Consolidated Financial Statements for the years ended 31 December 1997 and 1996

Independent Auditors' Report to the Shareholders and Board of Directors of JSC "Krasnij Oktyabr"

We have audited the accompanying consolidated balance sheet of JSC "Krasnij Oktyabr" ("the Company") and its subsidiaries (collectively "the Group") as at 31 December 1997, and the related consolidated income statement, and cash flows for the year then ended set out on pages 4 to 28. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 as to 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

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 1997, and of the consolidated results of operations and cash flows for the year then ended in accordance with International Accounting Standards.

Without qualifying our opinion above, we draw attention to note 17 to the Financial Statements. Subsequent to 31 December 1997, significant economic difficulties in the Russian Federation have emerged. These include, but are not limited to, a steep decline in prices of domestic debt and equity securities, a devaluation of the Rouble, volatility in foreign exchange rates, increasing rates of interest on government and corporate borrowings, default on government debt and increased difficulty in obtaining or renewing financing facilities. The financial condition of the Group and its future operations could be adversely affected by continued economic difficulty. These financial statements do not include any adjustments which may be necessary as a result of these economic difficulties.

Coopers & Lybrand
Moscow, Russia
October 1998

Consolidated Balance Sheets as at 31 December 1997 and 1996

	Notes 1(a)	31 December 1997 For information purposes only Unaudited US$'000	31 December 1997 Rbl'mln	31 December 1996 Restated Rbl'mln
Assets				
Non current assets				
Intangible assets	2	30,654	182,693	186,754
Property, plant and equipment	3	89,814	535,295	434,148
Investments	4	2,629	15,665	35,672
Total Non-Current Assets		**123,097**	**733,653**	**656,574**
Current Assets				
Inventories	5	26,058	155,304	110,376
Trade and other receivables	6	17,073	101,755	111,133
Current investments		-	-	573
Cash and cash equivalents	7	21,072	125,591	54,993
Total Current Assets		**64,203**	**382,650**	**277,075**
Total assets		**187,300**	**1,116,303**	**933,649**
Shareholders' Equity				
Share capital	8	8,401	50,066	55,194
Share premium		61,049	363,850	231,158
Revaluation reserve		35,318	210,497	227,732
Paid in capital from treasury stock		2,990	17,826	17,766
Retained earnings		28,711	171,117	176,296
Total Shareholders' Equity	8	136,469	813,356	708,146
Minority Interest		3,812	22,714	2,362
		140,281	**836,070**	**710,508**
Liabilities				
Long-term Liabilities				

Interest bearing borrowings	9	5,940	35,400	-
Deferred income	10	1,665	9,924	9,746
Deferred taxation	11	14,114	84,119	82,057
Total Long-term Liabilities		21,719	129,443	91,803
Current Liabilities				
Interest bearing borrowings	9	4,416	26,316	20,900
Prepayments from customers		1,480	8,820	12,728
Trade accounts payable		5,186	30,909	27,915
Taxation and social security		4,750	28,318	30,632
Other payables		642	3,825	4,798
Dividends payable		4,598	27,403	17,417
Accruals and deferred income	10	4,228	25,199	16,948
Total Current Liabilities		**25,300**	**150,790**	**131,338**
Total Liabilities		**47,019**	**280,233**	**223,141**
Total Shareholders' Equity, Minority Interests and Liabilities		**187,300**	**1,116,303**	**933,649**

Consolidated Income Statements for the years ended 31 December 1997 and 1996

	Notes 1(a)	31 December 1997 For information purposes only Unaudited US$'000	31 December 1997 Rbl'mln	31 December 1996 Restated Rbl'mln
Revenue		174,506	1,040,058	1,028,636
Cost of sales		(116,167)	(692,355)	(667,093)
Gross profit		58,339	347,703	361,543
Other operating income		552	3,287	5,475
Selling and distribution expenses		(5,489)	(32,713)	(11,608)
General and administration expenses		(28,868)	(172,051)	(200,928)
Depreciation and amortisation	2, 3	(9,332)	(55,618)	(49,144)
profit from operations		15,202	90,608	105,338
Cost of providing social welfare		(5,376)	(32,046)	(27,315)
Amortisation of deferred income	10	802	4,785	3,967
Interest income		1,027	6,123	9,083
Interest expense		(1,669)	(9,949)	(1,914)
Loss on net monetary position		(2,600)	(15,493)	(17,027)
Loss on disposal of investments		(1,881)	(11,215)	-
Income from investments				
- Associated company	4	79	468	1,093
- Other		212	1,266	2,389
Profit before profit tax		5,796	34,547	75,614
Profit tax	12	(5,251)	(31,294)	(35,488)
Profit after tax		545	3,253	40,126
Minority interest		122	726	478
Net profit from operating activities		667	3,979	40,604
Dividends payable	13	(4,428)	(26,393)	(17,417)
Retained for the year	8	(3,761)	(22,414)	23,187
		US$	**Rbl**	**Rbl**
Earnings per share				
- basic and diluted	14	(135)	(807)	5,076

Consolidated Cash Flow Statements for the years ended 31 December 1997 and 1996

	Notes 1(a)	31 December 1997 For information purposes only Unaudited US$'000	31 December 1997 Rbl'mln	31 December 1996 Restated Rbl'mln
Cash flows from operating activities				
Profit before profits tax		5,796	34,547	75,614
Adjustments for non-cash transactions:				
Depreciation and amortisation	2, 3	9,332	55,618	49,144
Loss on disposal of tangible fixed assets		1,554	9,265	3,492
Loss on monetary position		2,599	15,493	17,027
Loss of disposal of investments		1,881	11,215	-
Amortisation of deferred income		(801)	(4,785)	(3,967)
Income from investments in associate companies	4	(79)	(468)	(1,093)
Income from investments in other		(212)	(1,266)	(2,389)

companies				
Interest expense		1,669	9,949	1,914
Interest income		(1,027)	(6,123)	(9,082)
Operating profit before working capital changes	15	20,712	123,445	130,660
Increase in trade and other receivables		(1,662)	(9,915)	(42,446)
Increase in inventories		(5,318)	(31,692)	(1,894)
(Decrease) / Increase in trade and other payables		(812)	(4,837)	67,875
Cash generated from operations		12,920	77,001	154,195
Interest paid		(1,720)	(10,249)	(2,385)
Profits tax paid		(3,556)	(21,192)	(75,428)
Net cash inflow from operating activities		7,644	45,560	76,382
Cash flows from investing activities				
Acquisition of subsidiaries net of cash acquired		(359)	(2,138)	(155)
Acquisition of interest in associates		-	-	(5,291)

Acquisition and disposal of fixed assets		(19,645)	(117,089)	(101,187)
Acquisition and disposal of investments		73	433	1,352
Interest received		1,237	7,374	10,535
Net cash utilised in investing activities		(18,694)	(111,420)	(94,746)
Cash flows from financing activities				
Proceeds from issuance of share capital		22,539	134,333	92,439
Repurchase of share capital		(1,126)	(6,708)	(15,794)
Proceeds from long-term borrowings		5,583	33,276	-
Dividends paid		(2,490)	(14,840)	(19,602)
Net cash from financing activities		24,506	146,061	57,043
Effect of inflation and exchange rate changes on cash and cash equivalents		(1,611)	(9,603)	(7,604)

Net increase in cash and cash equivalents		11,845	70,598	31,075
Cash and cash equivalents:				
Balance at the beginning of the year		9,227	54,993	23,918
Balance at the end of the year	7	21,072	125,591	54,993

Notes to the Consolidated Financial Statements

Background

JSC "Krasnij Oktyabr" ("the Company") was registered, in the Russian Federation, as an open joint stock company on 25 November 1992, in accordance with the Presidential Decree on Privatisation of State Enterprises No 721 dated 29 January 1992. At that time, the Company issued 224,001 shares, 51% issued to employees, 29% issued as voucher options (exercised), and 20% sold to raw material suppliers, as per the closed subscription.

The Company, together with its subsidiaries and associates, all incorporated in the Russian Federation, form "the Group". The Group's principal activities are the production of chocolate and confectionery within the Russian Federation. These are considered to comprise one industry and geographic segment.

1. ACCOUNTING POLICIES

(a) Basis of presentation

The Group companies maintain their accounting records and prepare their statutory financial statements in Russian Roubles in accordance with Federal Accounting Law No 129-FZ dated 21 November 1996, and the Regulations on Accounting and Reporting in the Russian Federation pursuant to Order No 170 of the Ministry of Finance of the Russian Federation dated 26 December 1994.

The accompanying financial statements are based on the statutory records, with adjustments and reclassifications to accord with International Accounting Standards ("IAS") promulgated by the International Accounting Standards Committee. The financial statements have been prepared using the historical cost convention, except that property, plant and equipment are stated at cost or valuation.

The Group has adopted IAS 12 (revised 1996) in the preparation of these financial statements, notwithstanding the fact that the standard is intended to apply to financial statements covering periods beginning on or after 1 January 1998.

The functional currency of the Group, and the reporting currency for these financial statements, is the Russian Rouble. However, these financial statements have also been presented in thousands of US Dollars for the convenience of readers outside the Russian Federation. The Financial Statements presented in thousands of US Dollars have not been audited.

For the purposes of this translation of convenience, the Rouble amounts, after appropriate adjustments for hyperinflation (see below), have been translated into US Dollars using the exchange rate at 31 December 1997 (5,960:1). The US Dollar amounts shown in the financial statements should not, however, be construed to represent that the Rouble amounts were, could have been, or will be, converted into US Dollars at that or any other rate of exchange. If the financial statements had been prepared in US Dollars by recording each transaction, or group of transactions, in US Dollars at the exchange rate applicable at the time of their occurrence, the figures in US Dollars might have differed significantly from those shown in these financial statements.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and operating costs during the reporting period. The most significant estimates relate to relisability and depreciable lives of property, plant and equipment, allowance for doubtful accounts, and deferred taxation. Actual results could differ from these estimates.

On 1 January 1998, the currency unit of the Russian Federation was redenominated with the effect that one thousand Roubles of the currency unit existing at 31 December 1997 became equivalent to one redenominated Rouble. All Rouble amounts appearing in these financial statements are stated in the currency unit existing at 31 December 1997 without adjustment for the subsequent redenomination.

(b) Inflationary accounting

IAS requires the financial statements reported in the currency of a hyperinflationary economy be stated in terms of current measuring units. All of the Group companies operate in an economy suffering from the effects of hyperinflation, defined as one in which the cumulative inflation rate in the last three calendar years exceeded 100%, and their financial statements are restated so that all figures are expressed in terms of the value of the currency at the most recent balance sheet date.

Management believes that indices derived from the Russian Federation Consumer Price Index ("the index") published by the Russian State Committee on Statistics ("Goskomstat"), set out below, provide the most appropriate measure of inflation in the economy (based on 1 January 1992 = 100):

	Inflation index
1 January 1993	2,968
1 January 1994	27,899
1 January 1995	87,883

1 January 1996	203,338
1 January 1997	247,762
1 January 1998	277,741

These have been applied to the historic cost values of transactions and balances as follows:

- All comparative figures including monetary assets and liabilities, and other disclosures in respect of earlier years, are restated by applying the change in the inflation index during the current year.
- Current year profit and loss transactions are restated by applying the change in the inflation index from the approximate date of the transaction to the balance sheet date.
- Monetary assets and liabilities at the latest balance sheet date are not restated.
- The gain or loss on net monetary position, which shows the effects of holding net monetary assets or liabilities, and inflating the individual items in the results of operations, is shown as a separate item in the consolidated profit and loss account.
- Non monetary assets and liabilities are restated by applying the change in the inflation index from the date of the transaction, or if applicable from the date of their most recent revaluation, to the latest balance sheet date, and are reduced to net realisable value, estimated recoverable value, or market value as necessary.

(c) Principles of consolidation

The Group comprises the Company and its subsidiaries. The effects of all transactions between entities within the Group are eliminated in full, and accounting policies of subsidiaries are conformed to those of the Company.

A subsidiary is an entity that is controlled by the Company, usually evidenced by ownership, directly or indirectly, of more than 50 percent of the voting share capital of the entity.

Associated entities over which the Company has a significant but not a controlling influence are accounted for using the equity method. Significant influence is usually evidenced by the Company owning, directly or indirectly, between 20% and 50% percent of the voting share capital.

Joint ventures in which the Group had joint control are included in the financial statements using the proportionate consolidation method.

(d) Method of consolidation

Acquisitions are recorded by use of the purchase method of accounting. The Company's interest in the individual assets and liabilities acquired is recognised separately at the date of acquisition, and measured at their fair value as at that date.

For subsidiaries that are not wholly owned, the minority's interest is measured at the proportion of the pre-acquisition carrying amounts of the assets and liabilities of the subsidiary, amended for the minority's share of subsequent profits or losses.

(e) Goodwill

Any excess of the cost of the acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired as at the date of acquisition ("goodwill") is treated as a long term asset and amortised over the assets useful life. This is considered to be a period of five years.

Where the acquirer's interest in the fair value of the identifiable assets and liabilities acquired as at the date of acquisition exceed the cost of acquisition, the excess ("negative goodwill") is treated as deferred income and recognised as income on a systematic basis over a period of five years.

(f) Intangible assets

Land rights have been capitalised based on an independent appraisers valuation of the rights assigned to the property that the Company leases from the City of Moscow, and are amortised over the lease term of 49 years.

(g) Property plant and equipment

All property, plant and equipment are carried at cost or valuation less accumulated depreciation. Cost or valuation includes all costs directly attributable to bringing the asset to working condition for its intended use.

All property, plant and equipment was revalued at 31 December 1995 to fair market value by independent appraisers. The increase in carrying value arising on revaluation, was credited directly to a revaluation reserve within shareholders' equity. Tax effects relating to the increases in carrying values of the assets are transferred from the revaluation reserve to the deferred tax balance.

The revaluation surplus included in equity is transferred directly to retained earnings when the surplus is realised. Some portion of the surplus is realised as assets are used, and the amount of this realised surplus is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. The remaining surplus is realised on the retirement or disposal of the asset.

In determining recoverable amounts of items of property, plant and equipment, expected future cash flows are discounted to their present values. Maintenance, repairs and minor renewals are charged to expense as incurred.

Items of plant and equipment that are retired or otherwise disposed of are eliminated from the balance sheet, along with the corresponding accumulated depreciation (if any). Any gain or loss resulting from such retirement or disposal is included in current income.

(h) Depreciation

Depreciation is recorded by a charge against income computed on a straight-line basis so as to amortise the cost or valuation of the assets over their expected useful lives. The expected useful lives are as follows:

Buildings	8 - 12
Plant, machinery and equipment	6 - 7
Non operating property (social assets)	23
Motor vehicles	5

(i) Long term investments

Investments held for the long term (other than subsidiaries, associates and joint ventures) are stated at cost, unless there has been an impairment in value below cost that is other than temporary. In that case, the investment is written down to its realisable value and the decrease is charged to income.

(j) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated on an average cost basis. Cost of work in progress and finished goods inventories includes materials, direct labour and an appropriate proportion of variable and fixed overhead expenditure.

(k) Trade accounts receivable

Trade accounts receivable are valued at expected realisable value, after provision for bad and doubtful accounts.

(l) Current investments

Investments held for the short term are stated at the lower of cost and market value determined on an individual investment basis.

(m) Components of cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks, and highly liquid investments with insignificant risk of changes in value and original maturities of three months or less at the date of acquisition.

(n) Taxes

The Company has adopted IAS 12 "Income taxes" (revised 1996). Prior periods have been restated to retrospectively reflect the effect of adoption of this revised standard.

Deferred taxation is provided using the balance sheet liability method based upon the concept of temporary differences. Under this method deferred taxes are required to be recognised for all temporary differences with certain specific exceptions. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset will be realised or the liability settled, based on tax rates and laws that have been enacted or substantively enacted at the balance sheet date. Deferred tax assets should be recognised when it is probable that taxable profits will be available against which the deferred tax asset can be utilised.

Tax inspectors in Russia often carry out detailed examinations of tax-payers' books and records months or even years after the period of assessment. Any additional taxes, fines and penalties which result or are expected to result from such examinations are recorded at the date of the assessment or when the preliminary findings of such examinations are known. These assessments are reflected in the current year's profit tax charge or are included in general and administrative expenses, as appropriate, together with estimates of liabilities for accounting periods which have not yet been subject to such examinations. Taxes payable by the Group on distribution to the Company of the undistributed profits of subsidiaries and associates are accrued, except where there is no intention to distribute those profits.

(o) Foreign currencies

Transactions denominated in foreign currencies are recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. Outstanding foreign currency monetary items at the balance sheet date are reported at the closing rate. Non-monetary items which are carried in terms of historical cost that is denominated in a foreign currency are reported using the exchange rate at the date of the transaction. Non-monetary items which are carried at fair value that is denominated in a foreign currency are reported using the exchange rates that existed when the values were determined.

Exchange differences arising on the settlement of monetary items or on reporting monetary items at rates different from those at which they were initially recorded in the period, or reported in previous financial statements, are recognised as income or expenses of the period in which they arise.

Cash flows arising from transactions in a foreign currency are recorded in the Group's reporting currency by applying to the foreign currency amount the average exchange rate for the year.

(p) Revenue recognition

Revenue from the sale of goods is recognised at the date goods are delivered.

(q) Research and development

Research and development costs are expensed as incurred.

(r) Non cash transactions

A certain proportion of purchases and sales are made directly to third parties in return for goods and services supplied, rather than for cash or credit. The fair value of the costs and revenues attributed by the Group to the counter value of such goods and services are accounted for as an addition to the Group's assets or inventory, a reduction in its liabilities, or charged or credited to income depending upon the nature of the goods or services supplied by the other party to the transaction.

(s) Financial instruments and Fair value

All financial instruments of the Group are reflected at fair value. Fair values are based on quoted prices for similar financial instruments, where available. For unquoted investments and investment securities, reported fair values are estimated on the basis of financial and other information. The Fair value of long term debt is estimated based on quoted market prices for similar issues by companies of similar credit status. The Fair value of derivatives are the amounts for which the open contracts could have been settled at the balance sheet date.

(t) Borrowing costs

Borrowing costs are charged to the Income Statement as an expense in the period in which they are incurred.

(u) Pension contributions

The Group is obliged to make contributions to the State pension scheme of the Russian Federation which requires contributions by the employer calculated as a percentage of current gross salary payments which is currently 28%. Such expense is charged to the Income Statement as incurred.

(v) Year 2000 costs

External and internal costs specifically associated with modifying internal use software for the year 2000 are charged to expense as incurred.

2. Intangible assets

	31 December 1997 Rbl'mln	31 December 1996 Rbl'mln
Trademarks & Licenses		
Balance at 1 January	-	371
Acquired during the year	-	-
Disposals	-	(371)
Balance at 31 December	-	-
Land rights		
Balance at 1 January	186,754	190,815
Amortised during the year	(4,061)	(4,061)
Balance at 31 December	182,693	186,754
Total intangible assets	182,693	186,754

The Group has a 49-year lease with the City of Moscow for the land on which the factory is constructed, entered into in 1993. The property is considered to be prime property, located on the bank of the river Moskva, in the centre of the city. The Group pays the City annual rent in the amount of approximately ECU 17,000 (US$ 19,000).

As of 31 December 1995, independent appraisers were retained to perform a valuation of the Group's fixed assets. The valuers placed a value on property land rights for the main Moscow factory location at Rbl'bln 190.8. The value was determined on the basis of future discounted cash flows which would be received by the Group if the property were to be vacated, and property subleased to other entities at the current Moscow property lease rates. Management of the Group consider the valuation to be a fair reflection of the current state of the property market in Moscow.

3. Property, plant and equipment

	Buildings Rbl'mln	Plant, machinery & equipment Rbl'mln	Non operating property Rbl'mln	Motor vehicles Rbl'mln	Total Rbl'mln
Cost or valuation					
At 1 January 1997	786,936	535,195	104,021	17,697	1,443,849
Additions in the year	17,508	102,379	6,244	1,270	127,401
Disposals in the year	(8,809)	(72,908)	(5,406)	(810)	(87,933)
Acquisition of subsidiaries	32,024	60,294	2,167	2,808	97,293
As at 31 December 1997	827,659	624,960	107,026	20,965	1,580,610
Depreciation					
At 1 January 1997	570,919	367,284	58,745	12,753	1,009,701
Charge for the year	12,464	31,404	1,370	6,319	51,557
Accumulated depreciation on disposal	(7,681)	(66,535)	(645)	(641)	(75,502)
Acquisition of subsidiaries	22,343	35,951	509	756	59,559
As at 31 December 1997	598,045	368,104	59,979	19,187	1,045,315
Net book value					
At 31 December 1997	229,614	256,856	47,047	1,778	535,295
At 31 December 1996	216,017	167,911	45,276	4,944	434,148

All assets were revalued to market value on the basis of valuations carried out by independent valuers as at 31 December 1995. IAS requires that the historic cost of assets should be disclosed. However, in the opinion of the Directors, this information, in a hyper - inflationary economy, would be of no benefit to users of these financial statements.

Assets in the Course of Construction

Assets in the course of construction included in tangible fixed assets amounted to Rbl'mln 120,021 (1996: Rbl'mln 71,726).

As at 31 December 1997, the Group had commitments for future capital construction expenditure in the amount of Rbl'mln 174,810 (1996: Rbl'mln 122,412).

4. Investments

A listing of significant subsidiaries, associates and joint ventures follows:

Name	**Country of Incorporation**	**Percent Ownership**	**Activity**
Subsidiaries			
OAO Ryazan confectionery factory "Red October"	Russia	97%	Confectionery production
OAO "TAKF" (Tambov)	Russia	52.2%	Confectionery Production
OAO "TKF Yasnaya Polyana"	Russia	50.2%	Confectionery Production
TOO "Yanus"	Russia	62.5%	Dairy Production
Joint Venture			
Cetefin S.A.	Russia	50.0%	Nut production

OAO "TKF Yasnaya Polyana" was acquired in June 1997 for cash consideration of Rbl'mln 2,496. Profits of this subsidiary were not significant to the group since acquisition.

A controlling interest in OAO "TAKF" (Tambov) was acquired for cash consideration of Rbl'mln 1,634 at 31 December 1997.

	31 December 1997 Rbl'mln	31 December 1996 Rbl'mln
Investments		
Investment in associated companies - below	2,971	11,781
Investments in other companies - not publicly quoted	12,694	23,891
Balance at 31 December	15,665	35,672
Associated companies		
Balance at 1 January	11,781	5,397
Investments acquired	-	3,753
Excess of cost of investment over share of net assets at acquisition	-	1,538
Amount reclassified as subsidiary on acquisition of controlling interest	(9,278)	-
Equity profit	468	1,093
At 31 December	2,971	11,781
Joint venture activity		
The following amounts have been proportionally consolidated in these financial statements as regards joint venture activity:		
Long term assets	627	731

Current assets	387	2,534
Current liabilities	(42)	(204)
Sales	528	4,431
Expenses	(883)	(540)

5. Inventories

	31 December 1997 **Rbl'mln**	**31 December 1996** **Rbl'mln**
Raw materials	110,564	85,569
Work in progress	14,536	12,159
Finished goods	30,204	12,648
	155,304	110,376

6. Trade and other receivables

	31 December 1997 **Rbl'mln**	**31 December 1996** **Rbl'mln**
Trade accounts and notes receivable	24,579	26,628
Taxation recoverable	10,819	7,477
Prepayments and accrued income	25,454	19,055
Deposits for tangible fixed assets	25,893	33,038
Other receivables	15,010	24,935
	101,755	111,133

7. Cash and cash equivalents

	31 December 1997 Rbl'mln	31 December 1996 Rbl'mln
Cash in hand	206	369
Cash at bank in local currency	92,015	6,131
Cash at bank in foreign currency	28,984	44,536
Promissory notes with Russian banks	4,386	3,957
	125,591	54,993

Promissory notes are included as cash equivalents as they mature within three months of issue.

Included in cash at bank in foreign currency at 31 December 1997 is Rbl'mln 18,028 (1996: Rbl'mln 20,611) held as security for the issue of a letter of credit to a supplier of tangible fixed assets (Note 3).

8. Shareholders' Equity

	Shares Number	Share Capital Rbl'mln	Share Premium Rbl'mln	Revaluation Reserve Rbl'mln	Paid in Capital from Treasury Stock Rbl'mln	Retained Earnings Rbl'mln	Total Equity Rbl'mln
At 31 December 1996	8,177,444	55,194	231,158	362,956	17,766	139,297	806,371
Prior year adjustment (Note 11)	-	-	-	(135,224)	-	36,999	(98,225)
As restated	8,177,444	55,194	231,158	227,732	17,766	176,296	708,146
Retained for the	-	-	-	-	-	(22,414)	(22,414)

year							
Shares issued	1,478,407	1,574	132,692	-	-	-	134,266
Shares repurchased	(68,365)	(6,702)	-	-	-	-	(6,702)
Profit on sale of treasury shares	-	-	-	-	60	-	60
Realised revaluation	-	-	-	(17,235)	-	17,235	-
At 31 December 1997	9,587,486	50,066	363,850	210,497	17,826	171,117	813,356

(a) Share Capital

	1997		1996	
	Number	**Rbl'mln**	**Number**	**Rbl'mln**
Ordinary shares				
Shares issued:				
× At 1 January	8,355,775	63,142	6,355,787	60,519
× Issue during the year	-	-	1,999,988	2,623
× At 31 December	8,355,775	63,142	8,355,775	63,142
Treasury stock held at 31 December	(242,838)	(14,571)	(178,331)	(7,948)
Shares outstanding	8,112,937	48,571	8,177,444	55,194
Preference shares				
Shares issued:				
× Issue during the year	1,474,549	1,495	-	-

× At 31 December	1,474,549	1,495	-	-
Shares outstanding	1,474,549	1,495	-	-
Total share capital	9,587,486	50,066	8,177,444	55,194

The Company has 8,355,779 authorised ordinary shares of Roubles 1,000 each and 1,474,549 preference shares of Roubles 1,000 each.

(b) Movements in the year

During 1997, the Company repurchased 68,365 ordinary shares (1996: 439,278) at a value of Rbl'mln 6,701 (1996: Rbl'mln 15,794) and 3,858 ordinary shares (1996: 310,230) have been sold for a net consideration of Rbl'mln 79 (1996: Rbl'mln 8,510).

The Company issued 1,474,549 preference shares at a premium of Roubles 90,369 per share on 14 July 1997.

In 1996, 2 million ordinary shares were placed from the sixth issue of share capital. Of this emission, 1.65 million ordinary shares were purchased by the City of Moscow (19.7% ownership). These shares were paid for 50% in cash, and the remainder as a grant of 15 property sites in various locations throughout Moscow. The majority of the properties were contributed to separate legal entities in exchange for a 100% shareholding in them. These locations are intended for use as distribution outlets for company's products.

(c) Other Reserves

The share premium and revaluation reserves cannot be distributed.

The paid in share capital from treasury stock reserve represents gains from disposal of treasury stock.

The reserves available for distribution to shareholders in accordance with Russian legislation amount to Rbl'mln 135,460 (1996: Rbl'mln 188,986).

(d) Ownership rights

The Company's ordinary shares carry voting rights, but have no guarantee of dividends becoming payable.

Holders of the Preference shares are entitled to receive dividends in preference to any dividend on the ordinary shares, when, as and if recommended by the Board of Directors and declared payable by the holders of the ordinary shares at the annual general meeting in an amount equal to US$ 1.20 per share for 1997 and 1998 (payable in Roubles) and, in each subsequent year, in the amount per share recommended by the Board of Directors and declared payable by the holders of the ordinary shares at the annual general meeting, which amount shall in no event be less than 130% of the annual dividend per share declared on the ordinary shares.

The holders of the preference shares are entitled to vote only on:

(a) any proposed reorganisation of liquidation of the Company,

(b) any proposed amendments to the Charter that limit the rights of the preference shares and

(c) any proposals upon which the holders of preference shares are entitled to vote pursuant to the law of the Russian Federation.

The preference shares are not convertible into ordinary shares and do not have rights to cumulative dividend.

9. Interest bearing borrowings

	31 December 1997 **Rbl'mln**	**31 December 1996** **Rbl'mln**
Bank loans	61,716	20,900
less: current portion of interest bearing borrowings	(26,316)	(20,900)
	35,400	-

During the year the Company extended its credit facilities to US$'mln 10 (1996: US$'mln 5) and established a line of credit in the amount of Rbl'mln 25,000. As at 31 December 1997 the Company had drawn down US$'mln 9.1 (1996: US$'mln 3.3) and Rbl'mln 4,400.

The lender of the US Dollar loan has a right of set-off against the Company's current account without notification. The loan is otherwise unsecured. Each tranche is for the duration of 6 months, and bear interest at the rate of LIBOR + 6% (1996: 7%). However, management consider the core debt to rollover into new tranches and have classified this as long term borrowings, not withstanding the debt becoming repayable within 6 months.

Stocks of raw materials in the amount of Rbl'mln 42,285 are pledged as security for the Rouble denominated loan. The loan bears interest at the rate of 30% and is repayable on 22 December 1998.

As at 31 December 1996 and 1997, in the opinion of management, interest rates available on new borrowing facilities were not materially different from the rates disclosed above. Therefore carrying amounts were not significantly different from their fair value.

Subsequent to 31 December 1997, significant economic difficulties have emerged in the Russian Federation that may mean that continued availability of loan financing on similar terms and conditions may become more difficult - see Note 17.

10. Deferred income

	31 December 1997 Rbl'mln	31 December 1996 Rbl'mln
Negative goodwill arising on consolidation of subsidiaries:		
As at 1 January	13,681	18,234
Acquired during the year	6,204	(586)
Released to income	(4,785)	(3,967)
As at 31 December	15,100	13,681
Less: current amount included in accruals and deferred income	(5,176)	(3,935)
	9,924	9,746

11. Deferred Taxation

In accordance with IAS 12, "Accounting for Taxes on Income", in previous years the Company has utilised the liability method of accounting for income taxes based upon the concept of timing differences. Under this method, deferred tax assets and liabilities were determined based upon the expected tax effects of items that were either taxable or tax deductible in periods different from those in which they are recorded in the financial statements. Deferred taxes were not required to be recognised for timing differences that would not reverse for some considerable period, of not less than three years. In addition, the Company did not recognise deferred taxes for revaluations of assets as was permitted by IAS 12. Deferred tax assets and liabilities were calculated using the rates of tax expected to apply when the timing differences reverse. The Company recognised deferred tax assets resulting from timing differences only when there was a reasonable expectation of realisation.

In 1996, the IASC replaced IAS 12 "Accounting for Taxes on Income" with "IAS 12 (revised 1996) "Income Taxes". The revised standard becomes operative for financial statements covering periods beginning on or after January 1, 1998. However the Company has chosen to adopt the new standard for the purposes of preparation of these financial statements. IAS 12 (revised 1996) requires an enterprise to account for deferred taxes under the balance sheet liability method based upon the concept of temporary differences. Deferred taxes are required to be recognised for all temporary differences with certain specific exceptions. Deferred tax assets and liabilities should be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax assets should be recognised when it is probable that taxable profits will be available against which the deferred tax asset can be utilised.

The adoption of IAS 12 (revised 1996) represents a change in accounting policy which occurs on the adoption of an International Accounting Standard. In accordance with IAS, the change in treatment has been applied retrospectively such that the resulting adjustment that relates to prior periods is reported in these financial statements as an adjustment to the opening balance of retained earnings (see note 8 to these financial statements), and comparative information has been restated.

The movements in net deferred taxation during the years ending 31 December 1997 and 1996, were as follows:

	31 December 1997 **Rbl'mln**	**31 December 1996** **Restated** **Rbl'mln**
As at beginning of year as previously stated	(16,168)	(3,846)
Prior year adjustment	98,225	101,474
Beginning of year as restated	82,057	97,628
Charge/(credit) for the year	2,062	(15,571)
Deferred tax liability as at 31 December	84,119	82,057

The components of net deferred tax assets and liabilities were as follows as of 31 December:

	31 December 1997 **Rbl'mln**	**31 December 1996** **Restated** **Rbl'mln**
Deferred tax assets		
Property Plant and equipment (other than included in revaluation)	20,301	39,715
Treasury stock profits, taxable in prior periods	8,094	1,930
Other	13,556	23,319
Total deferred tax assets	41,951	64,964

Deferred tax liabilities		
Revaluation of property, plant, equipment and intangible land rights debited to equity	121,883	131,164
Other	4,187	15,857
Total deferred tax liabilities	126,070	147,021
Net total deferred tax liabilities	84,119	82,057
Aggregate temporary differences associated with investment in subsidiary not recognised	21,975	3,471

In addition deferred tax of Rbl'mln 9,281 (1996: Rbl'mln 8,470) was transferred from retained earnings to revaluation reserve. This relates to the difference between the actual depreciation/amortisation charged on carrying value and that charged to taxable profits.

12. Taxes

	31 December 1997 **Rbl'mln**	**31 December 1996** **Restated** **Rbl'mln**
Current profit tax expense	29,028	50,758
Equity share of profits tax of associates	204	301
Deferred tax expense relating to the origination and reversal of temporary differences	2,062	(15,571)
Profit tax expense for the year	31,294	35,488
Explanation of the relationship between profits tax expense and profit before profits tax		
Profit before profits tax	34,547	75,614

Profit tax calculated at 35% (1996: 35%)	12,091	26,465
Tax relief for capital investment	(26,328)	(16,436)
Tax effect of:		
× income not assessable to tax	(1,675)	(1,389)
× expenses not deductible for tax purposes	47,206	26,848
Profits tax expense for the year	31,294	35,488

13. Dividends

The Board of Directors declared a dividend of 2 redenominated Roubles per ordinary share and 1.2 US Dollars per preference share payable between April and September 1998 to shareholders on the register on 16 March 1998 for the year ended 31 December 1997. Based on the results to 31 December 1996, dividends were declared in the amount of 1,900 Roubles per ordinary share, which were paid in 1997.

14. Earnings per share

Basic and diluted earnings per ordinary share is calculated by dividing net (loss)/profit from operating income after tax (and preferred dividends) for the year of Rbl'mln (6,567) (1996: Rbl'mln 40,604) by the weighted average number of ordinary shares in issue during the year; 8,141,420 shares (1996: 7,998,576 shares).

15. Non Cash Transactions

Included in sales are barter transactions amounting to Rbl'mln 94,030 (1996: Rbl'mln 106,653). These transactions have been valued at fair value for the goods and services exchanged.

16. Related party transactions

As disclosed in Note 2, the Group has a 49-year property lease from the City of Moscow, which has become a 19.7% shareholder in the Company during 1996. Annual lease payments are approximately 17,000 ECU (US$ 19,000) for 90,000 m2, which is significantly less than the market value of such property in Moscow at this time.

17. Post balance sheet events

(a) Economic Difficulties in the Russian Federation

Subsequent to 31 December 1997 significant economic difficulties in the Russian Federation have emerged. These include, but are not limited to, a steep decline in prices of domestic debt and equity securities, a devaluation of the rouble, volatility in foreign exchange rates, increasing rates of interest on government and corporate borrowings, default on government debt, and increased difficulty in obtaining or renewing financing on similar terms and conditions as prevailed at 31 December 1997.

An investment held for the long term amounting to Rbl'mln 6,678 may have no value as at the date of release of these financial statements as result of the above circumstances.

It is not possible at the time of signing these financial statements for management to predict the extent, severity or duration of the current economic difficulties nor quantify what impact they may have on the current financial position or future operations of the Group, although the circumstances as they affect the Group are being constantly evaluated in order to minimise any adverse impact on the Group.

(b) Contracts Entered into Subsequent to Balance Date

On 23 April 1998, the Company acquired 54% of OOO "Konditer" for a consideration of Rbl'mln 3,778.

18. Contingencies

(a) Legal proceedings

The Company is subject to a number of proceedings arising out of the normal conduct of its business. The Company believes that the ultimate resolution of these matters will not have a material adverse effect on the results of operations or the financial position of the Company.

(b) Taxation environment

Taxation inspections in Russia frequently involve detailed examinations of tax payers accounting records and procedures months or even years after the end of the period of assessment. The penalty regime is punitive. Consequently, companies can find themselves subject to the imposition of costs and fines which can be significant.

(c) Insurance

The Group does not carry insurance on any of its assets except raw materials. Risks such as public liability are not insured.

19. Financial instruments

The Group maintains cash and cash equivalents with various financial institutions. The Group's policy is to deal only with financial institutions which are well established and considered by management to be subject to minimal risk of default and temporary or permanent loss of availability of funds.

Credit risk with respect to trade accounts receivable is dispersed due to the company's large customer base, and given that most customers in Russia are required to prepay for goods or pay cash on delivery.

The Group utilises term credit facilities denominated in foreign currency. The interest rates applied to the facility is a floating interest rate based on LIBOR.

The carrying amounts of financial assets and liabilities approximate to their fair value.