful accounts based on management's periodic review of accounts, including the aging of account balances. Accounts receivable are written off when evidence exists that they will not be collectible.

2 Summary of significant accounting policies continued

Inventory
Inventories, including work-in-process, are valued at the lower of cost or market value. Cost is the price paid or the consideration given to acquire the asset. Cost is determined on the basis of weighted average cost. For processed inventories, cost is the sum of the expenditures and charges, direct and indirect, in bringing goods to their existing condition or location. It includes the applicable allocation of fixed production and variable overhead costs. Market value is the current replacement cost, whether by purchase or by reproduction, limited to the estimated selling price less any costs of completion and disposal (net realizable value) at the maximum level, and net realizable value, less an allowance for normal profit at the minimum level. Net realizable value is the selling price in the ordinary course of business, less costs to complete, market and distribute. Write downs are made for unrealizable inventory in full.

Livestock
Animals with short productive lives, such as poultry and pigs are classified as inventory on the statement of financial position. Full cost absorption is used in determining the asset value of livestock.

Newborn cattle, pigs and other immature animals purchased for breeding are initially accounted for as inventory. Immature cattle and pigs are not considered to be in service until they reach maturity, at which time their accumulated cost becomes subject to depreciation. The Group treats breeding animals as fixed assets with costs to be depreciated over their useful lives, as follows:

	Age of transfer into main herd, years	Depreciation, years
Sows	0.5	2
Cattle	2	7

Value Added Tax
Value Added Tax (“VAT”) related to sales is payable based upon invoices issued to customers. Input VAT incurred on purchases may be offset, subject to certain restrictions, against VAT related to sales.

Input VAT related to purchase transactions that are subject to offset against taxes payable after the financial statement date are recognized on the statement of financial position, gross.

Property, plant and equipment
Due to the state of the records relating to the construction and acquisition of a significant portion of the assets of the Group companies, their carrying amounts as of 31 December 2001 were determined through valuation and are stated based on estimated fair value. For companies acquired through business combinations, estimated fair value of property, plant and equipment was retrospectively applied to determine the fair value of acquired net assets. Certain fixed assets were adjusted for the excess of the value of net assets acquired over the purchase price paid in business combinations or adjusted to fair value as of the date of such combinations occurring subsequent to 31 December 2001. Assets acquired subsequent to 31 December 2001 are stated at historical cost.

Depreciation is calculated on a straight-line basis over the estimated remaining useful lives of the related assets, as follows:

Buildings and infrastructure	10-39 years
Machinery and equipment	3-22 years
Vehicles	3-7 years
Cattle	7 years
Pigs	2 years
Other	3-10 years

2 Summary of significant accounting policies continued

Impairment of long-lived assets
When events and circumstances occur indicating that the carrying amount of a long-lived asset (group) may not be recoverable, the Group estimates the future undiscounted cash flows expected to be derived from the use and eventual disposition of the asset (group). If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the long-lived asset (group), the Group then calculates impairment as the excess of the carrying value of the asset (group) over the estimate of its fair market value.

Goodwill and other intangible assets
Goodwill represents the purchase price for businesses acquired in excess of the fair value of identifiable net assets acquired.

Goodwill and intangible assets deemed to have indefinite lives are subject to annual impairment tests at fiscal year end in accordance with SFAS No. 142. Other intangible assets with determinable useful life are amortized over their useful lives.

In the Group's assessment of goodwill, management makes assumptions regarding estimates of future cash flows and other factors to determine the fair value of the respective assets. Other intangible assets principally represent trademarks acquired that have been determined to have an indefinite life. Management evaluates a number of factors to determine whether an indefinite life is appropriate, including product history, operating plans and the macroeconomic environment.

The fair value of the Group's trademarks is determined using a royalty rate method based on expected revenues by trademark.

Investments
The Group holds equity interests in certain companies, which are not readily marketable securities and are valued at cost. Management periodically assesses the ability of the Group to realize the carrying values of investments and records any impairment as required.

The equity accounting method is used when the Group has the ability to exercise significant influence over the investee.

Notes receivable purchased by the Group are classified as held to maturity. Such notes are valued at cost upon acquisition with any discounts or premiums arising on purchase reported in the balance sheet as direct deductions / additions to the face value. Amortization of such discounts / premiums are recorded as additions / reductions to interest income.

Product guarantees
The Group offers product guarantees to its customers, providing them with an option to return damaged and non conforming goods and goods of initial improper quality. The period that goods may be returned is set to a maximum of one month from the date of shipment. Returns are accounted for as deductions to sales (Note 12).

Revenue recognition
Revenue is recognised when it is probable that the economic benefits associated with a transaction will flow to the Group, delivery has occurred or services have been rendered, the amount of the revenue can be measured reliably and the collectibility of the revenue is reasonably assured.

Sales are recognised, net of VAT and discounts, when goods are shipped to customers. At the time of shipment, in accordance with the Group's standard sales terms, title is transferred and the customer assumes the risk and rewards of ownership.
In contracts with certain large retail chains, title changes upon acceptance of goods by the customer at delivery. Sales made under these contracts are recognized upon acceptance.

The Group grants discounts to customers primarily based on the volume of goods purchased. Such discounts range up to 12% of the sales amount and are graduated to increase with purchases made. Discounts are accrued against sales and accounts receivable in the month earned. Other strategically targeted discounts are immaterial.

2 Summary of significant accounting policies continued

Any consideration given to direct or indirect customers of the Group in the form of cash, such as listing fees, are included in the consolidated statement of operations as deductions from sales.

Shipping and handling costs
Shipping and handling costs incurred by the Group are reflected in selling and distribution expenses in the accompanying consolidated statements of operations.

Marketing expenses
Marketing costs are expensed as incurred. Marketing expenses are reflected in selling and distribution expenses in the accompanying consolidated statements of operations.

Interest expense
The Group capitalizes interest costs on qualifying fixed assets acquired in accordance with the provisions of SFAS No. 34 “Capitalization of Interest Costs.” Interest capitalized in the years ended 31 December 2006 and 2005 was $2 534 and $1 016, respectively.

Taxation
Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing differences between the financial and tax reporting basis of assets and liabilities, as well as loss carry forwards, using enacted tax rates expected to be in effect at the time these differences are realized. Valuation allowances are recorded for deferred tax assets where it is more likely than not that such assets will not be realized.

Earnings per share
Earnings per share for 2005 have been determined using the number of Group shares issued on foundation of the holding company on 22 September 2005, to the members of the Control Group, as if those shares had been outstanding for that period. Earnings per share for the year ended 31 December 2006 have been determined using the weighted average number of Group shares outstanding over the period.

There are no securities to consider for dilution.

Fair value of financial instruments
The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and short-term notes and loans receivable and payable reported in the consolidated statement of financial position approximate fair values due to the short maturity of those instruments.

The fair values of notes and loans were estimated by discounting future cash flows using a discount rate that reflects the estimated market borrowing rates. Market borrowing rates on locally sourced funds available to the Group at 31 December 2006 and 2005 were estimated at 11% and 14%, respectively, for rouble denominated loans and 11% at both period ends for US dollar and EURO denominated loans.

As of 31 December 2006	**Book value US$000**	**Fair value US$000**
Lines of credit	227 822	233 014
Bonds	75 956	75 956
Loans from government agencies	46 183	43 144
Bank loans	14 196	14 196
Other borrowings	1 471	1 471

2 Summary of significant accounting policies continued

As of 31 December 2005	Book value US$000	Fair value US$000
Lines of credit	117 529	117 529
Loans from government agencies	28 988	26 216
Bank loans	79 447	79 447
Other borrowings	3 684	3 684

Further disclosures of long-term notes payable and loans are contained in Note 9.

Concentration of credit risk

Financial instruments that potentially expose the Group to concentration of credit risk consist primarily of cash and cash equivalents, accounts receivable from customers and advances paid to vendors. As of 31 December 2006, 86% of the total cash balance is held on deposit in one Russian financial institution.

As of 31 December 2006, the Group's risk associated with external customers is diversified due to a large customer base with approximately 10% of the Group's net accounts receivable balance due from one customer. No other single customer or customer group represents greater than 10% of net accounts receivable. No concentration of credit risk was noted in net accounts receivable as of 31 December 2005.

As of 31 December 2006, approximately 15% and 17% of net advances paid were outstanding with two vendors, respectively. No other single customer or customer group represents greater than 10% of net advances paid. No concentration of credit risk was noted in net advances paid as of 31 December 2005.

The maximum amount of loss due to credit risk, based on the fair value of the financial instruments that the Group would incur if affiliated companies failed to perform according to the terms of the contracts, is $9 381.

Minority interest

Minority interest is accounted for at historical value, which is the minority's share in the book value of a subsidiary's net assets at the date control over a subsidiary was established. If control over a subsidiary is lost and subsequently re-established, the minority interest is accounted for at the historical value determined at the time the company was first consolidated.

New accounting pronouncements

In July 2006, the FASB issued interpretation No. 48, "Accounting for Uncertainty in Income Taxes," ("FIN 48"), to clarify the accounting for uncertain tax positions stated in SFAS No. 109. FIN 48 applies to all tax positions that are within the scope of FAS No. 109 and requires a two-step approach for recognizing and measuring tax benefits. FIN 48 establishes a "more-likely-than-not" recognition threshold that must be met before a tax benefit can be recognized in the financial statements. To meet this threshold, the enterprise must determine that upon examination by the taxing authority, the tax position is more likely to be sustained than not, based on the technical merits of the position. Once the recognition threshold has been met, enterprises are required to recognize the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement with the taxing authority. In both steps, enterprises must presume that the taxing authority has full knowledge of all relevant information. FIN 48 also requires enterprise to make explicit disclosures at the end of each reporting period about uncertainties in their income tax positions, including a detailed rollforward of tax benefits taken that do not qualify for financial statement recognition. FIN 48 is effective for fiscal years beginning after 15 December 2006, and should be applied to all tax positions upon initial adoption. The cumulative effect of applying the provisions of FIN 48 should be reported as an adjustment to the opening balance of retained earnings for that fiscal year. The Group is currently assessing the impact of adopting FIN 48.

2 Summary of significant accounting policies continued

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurement”, (“the Statement”). The Statement provides a single definition of fair value, along with a framework for measurement and requires additional disclosure about using fair value to measure assets and liabilities. The Statement emphasizes that fair value measurement is market-based, not entity-specific, and establishes a fair value hierarchy in which the highest priority is quoted prices in active markets. Under the Statement, fair value measurements are disclosed according their level within this hierarchy. While the Statement does not add any new fair value measurements, it does change practice as follows: requiring entities to include their own credit standing when measuring their liabilities, modifying the transaction price assumption, prohibiting broker-dealers and investment companies from using block discounts when valuing large blocks of securities and requiring entities to adjust the value of restricted stock for the effect of the restriction even when the restriction lapses within one year. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Group is currently assessing the impact of adopting the Statement.

3 Cash and cash equivalents

	2006 US$000	2005 US$000
Rouble cash	222	252
Rouble bank accounts	106 766	4 939
Total cash and cash equivalents	**106 988**	**5 191**

Cash and cash equivalents in bank as of 31 December 2006, include deposits of $92 286 earning 5.2% annual interest with a two month original maturity.

4 Inventory

Inventory as of 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Raw materials and goods for resale	49 931	29 672
Work in-process	6 603	5 698
Finished goods	3 826	7 152
Livestock	28 756	13 261
Total inventory	**89 116**	**55 783**

Finished goods intended for use by other Group companies are classified as raw materials. Inventory pledged under loan agreements (Note 9) totalled $15 139 and $17 556 as of 31 December 2006 and 2005, respectively. On 31 December 2006, the pledged amount consisted of raw materials in the amount of $5 367, finished goods of $1 209 and livestock of $8 563.

5 Other current assets

Other current assets as of 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
VAT and other taxes receivable	18 570	21 371
Spare parts	3 518	2 247
Notes receivable (effective annual interest rate of 9.67%)	3 456	165
Prepaid expenses	2 293	2 513
Total other current assets	**27 837**	**26 296**

6 Property, plant and equipment

The carrying amounts of property, plant and equipment as of 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Buildings and infrastructure	172 573	104 073
Machinery and equipment	78 953	62 726
Vehicles	14 594	6 782
Cattle	567	382
Sows	4 879	2 462
Other	1 824	1 747
Advances paid for property, plant and equipment	22 120	8 041
Construction in progress and equipment for installation	57 995	63 770
Total property, plant and equipment, net	**353 505**	**249 983**

Accumulated depreciation amounted to $98 403 and $67 997 as of 31 December 2006 and 2005, respectively. Depreciation expense amounted to $24 524 and $20 162 for the years ended 31 December 2006 and 2005, respectively, and includes depreciation of leased equipment.

Machinery and equipment includes $3 965 and $4 396 of leased equipment as of 31 December 2006 and 2005. Accumulated depreciation of leased equipment amounted to $835 and $981 as of 31 December 2006 and 2005, respectively.

Property, plant and equipment pledged under loan agreements totalled $49 947 and $126 056 as of 31 December 2006 and 2005, respectively.

7 Goodwill and other intangible assets, net

Goodwill arose on the purchase by the Group of its controlling stake in JSC BMPP and relates to the meat processing segment of the business.

Other intangibles include the “Cherkizovsky” («Черкизовский») and “Biruliovsky” («Бирюлевский») trademarks acquired by the Group and computer software with a net book value of $774 and $447 as of 31 December 2006 and 2005, respectively. Management has determined that the trademarks have indefinite useful lives and are, therefore, not subject to amortization. Software is amortized over its useful life of 2 years.

Management does not believe that goodwill or indefinite life trademarks are impaired as of 31 December 2006.

8 Long-term notes receivable

During June 2006, the Group purchased notes receivable from Gazprombank with a maturity date in June 2014.
As of 31 December 2006, the balance comprised:

	Book Value US$000	Discount US$000	Face Value US$000	Effective %
Gazprombank notes receivable	6 904	(6 219)	13 123	8.36%

9 Borrowings

Borrowings of the Group as of 31 December 2006 and 2005 comprised:

	2006		2005	
	Current US$000	Non-current US$000	Current US$000	Non-current US$000
Lines of credit (interest rates 6%-16%)	65 586	162 236	45 849	71 680
Bonds (interest rate 8.85%)	–	75 956	–	–
Loans from government agencies (interest rates 0%-6%)	28 874	17 309	20 692	8 296
Bank loans (interest rates 11%-16.5%)	7 360	6 836	21 340	58 107
Other borrowings (interest rates 0%-0.1%)	1 471	–	1 700	1 984
Finance leases (interest rates 8%-24%)	714	129	1 060	244
	104 005	**262 466**	**90 641**	**140 311**
Total borrowings		**366 471**		**230 952**

Maturity of the non-current portion of borrowings is as follows:

	2008 US$000	2009 US$000	2010 US$000	2011 US$000	2012 US$000	>2012 US$000	Total US$000
Total borrowings	25 972	117 232	64 119	15 916	717	38 510	**262 466**

The Group's borrowings are denominated in roubles ($364 118), Euro ($1 742) and US dollars ($611).

Finance leases

As of 31 December 2006 and 2005, the Group operated certain fixed assets under leasing contracts that qualified for treatment as finance leases. The lower of the incremental borrowing and the rate implicit in the lease agreement was used in capitalizing the leases.

9 Borrowings continued

The total minimum lease payments due under these lease agreements comprised:

	2006		2005	
Payments falling due	Total minimum lease payments US$000	Portion related to interest US$000	Total minimum lease payments US$000	Portion related to interest US$000
Within one year	760	46	1 140	80
In year two	123	5	230	13
In year three	11	–	27	–
	894	**51**	**1 397**	**93**

Bonds
During June 2006, the Group raised 2 billion roubles through an issue of callable bonds with a nominal value of 1 000 roubles. The bonds were sold at their nominal value and are due in 2011.

The coupon rate, payable semi-annually, was set at 8.85% per annum for the first 3 years, with the rate for subsequent years to be set by the Group at a later date. Investors in the bonds have the right to put the bonds to the Group at the time of the interest rate reset.

Bank loans
Gazprombank
Borrowings from Gazprombank consist of one short and two long-term rouble denominated loans with interest rates ranging from 11.5% to 12% per annum. Property, plant and equipment in the amount of $176 and notes receivable with a carrying value of $6 904 were pledged as collateral under these loan agreements.

EBRD and Raiffeisen loans
In June 2006 the Group opted for the early repayment of EBRD and Raiffeisen loans in full. According to the loan agreement the Group was required to pay an early repayment fee which was set at 2% of the outstanding balance on Tranches Two A and Two B of the loan (Note 16).

Savings Bank of Russia
Borrowings from the Savings Bank of Russia consist of seven short-term loans with interest ranging from 11% to 14% per annum. Inventory and livestock with a carrying amount of $4 799 were pledged as collateral under these loan agreements.

Lines of credit
Savings Bank of Russia
Borrowings from the Savings Bank of Russia consist of thirty four lines of credit with interest ranging from 10% to 15% per annum. Property, plant and equipment in the amount of $27 399 and inventory with a carrying amount of $6 293 were pledged as collateral under these agreements.

9 Borrowings continued

Gazprombank
Borrowings from Gazprombank consist of five lines of credit with interest ranging from 11.5% to 14.2% per annum. Property, plant and equipment in the amount of $8 326 were pledged as collateral under these agreements.

Shares of and participating interests in the following Group companies are pledged as collateral under the facility:

- JSC Lipetskmyasoprom – 100%
- JSC Vasiljevskaya – 51%
- CJSC Petelinskaya – 51%
- LLC Budenovets Agrifirm – 51%
- LLC Mikhailovsky Feed Milling Plant – 51%
- LLC Kuznetsovsky Kombinat – 51%
- LLC Ardymsky Feed Milling Plant – 51%
- CJSC Botovo – 51%

51% of outstanding shares of a related party are also pledged as collateral.

Raiffeisen
Borrowings from Raiffeisen consist of one unsecured loan facility bearing interest at 6% per annum.

Total amount of unused credit as of 31 December 2006 is $73 628.

Loans from government agencies

Regional treasury (Lipetsk)
Borrowings from the Department of finance of the Lipetsk regional administration consist of one long-term loan bearing interest at 1% per annum. Property, plant and equipment in the amount of $862 were pledged as collateral under these loan agreements.

Department of Food Supply of the City of Moscow
Borrowings from the Department of Food Supply of the City of Moscow consist of three loans with interest ranging from 3.67% to 4.3% per annum.

Shares of and participating interests in the following Group companies are pledged as collateral under the facility:

- JSC Biruliovsky meat processing plant (JSC BMPP) – 54.09%
- JSC Meat Processing Plant Ulyanovsky (JSC MPP Ulyanovsky) – 50% plus one share

Department of Taxes and Financial Policies, Moscow City Government
Borrowings from the Department of Taxes and Financial Policies of the Moscow City Government consist of two loans with interest ranging from 5.75% to 6% per annum.

Shares of and participating interests in the following Group companies are pledged as collateral under the facility:

- JSC Vasiljevskaya – 41%
- JSC Meat Processing Plant Ulyanovsky (JSC MPP Ulyanovsky) – 35.4%

Other borrowings

Other borrowings primarily represent unsecured loans from the Control Group with interest rates ranging from 0% to 0.1%.

10 Tax related payables

Short-term tax related payables as of 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Corporate income tax	2 742	1 290
Value added tax	1 974	9 513
Payroll related taxes	1 166	981
Personal income tax withheld	973	684
Property tax payable	950	757
Transportation tax	22	38
Other taxes	307	311
Total short-term taxes payable	**8 134**	**13 574**

Long-term tax related payables as of 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Payroll related taxes	38	46
VAT	12	–
Total long-term taxes payable under restructuring agreements	**50**	**46**

The schedule of tax repayment comprises:

	US$000
2010	18
2011	8
2012	8
2013	8
2014	8
	50

11 Shareholders' equity

During the second half of 2005 all direct ownership in Group companies was contributed by the Control Group into the share capital of OJSC Cherkizovo Group (except entities distributed to shareholders in the Spin-off).

As of 31 December 2005, 547 026 shares of ordinary stock were authorized, of which 328 216 were issued and outstanding with a par value of 1 rouble.

In May 2006 the Group made an offering of global depositary receipts on the London Stock Exchange. As part of this process, the Group issued an additional 67 427 shares of common stock with a par value of 1 rouble in exchange for $146 249. As of 31 December 2006, 547 026 shares of ordinary stock were authorized, of which 395 643 were issued and outstanding. All issued and outstanding shares have equal voting rights. Cherkizovsky Group Ltd. owned 67.1% of outstanding share capital. The Group is authorized to issue preferred shares not exceeding 25% of its ordinary stock. No such shares are currently issued or outstanding.

11 Shareholders’ equity continued

In accordance with Russian legislation, earnings available for dividends are limited to retained profits calculated in accordance with statutory rules in local currency.

The Group accrued $770 and $1 841 during the years ended 31 December 2006 and 2005, respectively, in the form of remuneration to shareholders not functioning in management roles.

12 Sales

Sales for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Produced goods and goods for resale	644 980	548 157
Other sales	1 774	4 373
Sales volume discounts	(9 917)	(3 378)
Sales returns	(6 852)	(4 255)
Total sales	**629 985**	**544 897**

During the years ended 31 December 2006 and 2005 the Group’s sales to related parties comprised:

	2006 US$000	2005 US$000
Produced goods and goods for resale	4 344	2 081
Other sales	1 138	142
Total sales to related parties	**5 482**	**2 223**

13 Cost of sales

Cost of sales for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Raw materials and goods for resale	391 563	346 156
Personnel (excluding pension costs)	40 338	33 218
Depreciation	20 870	17 096
Utilities	11 805	10 025
Pension cost (Note 19)	6 615	6 000
Other	9 744	7 542
Total cost of sales	**480 935**	**420 037**

14 Selling, general and administrative expenses

Selling, general and administrative expenses for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Personnel (excluding pension costs)	42 171	33 830
Advertising and marketing	8 636	4 801
Transportation	7 438	6 021
Materials and supplies	7 303	5 678
Pension costs	6 244	5 022
Taxes (other than income tax)	5 378	4 831
Audit, consulting and legal fees	3 852	2 772
Depreciation	3 654	3 066
Security services	2 814	2 621
Utilities	1 504	975
Bank charges	1 493	1 663
Information technology and communication services	647	665
Insurance	848	879
Other	6 367	7 363
Total general and administrative expenses	**98 349**	**80 187**

15 Other operating expenses

Other operating expenses for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Loss on disposal of property, plant and equipment	1 717	637
Unusual loss related to privatisation of subsidiary	–	467
Total other operating expenses	**1 717**	**1 104**

In April 2004 LLC Ardymsky Feed Milling Plant entered into litigation related to the privatization of the company and legal title to certain property, plant and equipment. In 2005, in accordance with a court's decision, legal title on some of the assets in dispute was transferred to the plaintiff. However LLC Ardymsky Feed Milling Plant was able to reach an out-of-court settlement with the plaintiff for $467. As a result, the plaintiff waived all rights to the assets in question and LLC Ardymsky Feed Milling Plant became their lawful owner. This amount has been included above as an unusual loss related to privatisation of the subsidiary.

16 Other income (expense), net

Other income and expense for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Loan origination fees (EBRD loan)	(1 690)	–
Bank fees related to early repayment of EBRD loan	(898)	–
Foreign exchange gain (loss)	4 567	(2 219)
Interest income	2 570	–
Gain from debt forgiveness	801	982
Other financial income (expense)	1 138	(64)
Total other income (expense), net	**6 488**	**(1 301)**

Gain on debt forgiveness relates to creditors, with whom the Group has not been able to make contact and where the statute of limitations on such debt have expired.

17 Interest expense, net

	2006 US$000	2005 US$000
Interest expense	17 390	15 189
Finance lease expenses	130	287
Amortization of discount	18	129
Total interest expense, net	**17 538**	**15 605**

In accordance with Russian legislation, enterprises engaged in agricultural activities and enterprises in certain areas purchasing meat receive subsidies to repay their interest expense. The Group has accounted for such subsidies by reducing the interest expense on associated loans by $5 805 and $3 729 for the years ended 31 December 2006 and 2005, respectively.

18 Income tax

The charge for income tax for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Current provision	6 703	9 866
Deferred tax benefit	(4 284)	(1 893)
Provision for income tax	**2 419**	**7 973**

The statutory income tax rates for the meat processing and agricultural sub-groups for the years presented are 24% and 0%, respectively, under Russian legislation.

The agricultural sub-groups will be subject to income tax starting January 1, 2008 as follows:

Years	Income tax rate
2008-2009	6%
2010-2011	12%
2012-2014	18%
Thereafter	24%

Income tax charge reconciled to the theoretical tax provision at the statutory rate for the years ended 31 December 2006 and 2005 is:

	2006 US$000	2005 US$000
Income from continuing operations before income tax, minority interest and extraordinary item	37 934	26 663
Income from continuing operations before income tax, minority interest and extraordinary item of entities taxed at agricultural rates	28 363	14 951
Income from continuing operations before income tax, minority interest and extraordinary item of generally taxed entities	9 571	11 712
Statutory tax rate (Agricultural)	0%	0%
Statutory tax rate (General)	24%	24%
Theoretical income tax expense at statutory rate	2 297	2 811
Expenses not deductible for Russian statutory taxation purposes, net	3 152	4 881
Tax deductible remunerations	(133)	(312)
Change in agricultural tax rates	290	–
Other permanent differences	(1 261)	520
Change in valuation allowance	(1 926)	73
Actual income tax provision	**2 419**	**7 973**

18 Income tax continued

	2006 US$000	2005 US$000
Deferred tax assets/(liabilities) arising from tax effect of temporary differences:		
Intangibles	(4 133)	(3 185)
Property, plant and equipment	(15 392)	(15 809)
Construction in process	1 458	339
Trade receivables and advances paid	815	1 077
Other receivables	1 039	–
Inventory	632	628
Payroll related liabilities	929	588
Loss carry forward	3 324	3 886
Other	(235)	516
Valuation allowance	(1 727)	(3 398)
Net deferred tax liability	**(13 290)**	**(15 358)**
Analyzed to:		
Deferred tax asset – long-term portion	1 927	388
Deferred tax liability – long-term portion	(19 843)	(19 402)
Long-term deferred tax liability, net	(17 916)	(19 014)
Deferred tax asset – current	4 672	3 656
Deferred tax liability – current	(46)	–
Current deferred tax asset, net	4 626	3 656
Total deferred tax liability, net	**(13 290)**	**(15 358)**

The valuation allowance is attributable to loss carryforwards which are not expected to be utilised by management. Management's judgement regarding the realizability of tax loss carryforwards was impacted in the current year by a decision of the tax inspectorate regarding the realizability of such carryforwards relating to prior years. The Group's tax loss carry forwards expire as follows:

	2012 US$000	2013 US$000	2014 US$000	2015 US$000	2016 US$000	Total US$000
Tax loss carry forwards	1 264	94	468	473	1 025	**3 324**

The movements in net deferred tax liability for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Net deferred tax liability, beginning of the year	(15 358)	(13 160)
Impact of translation loss on beginning balance	(2 221)	130
Deferred tax in spun-off entities	–	(252)
Deferred tax acquired on acquisition of new consolidated entities	–	(23)
Deferred tax acquired on acquisition of minority interest in consolidated entities	5	(3 946)
Deferred tax benefit	4 284	1 893
Net deferred tax liability, end of the year	**(13 290)**	**(15 358)**

At the beginning of 2006 the Government delayed the introduction of income tax for agricultural companies until 2008. This resulted in a reduction of deferred income tax assets in the amount of $290. The full amount of the change was expensed in 2006.

19 Pension costs

The Group makes payments for employees into the Pension fund of the Russian Federation. From 1 January 2005, all contributions to the Pension fund are calculated by the application of a regressive rate from 20% to 2% of the annual gross remuneration of each employee.

20 Related parties

Shareholders / Control Group

The structure of the Group prior to September 2005 was not united in the form of a legal holding. In order to show a fair presentation of the results of operations for periods prior to this date, management believes that it is necessary to combine the holdings of the Control Group for that period.

Management has determined which individuals should be included in the Control Group using the following principles:

1. Individuals who are members of the main shareholder's immediate family, but limited to two generations.

   a) Generation one is defined as the main shareholder, spouse and any brothers or sisters of these two individuals,

   b) Generation two is defined as the children of any persons in the generation one group,

   c) Generation two individuals with deceased parents who are brothers or sisters in the generation one group are not considered to be immediate family and are not included in the Control Group.

   d) Individuals with whom contemporaneous written agreement has been obtained demonstrating an obligation to act in concert with members of the Control Group.

During 2006 and 2005, related parties provided debt financing to the Group and served as guarantors for certain third party debts.

Entities disposed of to shareholders

Transactions with entities disposed of to shareholders comprise mostly of purchases of raw materials from CJSC Penzamyasoprom and sale of mixed fodder to CJSC Penzamyasoprom. Settlements between related entities are generally made in cash. These related parties are under common ownership and the existence of that control could result in operating results or financial position of the Group significantly different from those that would have been obtained were the enterprises autonomous. Such transactions are expected to continue to play a role in the operations of the Group in the future.

20 Related parties continued

Other related parties

Other related party purchases during 2006 and 2005 are mostly represented by purchases of IT technology and security services.

As of 31 December 2006 and for the year then ended, balances and transactions with related parties are summarized as follows:

	Shareholders US$000	Companies disposed to shareholders and other related parties US$000	Total US$000
Balances			
Short-term loan receivable	–	2 544	2 544
Trade receivables	–	2 772	2 772
Advances issued	–	1 835	1 835
Other receivables and prepayments	–	1 561	1 561
Long-term loans receivable	12	657	669
Trade payables	–	(1 454)	(1 454)
Short-term loans	(72)	(247)	(319)
Other payables	(144)	(1 270)	(1 414)
Current portion of long-term loans payable	(879)	–	(879)
Long-term notes payable	(190)	–	(190)
Long-term loans payable	–	–	–
Long-term payables to shareholders related to lease agreements	(1 133)	–	(1 133)
Activities			
Sales	–	5 482	5 482
Rent income from related party	–	30	30
Purchase of IT services	–	(266)	(266)
Purchase of security services	–	(735)	(735)
Purchase of goods and services	–	(12 298)	(12 298)
Purchase of property plant and equipment	–	(138)	(138)

20 Related parties continued

As of 31 December 2005 and for the year then ended, balances and transactions with related parties are summarized as follows:

	Shareholders US$000	Companies disposed to shareholders and other related parties US$000	Total US$000
Balances			
Short-term loan receivable	–	1 880	1 880
Trade receivables	–	1 202	1 202
Advances issued	–	1 655	1 655
Other receivables and prepayments	–	1 396	1 396
Long-term loans receivable	–	8	8
Trade payables	–	(1 179)	(1 179)
Short-term loans	(66)	(417)	(483)
Other payables	–	(1 978)	(1 978)
Current portion of long-term loans payable	(752)	–	(752)
Long-term notes payable	(3 559)	–	(3 559)
Long-term loans payable	(1 663)	–	(1 663)
Long-term payables to shareholders related to lease agreements	(1 115)	–	(1 115)
Activities			
Sales	1	2 222	2 223
Rent income from related party	–	233	233
Purchase of IT services	–	(391)	(391)
Purchase of security services	–	(712)	(712)
Purchase of goods and services	–	(4 042)	(4 042)
Purchase of property plant and equipment	–	(652)	(652)

21 Long – term payables to shareholders

During 2005 certain Group companies were spun-off as a part of the Restructuring transaction. Some property, plant and equipment that remained in distributed entities were necessary for the continuing operations of the Group. This equipment was partly transferred to the companies remaining in the Group. The equipment that was not possible to transfer due to timing issues was leased by the distributed companies on bargain terms. The lease terms include bargain options for the Group to continue the agreement over the life of the underlying equipment. For the purposes of calculating the lease term, the Group used the remaining useful life of the underlying assets. The value of property, plant and equipment at lease inception was $4 137.

Payables to shareholders for leased property, plant and equipment as of 31 December 2006 comprise:

	US$000
Settlements with shareholders for leasing, long-term portion	1 133
Settlements with shareholders for leasing, current portion	39
Total settlements with shareholders for leasing	**1 172**

Movements in the liability for the year ended 31 December 2006 were:

	US$000
Liability to shareholders for leasing as of January 1, 2006	1 147
Interest accrued at 14% on leasing liability	162
Repayment of liability to shareholders	(241)
Translation gain	104
Liability to shareholders for leasing as of 31 December 2006	**1 172**

22 Segment reporting

The Group's operations are divided into three segments by types of products produced: meat processing, poultry and pork. Substantially all of the Group's operations are located within the Russian Federation. The pork and poultry segments share a common legal and organizational structure as well as a common chief operating decision maker. For the purpose of determining reportable segments, the Group has determined the chief operating decision maker of each segment to be the individual responsible for allocating resources to and assessing the performance of each component of the business. Discreet information for each segment is presented to the respective decision makers and is significant in managing operations.

Segment information at 31 December 2006 and for the year then ended comprised:

	Meat-processing US$000	Poultry US$000	Pork US$000	Corporate assets/ expenditures US$000	Intersegment US$000	Combined US$000
Total sales	453 194	155 682	27 816	568	–	637 260
Including:						
Other sales	1 474	10 213	2 113	–	–	13 800
Sales volume discounts	(6 999)	(2 918)	–	–	–	(9 917)
Intersegment sales	(1 592)	(4 661)	(455)	(567)	–	(7 275)
Sales to external customers	451 602	151 021	27 361	1	–	629 985
Cost of sales	(371 281)	(98 841)	(17 509)	(3)	6 699	(480 935)
Gross profit	81 913	56 841	10 307	565	(576)	149 050
Operating expenses	(65 296)	(27 956)	(3 093)	(4 310)	589	(100 066)
Operating income	16 617	28 885	7 214	(3 745)	13	48 984
Other income and expenses, net	3 008	1 016	63	10 212	(7 811)	6 488
Interest expenses	(11 534)	(8 958)	(518)	(4 295)	7 767	(17 538)
Segment profit	8 091	20 943	6 759	2 172	(31)	37 934
Expenditure for segment property, plant and equipment	14 605	29 398	57 275	24	–	101 302
Segment assets	291 366	190 375	164 061	257 315	(177 253)	725 864
Supplemental information						
Depreciation expense	15 657	6 961	1 906	–	–	24 524
Income Tax expense	2 616	(791)	(119)	713	–	2 419
Reconciliation between segment profit and consolidated income from continuing operations						
Segment profit	37 934					
Minority interest	(2 319)					
Income taxes	(2 419)					
Consolidated income from continuing operations	33 196					
Reconciliation between total segment assets and total assets per financial statements						
Total segment assets	725 864					
Assets of discontinued operations	–					
Total assets per financial statements	725 864					

22 Segment reporting continued

Segment information at 31 December 2005 and for year then ended comprised:

	Meat-processing US$000	Poultry US$000	Pork US$000	Corporate assets/ expenditures US$000	Intersegment US$000	Combined US$000
Total sales	410 179	127 641	24 297	–	–	562 117
Including:						
Other sales	2 591	7 217	6 918	–	–	16 726
Sales volume discounts	(2 503)	(875)	–	–	–	(3 378)
Intersegment sales	(870)	(10 520)	(5 830)	–	–	(17 220)
Sales to external customers	409 309	117 121	18 467	–	–	544 897
Cost of sales	(336 816)	(79 592)	(20 831)	–	17 202	(420 037)
Gross profit	73 363	48 049	3 466	–	(18)	124 860
Operating expenses	(52 663)	(25 019)	(3 071)	(10)	(61)	(80 824)
Nonrecurring expense (Note 15)	–	(467)	–	–	–	(467)
Operating income	20 700	22 563	395	(10)	(79)	43 569
Other income and expenses, net	(1 245)	(28)	(18)	(10)	–	(1 301)
Interest expenses	(8 429)	(6 723)	(453)	–	–	(15 605)
Segment profit	11 026	15 812	(76)	(20)	(79)	26 663
Expenditure for segment property, plant and equipment	8 530	37 205	40 157	–	–	85 892
Segment assets	231 971	140 162	98 473	198	(50 847)	419 957
Supplemental information						
Depreciation expense	13 354	4 965	1 843	–	–	20 162
Income tax expense	7 246	465	262	–	–	7 973
Reconciliation between segment profit and consolidated income from continuing operations before extraordinary item						
Segment profit	26 663					
Minority interest	(1 387)					
Income taxes	(7 973)					
Consolidated income from continuing operations before extraordinary item	17 303					
Reconciliation between total segment assets and total assets per financial statements						
Total segment assets	419 957					
Assets of discontinued operations	3 855					
Total assets per financial statements	423 812					

Corporate assets comprise cash in bank received from both the issuance of new shares and bond issue, and loans to Group companies.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Group evaluates performance based on profit or loss from operations before income taxes. The Group attempts to account for inter-segment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices.

22 Segment reporting continued

The meat processing segment is involved in the production of a wide range of meat products, including sausages, ham and raw meat.

Pork and poultry are strategic segments that produce and offer distinctive products, such as semi-finished poultry products, raw meat, eggs and other poultry meat products in the poultry segment and raw pork meat in the pork segment.

All three segments are involved in other business activities, including dairy, crop cultivation and related services, which are non-core business activities.

23 Acquisitions, divestitures, investments in affiliates

Subsidiaries

As of 31 December 2006, the Group controls the meat processing and agricultural sub-groups through its 100% ownership in AIC Cherkizovsky Ltd. and AIC Mikhailovsky Ltd.

APK Cherkizovsky is a sub-group consisting of meat processing plants, distribution companies and other companies registered and operating in the Russian Federation. On 31 December 2006 and 2005 the following principal companies were included in the APK Cherkizovsky sub-group:

			Consolidated interest	
Name of company	**Legal form**	**Nature of business**	**% 31.12.2006**	**% 31.12.2005**
JSC MPP Babaevskiy	Closed Joint Stock Company	Meat processing plant	85%	85%
JSC Belmiaso	Open Joint Stock Company	Meat processing plant	75%	75%
JSC Biruliovsky meat processing plant (JSC BMPP)	Open Joint Stock Company	Meat processing plant	95%	95%
JSC Meat and Poultry Processing Plant Penzensky (JSC MPPP Penzensky)	Open Joint Stock Company	Meat processing plant	95%	95%
JSC Meat Processing Plant Ulyanovsky (JSC MPP Ulyanovsky)	Open Joint Stock Company	Meat processing plant	85%	79%
JSC Cherkizovsky meat processing plant (JSC CMPP)	Open Joint Stock Company	Meat processing plant	87%	87%
AIC Cherkizovsky Ltd. (CJSC Eko-Torg prior to 1 September 2004)	Limited Liability Company	Asset holding company	100%	100%
MPP Salsky Ltd.	Limited Liability Company	Meat processing plant	81%	81%
TIC Cherkizovo Ltd. (Cherkizovo-2)	Limited Liability Company	Procurement company	100%	100%
LLC Cherkizovo-Kashira (Cherkizovo-Kashira Ltd.)	Limited Liability Company	Meat processing plant	99%	99%
JSC Trading Company of Agroindustrial Complex Cherkizovsky (JSC Trading Company of AIC Cherkizovsky)	Open Joint Stock Company	Trading company: distribution of products of APK Cherkizovsky	100%	100%

Prior to September 2005, all companies listed above were under the control of the Control Group who owned, directly or indirectly, a majority of the voting rights in each company.

23 Acquisitions, divestitures, investments in affiliates continued

During September 2005, a restructuring of APK Cherkizovsky was performed in order to establish control over all meat processing companies solely through AIC Cherkizovsky Ltd., thereby eliminating all direct ownership in such companies by the Control Group. This was primarily accomplished by contributing the shares of companies held by the Control Group to the share capital of AIC Cherkizovsky Ltd. As of 31 December 2005, all companies listed above were under the control of AIC Cherkizovsky Ltd.

APK Mikhailovsky is a sub-group of companies registered and operating in the Russian Federation engaged in the production of various types of compound feed, raising of poultry, pigs and cattle and the distribution of meat. On 31 December 2006 and 2005 the following principal companies were included in the APK Mikhailovsky sub-group:

			Consolidated interest	
Name of company	**Legal form**	**Nature of business**	**% 31.12.2006**	**% 31.12.2005**
CJSC Budenovets Agrifirm (**)	Closed Joint Stock Company	Pig breeding	–	73%
CJSC Krugovskaya (**)	Closed Joint Stock Company	Raising poultry	–	76%
CJSC Petelinskaya	Closed Joint Stock Company	Raising poultry	84%	84%
JSC Vasiljevskaya	Open Joint Stock Company	Raising poultry	100%	100%
LLC Ardymsky Feed Milling Plant (Ardymsky Feed Milling Plant Ltd.)	Limited Liability Company	Mixed fodder production	89%	89%
LLC Penzenskaya	Limited Liability Company	Raising poultry	100%	100%
LLC Petelino Trade House	Limited Liability Company	Trading company: distribution of products of APK Mikhailovsky	84%	84%
CJSC Botovo	Closed Joint Stock Company	Pig breeding	76%	76%
LLC Petelinsky Poultry Factory	Limited Liability Company	Meat processing	84%	84%
LLC Trading House Petelino-Samara	Limited Liability Company	Trading company: distribution of products of APK Mikhailovsky	100%	100%
LLC Kuvak-Nikolskoie Poultry Factory	Limited Liability Company	Raising poultry	100%	100%
JSC Lipetskmyasoprom	Open Joint Stock Company	Pig breeding	100%	100%
LLC Mikhailovsky Feed Milling Plant (*)	Limited Liability Company	Mixed fodder production	100%	100%
LLC Kuznetsovsky Kombinat (*)	Limited Liability Company	Pig breeding	100%	100%
LLC Agro-industrial Complex Mikhailovsky (AIC Mikhailovsky Ltd.) (*)	Limited Liability Company	Holding company	100%	100%
LLC Tambovmyasoprom	Limited Liability Company	Pig breeding	99%	–
LLC Budenovets Agrifirm	Limited Liability Company	Pig breeding	100%	–

*Companies created in the process of restructuring
**Discontinued operations

As of 31 December 2006, all companies listed above with ownership interest as of that date were under the control of AIC Mikhailovsky Ltd. which owned, directly or indirectly, a majority of the shares in each company.

In August 2006, the Group purchased an additional stake of 5.65% in JSC Meat Processing Plant Ulyanovsky for the total cash consideration of $137. An excess of fair value over purchase price of $21 arose at the purchase date.

In September 2006, management of the Group made a decision to dispose the non-core business operations of CJSC Budenovets Agrifirm and CJSC Krugovskaya (“the Discontinued Entities”) in exchange for $162 in cash. The disposal was completed by the end of 2006.

23 Acquisitions, divestitures, investments in affiliates continued

Legal obligations of approximately $2 348 (as of the balance sheet date) exist for the Group to purchase fixed assets owned by the Discontinued Entities in 2007. Such fixed assets as well as the liability relating to their purchase were included in the calculation of the gain / loss resulting on sale of discontinued operations. The fixed assets remained at their historical book value in the accounting records and the related liability is included in other payables.

Net assets of discontinued operations were as follows as of the date of disposal:

	At disposal US$000
Trade receivables, net	2 751
Inventory	656
Livestock	752
Property, plant and equipment	1 616
Other assets	1 502
Total assets	**7 277**
Trade and other payables	(1 668)
Short and long-term loans	(1 868)
Other liabilities	(2 969)
Total liabilities	**(6 505)**
Net assets of discontinued operations	**772**

Results from discontinued operations were as follows:

	2006 US$000	2005 US$000
Sales	1 377	1 424
Cost of sales	(1 082)	(1 154)
Operating expenses	(293)	(588)
Operating income / (loss)	**2**	**(318)**
(Loss) gain from disposal of property, plant and equipment	(8)	24
Financial expenses, net	(101)	2
Loss before provision for income taxes and minority interest	**(107)**	**(292)**
Provision for income taxes	(121)	32
Minority interest	29	(46)
Loss from discontinued operations	**(199)**	**(306)**

24 Commitments and contingencies

Legal
As of 31 December, 2006, several Group companies reported negative net assets in their statutory financial statements. In accordance with the Civil Code of the Russian Federation, a liquidation process may be initiated against a company reporting negative net assets. Management believes that it is remote that the liquidation process will be initiated against those companies.

The Group has been and continues to be the subject of legal proceedings and adjudications from time to time. Management believes that the resolution of all such outstanding matters will not have a material impact on the Group's financial position or results of operations.

Taxation
Laws and regulations affecting businesses in the Russian Federation continue to change rapidly. These changes are characterized by poor drafting, different interpretations and arbitrary application by the authorities. Management's interpretation of such legislation as applied to the activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. It is therefore possible that significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. Where uncertainty exists, the Group has accrued tax liabilities as management's best estimate of the probable outflow of resources which will be required to settle such liabilities. Management believes that it has provided adequately for tax liabilities based on its interpretations of tax legislation. However, the relevant authorities may have differing interpretations, and the effects could be significant. Management believes that the total amount of possible tax risks, in accordance with FAS 5 "Accounting for Contingencies," is $3 615 as of 31 December 2006.

Environmental remediation costs
The Group's management believes that it is in compliance with applicable legislation and is not aware of any potential environmental claims; therefore, no liabilities associated with such costs are recorded as of 31 December 2006.

Capital commitments
At 31 December 2006, the Group had large capital projects in progress at JSC Lipetskmyasoprom and LLC Tambovmyasoprom. As part of these projects, commitments had been made to contractors of approximately $72 826 and $86 293, respectively, towards completion of the projects.

Also the Group is in the process of implementing an integrated management planning and accounting system related to the meat processing segment of the business. As part of this project, commitments have been made to contractors of approximately $1 678 toward completion of the project.

25 Subsequent events

For the period from January 1, 2007 through April 13, 2007, the Group made repayments on short-term and long-term debt of approximately $70 874. The Group also entered into additional agreements or received additional funds under existing short and long-term loan agreements over the same period totalling approximately $88 899.

At a general meeting of the shareholders of the Group on March 26, 2007, a decision was made to split the issued shares of the Group by converting each issued share with a par value of 1 rouble into 100 shares with a par value of .01 roubles per share.

On April 14, 2007, the Group signed a Memorandum of Understanding anticipating the acquisition of 100% of the share capital in the holding company of OAO Chicken Kingdom. No further details of any pending transaction were made public.