Open Joint Stock Company “Company M.video” and subsidiaries

Consolidated Financial Statements
Year Ended 31 December 2008

OJSC "COMPANY M.VIDEO" AND SUBSIDIARIES

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OJSC "COMPANY M.VIDEO" AND SUBSIDIARIES

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on pages 2-3 is made with a view of distinguishing the respective responsibilities of the management and those of the independent auditors in relation to the consolidated financial statements of OJSC "Company M.video" and subsidiaries (the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the consolidated financial position of the Group as at 31 December 2008 and the consolidated results of its operations, cash flows and changes in equity for the year then ended, in compliance with International Financial Reporting Standards ("IFRS").

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 prudent;
- Stating whether IFRS have 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 consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- 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
- Detecting and preventing fraud and other irregularities.

The consolidated financial statements for the year ended 31 December 2008 were approved on 24 June 2009 by:

A. Tynkovan	**C. Parks**
Chief Executive Officer	Chief Financial Officer

Deloitte.

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INDEPENDENT AUDITORS' REPORT

To the shareholders of Open Joint Stock Company "Company M.video":

We have audited the accompanying consolidated financial statements of Open Joint Stock Company "Company M.video" and its subsidiaries (the "Group"), which comprise of the consolidated balance sheet as at 31 December 2008 and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the preparation and fair presentation of the consolidated financial statements in order to design 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2008, and its consolidated financial performance and the consolidated results of its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte & Touche

Moscow
24 June 2009

CONSOLIDATED BALANCE SHEET
AS AT 31 DECEMBER 2008
(in millions of Russian Rubles)

	Notes	31 December 2008	31 December 2007
ASSETS			
NON-CURRENT ASSETS:			
Property, plant and equipment*	6	5,917	4,418
Intangible assets*	7	335	43
Long-term loans and notes receivable		5	5
Deferred tax assets	15	915	723
Advances paid for property, plant and equipment		-	42
Forward exchange contract		388	32
Other assets*		114	65
Total non-current assets		**7,674**	**5,328**
CURRENT ASSETS:			
Inventories	8	14,115	10,187
Trade accounts receivable	9	138	76
Other accounts receivable and prepaid expenses	10	2,043	1,758
Value added tax recoverable and other taxes receivable	11	1,489	1,590
Income tax receivable		54	6
Other current assets*		164	97
Forward exchange contract		433	-
Short-term investments*	12	1,624	1,305
Cash and cash equivalents	13	5,448	2,380
Total current assets		**25,508**	**17,399**
TOTAL ASSETS		**33,182**	**22,727**

* For information relating to prior period reclassification, refer to Notes 2, 23.

CONSOLIDATED BALANCE SHEET (CONTINUED)
AS AT 31 DECEMBER 2008
(in millions of Russian Rubles)

	Notes	2008	2007
EQUITY AND LIABILITIES			
EQUITY:			
Share capital	14	1,798	1,798
Additional paid-in capital		4,576	4,576
Retained earnings		1,615	265
Total equity		**7,989**	**6,639**
NON-CURRENT LIABILITIES:			
Long-term loans and borrowings	16	3,114	2,127
Deferred tax liabilities	15	446	507
Provisions*	23	119	68
Total non-current liabilities		**3,679**	**2,702**
CURRENT LIABILITIES:			
Trade accounts payable	17	14,878	9,176
Other payables and accrued expenses	18	1,309	600
Advances received from customers		318	293
Bonds payable	19	-	118
Short-term loans and borrowings	21	3,943	2,565
Value added tax and other taxes payable	20	138	98
Income tax payable		263	111
Deferred revenue	22	505	305
Provisions*	23	160	104
Forward exchange contract		-	16
Total current liabilities		**21,514**	**13,386**
Total liabilities		**25,193**	**16,088**
TOTAL EQUITY AND LIABILITIES		**33,182**	**22,727**

* For information relating to prior period reclassifications, refer to Notes 2, 23.

The Notes on pages 10 to 59 form an integral part of these consolidated financial statements. The independent auditors' report is presented on pages 2-3.

Signed on behalf of the Board of Directors: 24 June 2009.

A. Tynkovan
Chief Executive Officer

C. Parks
Chief Financial Officer

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008
(in millions of Russian Rubles, except earning per share)

	Notes	2008	2007
REVENUE	24	71,486	52,317
COST OF SALES*	25	(53,610)	(40,352)
GROSS PROFIT		17,876	11,965
Selling, general and administrative expenses*	26	(16,071)	(10,733)
Other operating income*	27	1,061	994
Other operating expenses*	28	(133)	(142)
OPERATING PROFIT		2,733	2,084
Finance costs, net*	29	(365)	(848)
PROFIT BEFORE INCOME TAX EXPENSE		2,368	1,236
INCOME TAX EXPENSE	15	(1,112)	(587)
NET PROFIT FOR THE YEAR		**1,256**	**649**
WEIGHTED AVERAGE NUMBER OF ORDINARY SHARES FOR BASIC AND DILUTED EARNINGS PER SHARE (in millions)**		180	155
BASIC AND DILUTED EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT (in RUB)		6.98	4.19

* For information relating to the prior year reclassification, refer to Notes 2, 25, 26, 28 and 29.

** The Company’s share registry for 30 million ordinary shares additionally issued in November 2007 was changed on 15 February 2008 (refer to Note 14).

The Notes on pages 10 to 59 form an integral part of these consolidated financial statements. The independent auditors’ report is presented on pages 2-3.

Signed on behalf of the Board of Directors: 24 June 2009.

A. Tynkovan
Chief Executive Officer

C. Parks
Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2008
(In millions of Russian Rubles)

	Notes	Share capital	Additional paid-in capital	Retained earnings/ (Accumulated deficit)	Total
Balance as at 1 January 2007		**1,498**	**-**	**(403)**	**1,095**
Issuance of shares	14	300	4,649	-	4,949
Share issuance costs		-	(92)	-	(92)
Related deferred income tax	15	-	16	-	16
Related current income tax	15	-	3	-	3
Recognition of share-based payment for ordinary shares previously issued	30	-	-	26	26
Related deferred income tax	15	-	-	(6)	(6)
Related current income tax	15	-	-	(1)	(1)
Net profit for the year		-	-	649	649
Balance as at 31 December 2007		**1,798**	**4,576**	**265**	**6,639**
Recognition of share-based payment for ordinary shares previously issued	30	-	-	87	**87**
Reversal of related income tax previously recognized in equity	15	-	-	7	**7**
Net profit for the year		-	-	1,256	1,256
Balance as at 31 December 2008		**1,798**	**4,576**	**1,615**	**7,989**

The Notes on pages 10 to 59 form an integral part of these consolidated financial statements. The independent auditors' report is presented on pages 2-3.

Signed on behalf of the Board of Directors: 24 June 2009.

A. Tynkovan
Chief Executive Officer

C. Parks
Chief Financial Officer

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2008
(In millions of Russian Rubles)

	Notes	2008	2007
OPERATING ACTIVITIES:			
Net profit for the year		1,256	649
Adjustments for:			
Income tax expense recognized in profit or loss	15	1,112	587
Interest expense on loans	29	631	583
Interest income	29	(226)	-
Coupon yield expense	29	10	171
Loss on sale or disposal of property, plant and equipment	6	2	-
Depreciation, amortization and impairment loss	26	863	523
Net foreign exchange loss/(gain)	27,29	734	(25)
Change in allowance for doubtful trade accounts receivable	9	-	23
Share-based payment	30	87	26
(Reversal)/accrual of allowance for doubtful notes receivable		(12)	31
Accrual of allowance for doubtful advances paid	10	90	30
Change in fair value of forward contracts	29	(937)	22
Change in allowance for goods returns		5	23
Change in allowance for obsolete and slow-moving goods	8	531	243
Change in allowance for probable tax risks other than income tax	33	-	7
Operating cash flows before movements in working capital		4,146	2,893
(Increase) in inventories		(4,469)	(3,469)
(Increase)/decrease in trade accounts receivable		(58)	545
(Increase) in other current assets		(13)	-
(Increase) in other accounts receivable and prepaid expenses		(453)	(481)
Decrease in value added tax recoverable and other taxes receivable		101	76
Decrease in deferred costs		-	17
Increase in trade accounts payable		5,462	3,367
Increase in other payables and accrued expenses		867	349
Increase in advances received from customers		25	144
Increase in warranty provision		5	-
Increase/(decrease) in value added tax and other taxes payable		40	(64)
Increase in deferred revenue		200	163
Cash generated by operations		5,853	3,540
Income tax paid		(1,254)	(1,130)
Interest paid		(629)	(894)
Forward contracts settlement		132	(53)
Net cash generated by operating activities		**4,102**	**1,463**

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2008
(In millions of Russian Rubles)

	2008	2007
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment (including construction in progress)	(2,535)	(1,476)
Short-term investments with banks	(4,834)	(1,690)
Proceeds from settlement of short-term investments	4,766	400
Decrease/(increase) in advances paid for property, plant and equipment	42	(28)
Purchases of intangible assets	(334)	(19)
Receipts from settlements of loans and notes receivable	29	114
Cash invested in loans and notes receivable	-	(41)
Interest received	304	-
Net cash used in investing activities	**(2,562)**	**(2,740)**
FINANCING ACTIVITIES:		
Proceeds from issue of equity shares, net of issuance cost	-	4,911
Proceeds from sale of equity shares	-	28
Proceeds from long-term borrowings	2,880	74
Proceeds from short-term borrowings	18,418	33,060
Repayment of borrowings	(19,833)	(33,465)
Bonds repaid	(118)	(1,883)
Net cash generated by financing activities	**1,347**	**2,725**
NET INCREASE IN CASH AND CASH EQUIVALENTS	**2,887**	**1,448**
NET FOREIGN EXCHANGE DIFFERENCE	181	-
CASH AND CASH EQUIVALENTS at the beginning of the year	**2,380**	**932**
CASH AND CASH EQUIVALENTS at the end of the year	**5,448**	**2,380**

Refer to Notes 6, 10 and 30 for details of non-cash transactions.

The Notes on pages 10 to 59 form an integral part of these consolidated financial statements. The independent auditors' report is presented on pages 2-3.

Signed on behalf of the Board of Directors: 24 June 2009.

A. Tynkovan
Chief Executive Officer

C. Parks
Chief Financial Officer

In millions of Russian rubles

1. GENERAL INFORMATION

The consolidated financial statements of OJSC "Company M.video" (the "Company") and subsidiaries (the "Group") for the year ended 31 December 2008 were authorized for issue in accordance with a resolution of the Board of Directors on 24 June 2009.

The Company and its subsidiaries (see the table below) are incorporated in the Russian Federation. The Company is registered at: 40/12, building 20, Nizhnaya Krasnoselskaya Street, Moscow, 105066, Russian Federation. Following the initial public offering in November 2007, the Company's shares were admitted to trading on RTS and MICEX in the Russian Federation.

LLC "Company M.video" was incorporated on 3 December 2003. The reorganization of the Group's operational activities occurred over the period to December 2005 with the full trading operations commencing on 1 January 2006. On 25 September 2006 the Company was reorganized from a Limited Liability Company to an Open Joint Stock Company.

The Group is the operator of a chain of consumer electronic stores operating in the Russian Federation. The Group specializes in the sale of TV, audio, video, Hi-Fi, home appliances and digital equipment, as well as related services.

The Group operates in two sectors: retail and wholesale. The retail sector is comprised of a chain of owned and leased stores (157 stores as at 31 December 2008; 122 stores as at 31 December 2007) and two online internet stores that sell to end users. The wholesale sector is comprised of sales to other retailers.

The accompanying consolidated financial statements include assets, liabilities and result of operations of the following Company's subsidiaries as at 31 December 2008 and 2007:

Name of subsidiary	Nature of business	Proportion of ownership interest and voting power held, % 2008	Proportion of ownership interest and voting power held, % 2007
LLC "M.video Management"	Trading	100	100
LLC "M.video Torg"	Equipment	100	100
LLC "M.video Trade"	Trading	100	100
LLC "Sphera Invest"	Real estate	100	100
LLC "Standard Invest"	Real estate	100	100
LLC "M.video Finance"	Finance	100	100

Shareholders

As at 31 December 2008 and 2007 the registered shareholders of OJSC "Company M.video" and their respective ownership and voting interests were as follows:

	2008	2007
Svece Limited	69.9626%	69.9626%
M.video Holding (Cyprus) Limited	0.7405%	0.8331%
Various shareholders	29.2969%	29.2043%
Total	**100%**	**100%**

Ultimate Shareholders

M.video Investment Ltd. (BVI), a company incorporated in the British Virgin Islands controls 100% of the voting and ordinary shares of M.video Holding (Cyprus) Limited and Svece Limited (a company incorporated in Cyprus), and is the ultimate parent entity of the Company.

Mr. Alexander Tynkovan, a citizen of the Russian Federation, has a controlling interest in M.video Investment Ltd. (BVI).

2. BASIS OF PREPARATION

Statement of compliance

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

Basis of Accounting

The consolidated financial statements have been prepared on a historical cost basis except for the valuation of financial instruments in accordance with IAS 39 "Financial Instruments: Recognition and Measurement" ("IAS 39") and valuation of items of property, plant and equipment measured at fair value which was used as deemed cost of the property, plant and equipment as at the date of transition to IFRS. The Group transitioned to IFRS on 1 January 2006.

All companies within the Group maintain their accounting records in accordance with Russian Accounting Standards ("RAS"). RAS differ substantially from those standards generally accepted under IFRS. Accordingly, the consolidated financial statements, which have been prepared based on the Russian statutory accounting records, reflect those adjustments necessary for such consolidated financial statements to be presented in accordance with IFRS.

Functional and presentation currency – The consolidated financial statements are presented in Russian Rubles ("RUB"), which is the Company's functional and presentation currency. Functional currency for each Group company has been determined as the currency of the primary economic environment in which the company operates.

Adoption of new standards and interpretations

The accounting policies adopted are consistent with those of the previous financial year except as discussed below.

The Group has adopted the following new and amended standards and IFRIC interpretations in these annual consolidated financial statements:

- IFRIC 11 "IFRS 2 – Group and Treasury Share Transactions";
- IFRIC 12 "Service Concession Arrangements";
- IFRIC 14 "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction".

The Group does not currently have any transactions that fall within the scope of IFRIC 12 and 14.

IFRIC 11 “IFRS 2 – Group and Treasury Share Transaction”

The Group has adopted IFRIC Interpretation 11 insofar as it applies to consolidated financial statements. This interpretation requires arrangements whereby an employee is granted rights to an entity’s equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed. The adoption of this interpretation did not have any effect on the financial position or performance of the Group as the Group’s accounting treatments of such transactions were consistent with the new interpretation.

The Group has early adopted the following standards and interpretations in these annual consolidated financial statements:

- IAS 23 “Borrowing Costs” (revised);
- IFRIC 13 “Customer Loyalty Program”.

IAS 23 “Borrowing Costs” (Revised)

The International Accounting Standards Board (“IASB”) issued an amendment to IAS 23 in April 2007. The revised IAS 23 requires capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. The Group’s previous policy was to expense borrowing costs as they were incurred. In accordance with the transitional provisions of the amended IAS 23, the Group has adopted this standard on a prospective basis. Therefore, borrowing costs are capitalized on qualifying assets with commencement date on or after 1 January 2008. A total of 8 million RUB of borrowing costs has been capitalized during the year ended 31 December 2008.

IFRIC 13 “Customer Loyalty Program”

The IFRIC issued IFRIC 13 in June 2007. This interpretation requires customer loyalty credits to be accounted as a separate component of the sales transaction in which they are granted. A portion of the fair value of the consideration received is allocated to the award credits and deferred. This is then recognized as revenue over the period that the award credits are redeemed. The Group applied this interpretation in connection with commencement of the Group’s new loyalty program in May 2008. As the loyalty program was operating only for a part of this reporting period, the prior year financial information has not been affected. A portion of the revenue attributable to award credits not yet redeemed by the Group’s customers as at 31 December 2008 was presented as deferred revenue in these consolidated financial statements and amounted to 113 million RUB.

Other changes in the application of the Group’s accounting policies

The Group has also changed accounting policy with respect to capitalization of expenditures on low value non-current assets. The nature and principle effect of this change are described below.

Capitalization of the expenditures on low value non-current assets

Due to change in approach starting 2008 the Group capitalizes expenditures on low value non-current assets such as furniture, trade equipment and computer equipment when it is probable that the Group will derive future economic benefits from them. Such low value assets are aggregated by specific groups when purchased and depreciated over three years. In prior periods the Company expensed these items immediately when the assets were acquired. The Group applied this change in accounting prospectively as it was impracticable to determine the prior period effect of this change. However, the Group believes that any potential effect of this change resulting from its retrospective application would not be material. The total value of low value items capitalized as part of property, plant and equipment during the year ended 31 December 2008 amounted to 73 million RUB.

In millions of Russian rubles

Reclassifications

In 2008 the Group changed presentation of certain items of assets, liabilities, income and expenses in order to enhance fair presentation of the consolidated financial statements. With this regard the Group made the following reclassifications to the prior year amounts to conform to the presentation of the current reporting period:

	as previously reported	reclassification	after reclassification	comment
Consolidated Balance Sheet				
Other non-current assets	162	(97)	65	Reclassification of the short term portion of the warranty provision in respect of additional service agreements together with equal corresponding asset (Note 23).
Other current assets	-	97	97	
Provisions, non-current	165	(97)	68	
Provisions, current	7	97	104	
Property, plant and equipment	4,412	6	4,418	Other insignificant reclassifications
Construction in progress	20	(20)	-	
Intangible assets	29	14	43	
Short-term loans and notes receivable	15	(15)	-	
Short-term investments	1,290	15	1,305	
Consolidated Income Statement				
Cost of sales	(39,953)	(399)	(40,352)	Transportation expenses incurred in 2007 related to goods delivered from suppliers outside the Russian Federation to the Group's warehouses in Moscow reclassified as part of the net cost of merchandise inventory sold (Notes 25 and 26).
Selling, general and administrative expenses	(11,132)	399	(10,733)	
Other operating income	947	47	994	Exchange difference arising from foreign currency borrowings incurred in 2007 was reclassified into finance cost (Notes 27, 28 and 29).
Other operating expenses	(167)	25	(142)	
Finance cost, net	(776)	(72)	(848)	

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation – The consolidated financial statements comprise the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The financial statements of the subsidiaries are prepared for the same reporting year as the parent company, using consistent accounting policies.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases.

All intra-group transactions, balances, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full on consolidation.

Business and geographic segments – The Group has only one reportable business and geographic segment thus according to IAS 14 "Segment Reporting" the Group does not present segment reporting information.

Going concern – These IFRS consolidated financial statements are prepared on the going concern basis.

Foreign currencies – The individual financial statements of each Group's entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency).

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing at the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are translated at the rates prevailing at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences are recognized in profit or loss in the period in which they arise. Exchange differences arising on loans and borrowings are reported as part of finance cost, while exchange differences related to operating items are included into other operating income and expenses.

Property, plant and equipment – Property, plant and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses. Deemed cost of the items of property, plant and equipment existing as at 1 January 2006, the date of transition to IFRS, was determined on the basis of fair values determined by independent appraisers as allowed by the provisions of IFRS 1. Fair value of properties was determined with reference to market prices, while fair value of the other items, including the Group's trade equipment, was predominantly based on the estimates of depreciated replacement costs. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Major replacements or modernizations of property, plant and equipment are capitalized and depreciated over their estimated useful lives. All other repair and maintenance expenditure is charged to the income statement during the financial period in which it is incurred.

Depreciation is charged so as to write off the cost or valuation of assets over their estimated useful lives, using the straight line method, on the following bases:

Buildings	20-30 years
Leasehold improvements	2-7 years
Trade equipment	5 years
Security equipment	3 years
Other fixed assets	3-5 years

For leasehold improvements the depreciation period includes the period when the Group has the possibility to extend the period of the lease, taking into account the legal provisions relating to lease terms, and its intention to seek a long term presence in the various retail locations in which it operates. This is relevant for leases of retail space which, on a portfolio basis, have a history of successful renewal. All other leasehold improvements are depreciated over the shorter of useful life or the related lease term.

Trade equipment is depreciated over the estimated useful life specified above unless there is a plan to fully renovate the store prior to reaching the predetermined estimated useful life. In this situation, the net book value of trade equipment will be depreciated over the remaining estimated useful life being the period of time up to the planned renovation works.

The assets' residual value and useful lives are reviewed and adjusted, if appropriate, at each balance sheet date. Where there are indicators that an asset's or cash generating unit's carrying amount is greater than its estimated recoverable amount, it is written down to its recoverable amount.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in income.

Construction in progress comprises the cost of equipment in the process of installation and other costs directly relating to the construction of property, plant and equipment including an appropriate allocation of directly attributable variable overheads that are incurred in construction. Depreciation of these assets, on the same basis as for other property assets, commences when the assets are ready for their intended use.

Intangible assets – Intangible assets acquired separately are reported at cost less accumulated amortization and accumulated impairment losses. Amortization is charged on a straight-line basis over estimated useful lives of these intangible assets. The estimated useful life and amortization method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

The estimated useful lives per class of intangible assets are as follows:

Software licenses	5-10 years;
Trade marks	5-10 years.

Impairment of tangible and intangible assets – At each balance sheet date the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit ("CGU") to which the asset belongs. For tangible and intangible assets the CGU is deemed to be each group of stores located in one city. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Taxation – Income tax expense represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred tax is recognized on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences, and deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are not recognized for taxable temporary differences associated with investments in subsidiaries as the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to be reversed in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to be applied in the period in which the liability is settled or the asset is realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax for the period

Current and deferred tax are recognized as an expense or income in the consolidated income statement, except when they relate to items credited or debited directly to equity, in which case the tax is also recognized directly in equity, or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is taken into account in calculating goodwill or in determining the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost.

Fair value – The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investment where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arms length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis or other valuation models.

Financial assets – Investments are recognized and derecognized on a trade date, where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into the following specified categories: financial assets as 'at fair value through profit or loss' ("FVTPL"), 'held-to-maturity investments', 'available-for-sale' ("AFS") financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

<u>Effective interest method</u>

The effective interest method is a method of calculating the amortized cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognized on an effective interest basis for debt instruments other than those financial assets designated as at FVTPL.

<u>Financial assets as at FVTPL</u>

Financial assets are classified as at FVTPL where the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held for trading if:

- It has been acquired principally for the purpose of selling in the near future; or
- It is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 "Financial instruments: recognition and measurement" permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets as at FVTPL are stated at fair value, with any resultant gain or loss recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any dividend or interest earned on the financial asset. Fair value is determined in the manner described in Note 3 above.

Held-to-maturity investments

Held-to-maturity investments are recorded at amortized cost using the effective interest method less impairment, with revenue recognized on an effective yield method. For the periods covered by the accompanying financial statements, the Group did not hold any investments in this category.

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortized cost using the effective interest method less any impairment and bad debts. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Available for sale financial assets

Available for sale ("AFS") financial assets are those non-derivative financial assets that are designated as available for sale or are not classified in any of the three preceding categories. After initial measurement, available for sale financial assets are measured at fair value with unrealized gains or losses being recognized directly in equity in the net unrealized gains reserve. When the investment is disposed of, the cumulative gain or loss previously recorded in equity is recognized in the income statement. Interest earned or paid on the investments is reported as interest income or expense using the effective interest rate. Dividends earned on investments are recognized in the income statement as 'Dividends received' when the right or payment have been established.

For available for sale investments for which there is no reliable market information to determine fair value, the investments are carried at cost.

Impairment of financial assets

Financial assets, other than those as at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted. For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade accounts receivable where the carrying amount is reduced through the use of an allowance account. When a trade accounts receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

With the exception of AFS equity instruments, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

In respect of AFS equity securities, any increase in fair value subsequent to an impairment loss is recognized directly in equity.

Derecognition of financial assets

The Group derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

Financial liabilities and equity instruments issued by the Group

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

Equity instrument

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recorded as the proceeds received, net of direct issue costs.

Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of:

- The amount of the obligation under the contract, as determined in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets"; and
- The amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies set out below.

Financial liabilities

Financial liabilities are classified as either financial liabilities as at FVTPL or other financial liabilities.

Financial liabilities as at FVTPL

Financial liabilities are classified as at FVTPL where the financial liability is either held for trading or it is designated as at FVTPL.

A financial liability is classified as held for trading if:

- It has been incurred principally for the purpose of repurchasing in the near future; or
- It is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 "Financial instruments: recognition and measurement" permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial liabilities as at FVTPL are stated at fair value, with any resultant gain or loss recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any interest paid on the financial liability. Fair value is determined in the manner described in Note 3 above.

<u>Other financial liabilities</u>

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

<u>Derecognition of financial liabilities</u>

The Group derecognizes financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

Share-based payments – Equity-settled share based payments to employees are measured at the fair value of the equity instruments at the grant date. Details regarding the determination of the fair value of equity-settled share-based transactions are set out in Note 30.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest. At each balance sheet date, the Group revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognized in profit or loss over the remaining vesting period with a corresponding adjustment to retained earnings.

Derivative financial instruments – The Group enters into derivative financial instruments to manage its exposure to foreign exchange rate risk on its foreign currency denominated debt, namely foreign exchange forward contracts. The Group does not use hedge accounting for these derivatives. As a result, such derivative financial instruments are treated as other financial assets and liabilities as at FVTPL. Gains and losses recognized for the changes in fair value of forward contracts are presented as part of finance costs or other operating expenses of the Group depending on whether its use is related to a financial item or an operating item.

The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

Costs of an equity transaction – The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided.

The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately. The related amount of income taxes recognized directly in equity is included in the aggregate amount of current and deferred income tax credited or charged to equity.

Value added tax – Value added tax ("VAT") related to sales is payable to tax authorities on the earliest of (a) cash received from customers in advance or (b) transfer of the goods or rendering services to customers. Input VAT is generally recoverable against sales VAT upon receipt of the VAT invoice. Input VAT on construction in progress can be reclaimed on receipt of VAT invoices for the particular stage of work performed or, if the construction in progress project can not be broken down into stages, on receipt of VAT invoices upon completion of the contracted work.

VAT is generally allowed to be settled on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date is recognized in the balance sheet on a gross basis and disclosed separately as an asset and liability. Where a provision has been made for the impairment of receivables, the impairment loss is recorded for the gross amount of the debtor, including VAT.

Inventories – Inventories are recorded at the lower of average cost or net realizable value. In-bound freight related costs from our suppliers are included as part of the net cost of merchandise inventories. Certain supplier bonuses that are not reimbursement of specific, incremental and identifiable costs to promote a supplier's products are also included in the cost of inventory. Other costs associated with storing and transporting merchandise inventories to our retail stores are expensed as incurred and included as part of selling, general and administrative expenses.

Net realizable value is the estimated selling price in the ordinary course of business less estimated costs of completion and the estimated costs necessary to make the sale.

Cash and cash equivalents – Cash and cash equivalents comprise cash at banks, in transit and on hand in stores and short term deposits with an original maturity of three months or less.

Borrowing costs – The borrowing costs are capitalized by the Group as part of the cost of the asset when the costs are directly attributable to the acquisition, construction of a qualifying asset including construction in progress with a commencement date on or after 1 January 2008. The Group defines qualifying assets as leasehold improvements and other assets acquired in connection with the new store openings which generally take four months or longer to become operational. Other borrowing costs are expensed as incurred.

Provisions – Provisions are recognized when the Group has a present obligation as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Warranties

Warranties are generally covered by the brand owner directly or through their authorized agents in Russia.

When a supplier is unable to offer warranty services for their products in the Russian Federation, the Group makes a provision for warranty costs. These costs are recognized at the date of sale of the relevant products at management's best estimate of the expenditure required to settle the Group's obligations.

Revenue recognition – Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates, discounts and value added tax. Inter-company revenue is eliminated. The following specific recognition criteria must also be met before revenue is recognized:

Sale of goods

Revenue from the sale of goods is recognized when all the following conditions are satisfied:

- The Group has transferred to the buyer the significant risks and rewards of ownership of the goods;
- The Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be reliably measured;
- It is probable that the economic benefits associated with the transaction will flow to the entity; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

The Group has two categories of goods for resale: retail and wholesale.

Retail revenue (excluding revenue from sale of additional service agreements) is recognized at the point of sale or when the delivery is complete, if later. Retail sales are transacted by either cash or credit card. The recognized revenue includes credit card fees payable for the transaction. Such costs are presented in operating expenses.

Starting from 2008 the Group operates a loyalty points program "M.video Bonus", which allows customers to accumulate points when they purchase goods in the Group's retail stores. The points can then be redeemed as a payment for merchandise, subject to a minimum number of points being obtained. Proceeds from sale to members of the loyalty program are allocated between the loyalty points and the other components of the sale. The consideration allocated to the loyalty points is measured by reference to their fair value, i.e. the amount for which the loyalty points could be sold separately. This amount is deferred and recognized as revenue when the points are redeemed. Expected breakage is recognized as revenue at the time of initial sale as it is excluded from the amount allocated to loyalty points.

Wholesale revenue is recognized when the customer has collected the goods from the warehouse or when goods are delivered and accepted at the customer's warehouse and after satisfying the criteria outlined above.

Revenue from services

Revenue from services is recognized in the period in which the services have been rendered. The following conditions are also satisfied:

- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the entity;
- The stage of completion of the transaction at the balance sheet date can be measured reliably; and
- The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Additional service agreements

Revenue from the sale of additional service agreements is recognized on an ‘as earned’ basis with the unearned portion (if any) spread over the remaining term of the contracts to reflect the costs the Group expects to incur in performance of its contractual obligations. The revenue is recognized in full when no further costs are expected to be incurred.

Costs directly associated with the sale of additional service agreements, such as sales bonuses paid to shop assistants, as well as commission paid to other parties to provide full or partial coverage of the Group’s obligations under existing additional service agreements are recognized in the income statement on the same basis as related revenue.

Revenue from the sale of additional service agreements is disclosed within retail revenue.

Agents

The Group recognizes as revenue any sales performed as an agent at net amounts. Such fees include sales of telephone service contracts, service and installation fees.

Gift cards

The Group sells gift cards to its customers in its retail stores and through its website. The gift cards have an expiration date and are required to be used during specified periods of time. The Group recognizes income from gift cards when: (i) the gift card is redeemed by the customer; or (ii) when the gift cards expire.

Interest income

Revenue is recognized as interest is accrued (using the effective interest method). Interest income is included in finance cost in the consolidated income statement.

Supplier bonuses – The Group receives bonuses from suppliers. All supplier bonuses are treated as volume allowances unless they are subject to a separate agreement which is specific, incremental and identifiable. Supplier bonuses which are earned by achieving certain volume purchases are recorded when it is reasonably assured the Group will reach these volumes. Supplier bonuses based on volume are recorded as a reduction of the carrying cost of the inventory to which they relate. Supplier bonuses provided as a reimbursement of specific, incremental and identifiable costs incurred to promote a supplier’s products are included as an expense (or asset cost) reduction when the cost is incurred.

Leases – The Group has not entered into any finance leases, although it does have a significant number of operating leases.

Operating lease payments are recognized as an expense on a straight line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred. The impact of lease escalation clauses are recognized in expenses in the period in which they are activated.

Any benefits received from the landlord as an incentive to enter into an operating lease are spread over the lease term on a straight line basis.

Pre-opening expenses – Expenses incurred in the process of opening new stores which do not meet capitalization criteria under IAS 16 "Property, plant and equipment" are expensed as incurred. Such expenses include rent, utilities and other operating expenses.

Employee benefits – The Group contributes to the Russian Federation state pension, medical and social insurance on behalf of all its current employees by paying unified social tax ("UST"). Any related expenses are recognized in the consolidated income statement as they become due. The Group does not operate any employer sponsored pension plans.

4. STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED

The following new or revised standards and interpretations issued by IASB and IFRIC have been published at the date of authorization of the Group's consolidated financial statements for the year ended 31 December 2008, but are not yet effective and will be mandatory for adoption in the Group's financial statements for periods ending after 31 December 2008:

Amendments to IFRS 1 "First-time Adoption of International Financial Reporting Standards" and IAS 27 "Consolidated and Separate Financial Statements"

The amendments to IFRS 1 allow an entity to determine the "cost" of investment in subsidiaries, jointly controlled entities or associates in its opening IFRS financial statements in accordance with IAS 27 or using a deemed cost. The amendment to IAS 27 requires all dividends from a subsidiary, jointly controlled entity or associate to be recognized in the income statement in the separate financial statement. Both revisions will be effective for financial years beginning on or after 1 January 2009. The revision to IAS 27 will have to be applied prospectively. The new requirement affects only the parent's separate financial statement and does not have an impact on the consolidated financial statements.

IFRS 2 "Share-based Payment" (revised)

The IASB issued an amendment to IFRS 2 in January 2008 that clarifies the definition of a vesting condition and prescribes the treatment for an award that is effectively cancelled. The adoption of this amendment will not have an impact of the financial position or performance of the Group as no events occurred that this clarification relates to.

IFRS 3 "Business Combinations" (revised) and IAS 27 "Consolidated and Separate Financial Statements" (revised)

The revised standards were issued in January 2008 and become effective for financial years beginning on or after 1 July 2009. IFRS 3 (revised) introduces a number of changes in the accounting for business combinations occurring after this date that will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results. IAS 27 (revised) requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as an equity transaction. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. Other consequential amendments were made to IAS 7 "Statement of Cash Flows", IAS 12 "Income Taxes", IAS 21 "The Effect of Changes in Foreign Exchange Rates", IAS 28 "Investment in Associates", and IAS 31 "Interests in Joint Ventures". The changes in IFRS 3 (revised) and IAS 27 (revised) will affect future acquisitions or loss of control and transactions with minority interests. The standards will have no effect on the Group's reported income or net assets on adoption.

IFRS 8 "Operating Segments"

The IASB issued IFRS 8 in November 2006. The standard is effective for annual periods beginning on or after 1 January 2009. IFRS 8 replaces IAS 14 "Segment Reporting" ("IAS 14") upon its effective date. Management concluded that the Group operates within one reportable segment; therefore adoption of the standard will not affect the Group's consolidated financial statements except for addition of certain mandatory disclosures.

IAS 1 "Presentation of Financial Statements" (revised)

The revised standard was issued in September 2007 and becomes effective for financial years beginning on or after 1 January 2009. The Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of recognized income and expenses, either in one single statement, or in two linked statements. The Group is evaluating presentation options allowed by the revised standard and will make its choice on its adoption.

IAS 32 "Financial Instruments: Presentation" and IAS 1 "Presentation of Financial Statements" – Puttable Financial Instruments and Obligations Arising on Litigations

The amendments to IAS 32 and IAS 1 were issued in February 2008 and become effective for financial years beginning on or after 1 January 2009. The revision provides a limited scope exception for puttable instruments to be classified as equity if they fulfill a number of specified features. The amendments to the standards will have no impact on the financial position or performance of the Group, as the Group has not issued such instruments.

IAS 39 "Financial Instruments: Recognition and Measurement – Eligible Hedge Items"

These amendments to IAS 39 were issued in August 2008 and become effective for financial years beginning on or after 1 July 2009. The amendment addresses the designation of one-side risk in a hedge item, and the designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item. The Group has concluded that the amendment will have no impact on the financial position or performance of the Group, as the Group has not entered into such hedges.

Improvements to IFRSs

In May 2008 IASB issued its first omnibus of amendments to some of its standards, primarily with a view to removing inconsistencies and clarifying wording. All such amendments are likely to have no effect on the Group's financial statements and have not been early adopted by the Group. These changes are effective since 1st January 2009 or later.

IFRIC 15 "Agreement for the Construction of Real Estate"

IFRIC 15 was issued in July 2008 and becomes effective for financial years beginning on or after 1 January 2009. The interpretation is to be applied retrospectively. It clarifies when and how revenue and related expenses from sale of a real estate unit should be recognized if an agreement between a developer and a buyer is reached before the construction of the real estate is completed. Furthermore, the interpretation provides guidance on how to determine whether an agreement is within the scope of IAS 11 "Construction Contracts" or IAS 18 "Revenue". IFRIC 15 will not have an impact on the consolidated financial statements because the Group does not conduct such activity.

IFRIC 16 "Hedges of a Net Investment in a Foreign Operation"

IFRIC 16 was issued in July 2008 and becomes effective for financial years beginning on or after 1 October 2008. The interpretation is to be applied prospectively. IFRIC 16 provides guidance on the accounting for a hedge of a net investment. As such it provides guidance on identifying the foreign currency risk that qualify for hedge accounting in the hedge of a net investment, where within the group hedging instruments can be held in the hedge of a net investment and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment. The interpretation will not have an impact of the consolidated financial statements because the Group does not perform transactions to which it relates.

IFRIC 17 "Distribution of Non-Cash Assets to Owners"

The IFRIC was issued in November 2008 and shall be applied prospectively for financial years beginning on or after 1 July 2009. The IFRIC clarifies when and how distribution of non-cash assets as dividends to the owners should be recognized. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 is not relevant to the Group's operations because it does not distribute non-cash assets to owners.

IFRIC 18 "Transfers of Assets from Customers"

The IFRIC was issued in January 2009 and shall be applied for financial years beginning on or after 1 July 2009. The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 is not expected to have any impact on the Group's financial statements.

5. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION OF UNCERTAINTY

In the application of the Group's accounting policies, which have been described in Note 3, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant, including, but not limited to, the uncertainties and ambiguities of the Russian legal and taxation systems and the difficulties in securing contractual rights as defined in contracts. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Significant estimates and assumptions

<u>Inventory valuation</u>

Management reviews the inventory balances to determine if inventories can be sold at amounts greater than or equal to their carrying amounts plus costs to sell. This review includes identification of slow moving inventories, obsolete inventories and partially or fully damaged inventories. The identification process includes historical performance of the inventory, current operational plans for the inventory, as well as industry and customer specific trends. Damaged stock is either provided for or written off depending on the extent of damage. Management makes a provision for any items considered to be obsolete. The provision represents the difference between the cost of inventory and its estimated net realizable value.

The net realizable value allowance was calculated using the following methodology:

(a) Stock held for resale – comparison of expected selling price versus the carrying value on a stock keeping unit basis;

(b) Damaged goods – examination of historical data relating to discounts associated with damaged goods and comparison to book value at the balance sheet date;

(c) Stock held at service centers – a provision is applied based on management estimate of the carrying value of the inventory;

(d) Additional amount is accrued if there is actual evidence of a decline in selling prices after the reporting period to the extent that such decline confirms conditions existing at the end of the period.

If actual results differ from management's expectations with respect to the selling of inventories at amounts equal to or less than their carrying amounts, management would be required to adjust the amount of inventories.

Allowances for doubtful accounts receivable

Allowance for doubtful accounts receivable is established if there is objective evidence that the Group will not be able to collect the amounts due according to original contractual terms and reduces accounts receivable to the amounts expected to be collected. In estimating uncollectible amounts, management considers factors such as current overall economic conditions, historical customer performance and anticipated customer performance. The Group's provisions cover individual balances where there is evidence that losses are probable as at the balance sheet date. Management uses significant judgment in estimating uncollectible amounts. While management believes its processes effectively address the exposure for doubtful accounts receivable, changes in the economy, industry or specific customer conditions may require adjustments to the allowance for doubtful accounts receivable recorded in the Group's consolidated financial statements.

Tax and customs provisions and contingencies

The Group is subject to various taxes arising in the Russian Federation. The majority of its merchandise is imported into Russia and is therefore subject to the Russian customs regulations. Significant judgment is required in determining the provision for income taxes and other taxes. The Group recognizes liabilities for anticipated tax issues based on estimates of whether additional taxes will be due. Refer to Note 33 for further discussion.

Recovery of deferred tax assets

Deferred tax assets are recognized for deductible temporary differences as management believes there will be sufficient future taxable profits to utilize those temporary differences.

Share-based payments

The cost of equity-settled transactions with employees is based on the Group's estimate of the number of equity instruments that will eventually vest and other estimates outlined in Note 30.

Useful life of property, plant and equipment

Trade equipment is depreciated over the estimated useful life specified in Note 3 above. The estimated useful life is adjusted when there is a plan to fully renovate the store in the near future, in which case carrying value of related trade equipment is depreciated over the period of time up to the planned renovation work. During the year ended 31 December 2007 the Group reassessed useful lives of the trade equipment prompted by revised renovation plans, which increased the consolidated depreciation expense during the current financial year by 7 million RUB (2007 – 22 million RUB).

Impairment of property, plant and equipment and intangible assets

The determination of impairment of property, plant and equipment involves the use of estimates that include, but are not limited, to the cause, timing and amount of impairment. Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the industry, increase of cost of capital, changes in the future availability of financing, technological obsolescence, current replacement cost and other changes in the circumstances that indicate that impairment exists. The determination of the recoverable amount of cash-generating unit involves the use of estimates by management. Methods used to determine the value in use include discounted cash flow-based methods, which require the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. These estimates, including the methods used are described in Note 6.

Revenue attributed to loyalty program points

The Group estimates the fair value of points awarded under M.video Bonus loyalty program by applying "bonus ruble conversion rate" so that part of consideration allocated to the award credits represents their purchase capacity. Management also makes assumption about expected redemption rates. Points issued under the program expire with the passage of time; therefore such estimates are subject to significant uncertainty as at balance sheet date. As at 31 December 2008, the estimated liability for unredeemed points was 113 million RUB.

Critical judgments in applying the entity's accounting policies

Recognition of revenue from sale of additional service agreements and associated costs

Revenue earned from the sale of additional service agreements is recognized on an 'as earned' basis with the unearned portion (if any) spread over the remaining term of the contracts to reflect the costs the Group expects to incur in performance of its contractual obligations.

With respect to sale of additional service agreements the Group operates under agreement concluded with a related party services provider which assumed substantially all of the Group's obligations under all of the existing and future additional service agreements for a consideration based on a fixed proportion of fees charged to customers.

The fixed commission paid to a related party service centre to provide coverage for the Group's obligations under the additional service agreements is recognized immediately as part of cost of sales. Other direct costs associated with the sale of additional service agreements, such as sales bonuses paid to shop assistants are disclosed as part of selling, general and administrative expenses.

Supplier bonuses

The Group receives various types of allowances from suppliers in the form of volume discounts and promotional, advertising and stocking fees. Management has concluded that substantially all supplier bonuses received or receivable by the Group should be treated as volume based, effectively reducing the cost of goods purchase from the suppliers, rather than a reimbursement of specific costs incurred by the Group.

Allowance for goods returns

The Group recognizes allowance for goods returns by the customers as a reduction of sales in the period in which the underlying sales are recognized. The amount of this allowance is calculated on the basis of management's best estimate of the amount of product that will ultimately be returned by customers.

In millions of Russian rubles

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as at 31 December 2008 and 2007 consisted of the following:

	Buildings	Leasehold improve-ments	Construction in progress	Trade equipment	Security equipment	Other	Total
Cost							
As at 31 December 2006	2,205	527	35	410	197	380	3,754
Additions	-	-	1,462	-	-	-	1,462
Transfers	83	787	(1,491)	191	122	308	-
Disposals	-	-	-	-	-	-	-
As at 31 December 2007	2,288	1,314	6	601	319	688	5,216
Additions	-	-	2,322	-	-	-	2,322
Transfers	694	838	(2,270)	220	133	385	-
Disposals	-	-	-	(22)	(4)	(10)	(36)
As at 31 December 2008	2,982	2,152	58	799	448	1,063	7,502
Accumulated depreciation and impairment loss							
As at 31 December 2006	9	42	-	89	66	89	295
Charge for the year	112	91	-	101	71	128	503
Disposals	-	-	-	-	-	-	-
As at 31 December 2007	121	133	-	190	137	217	798
Charge for the year	123	196	-	154	105	208	786
Disposals	-	-	-	(21)	(4)	(9)	(34)
Impairment loss	-	26	-	3	2	4	35
As at 31 December 2008	244	355	-	326	240	420	1,585
Net book value							
As at 31 December 2007	**2,167**	**1,181**	**6**	**411**	**182**	**471**	**4,418**
As at 31 December 2008	**2,738**	**1,797**	**58**	**473**	**208**	**643**	**5,917**

As at 31 December 2008 there was no property, plant and equipment which served as collateral for the Group's borrowings (31 December 2007: 418 million RUB), for more details refer to Notes 16 and 21.

As at 31 December 2008 and 2007 there were no commitments for the acquisition of property, plant and equipment.

During the year 2008 the borrowing costs of 8 million RUB (2007: nil) were capitalized as part of the cost of the Group's property, plant and equipment. Capitalization rate for 2008 was 7% (2007: not applicable).

Impairment of property, plant and equipment

Due to the deterioration in the economic situation in the Russian Federation as a result of the recent turmoil in global capital and credit markets there have been certain indicators which required the Group to review its non-current assets for impairment at the balance sheet date. The Group performed an impairment test for all cash-generating units representing each city in which the Group's stores are located. The recoverable amount of the cash-generating units has been determined based on value in use calculation using cash flow projections based on financial budgets approved by the Board of Directors for the next year and projected growth rates for next four years with reference to gross regional domestic product for the regions where the Group operates and expected inflation for the Group's merchandise. These growth rates are ranging from 4% to 8% and the expected long-term inflation 5%. Cash flows beyond the five – year period were extrapolated using a long-term growth rate of 5%.

The pre-tax discount rate used in calculations was 21.56%. It is based on the Group's weighted average cost of capital and reflects management's estimates of the risks associated with the investments into the Group. In determining appropriate discount rate regard has been given to published analyst research with respect to the Group.

In accordance with IAS 36 "Impairment of Assets" the recoverable amount of each individual CGU was compared with its carrying amount. An impairment loss in the amount 35 million RUB was recognized and included into selling, general and administrative expenses as part of "Depreciation, amortization and impairment loss". The impairment loss relates to capital expenditures incurred at year-end to open new store in Ulyanovsk. No other impairment losses were identified.

The management has concluded there are no reasonably possible changes in key assumptions which would cause the carrying amount of the Group's assets to materially exceed its value in use.

In millions of Russian rubles

7. INTANGIBLE ASSETS

Intangible assets as at 31 December 2008 and 2007 consisted of the following:

	Software licenses	Trade marks	Total
Cost			
As at 31 December 2006	34	2	36
Additions	31	-	31
Disposals	-	(1)	(1)
As at 31 December 2007	65	1	66
Additions	323	11	334
Disposals	-	-	-
As at 31 December 2008	388	12	400
Accumulated amortization			
As at 31 December 2006	3	-	3
Charge for the year	20	-	20
As at 31 December 2007	23	-	23
Charge for the year	41	1	42
As at 31 December 2008	64	1	65
Net book value			
As at 31 December 2007	**42**	**1**	**43**
As at 31 December 2008	**324**	**11**	**335**

During 2008 the Group incurred expenditures in the total amount of 334 million RUB which for the most part related to the acquisition of software for the customer loyalty program and implementation of additional functionality of the Group's ERP system SAP.

Amortization expense has been included in selling, general and administrative expenses.

As at 31 December 2008 and 2007 the Group had commitments for the acquisition of software licenses. Refer to Note 33 for further details.

8. INVENTORIES

Inventories as at 31 December 2008 and 2007 consisted of the following:

	2008	2007
Goods for resale	14,646	11,032
Other inventories	977	132
Less: allowance for obsolete and slow-moving goods	(1,508)	(977)
Total	**14,115**	**10,187**

For information relating to the cost of inventory recognized as an expense during the year ended 31 December 2008 and 2007 refer to Note 25.

As at 31 December 2008 the value of inventory pledged as collateral for Group's borrowings was 10,063 million RUB (31 December 2007: 9,988 million RUB).

In millions of Russian rubles

9. TRADE ACCOUNTS RECEIVABLE

Trade accounts receivable as at 31 December 2008 and 2007 consisted of the following:

	2008	2007
Trade accounts receivable from third parties	223	165
Allowance for goods returns	(62)	(66)
Allowance for doubtful trade accounts receivable	(23)	(23)
Total	**138**	**76**

Trade receivables are non-interest bearing and are generally on 7-30 day terms.

Ageing of past due but not impaired trade accounts receivable:

	2008	2007
30-60 days	8	3
60-90 days	-	-
90-120 days	-	9
120+ days	-	21
Total	**8**	**33**

Movement in the allowance for doubtful trade accounts receivable:

	2008	2007
Balance at the beginning of the year	23	-
Impairment losses recognized on accounts receivable	2	23
Amounts written off as uncollectible	-	-
Amounts recovered during the year	(2)	-
Impairment losses reversed	-	-
Balance at the end of the year	**23**	**23**

The Group did not have any individually significant impaired trade accounts receivable balances as at 31 December 2008.

For details relating to trade accounts receivable from related parties refer to Note 31.

Refer to Note 34 for discussion of concentration of credit risk.

In millions of Russian rubles

10. OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

Other accounts receivable and prepaid expenses as at 31 December 2008 and 2007 consisted of the following:

	2008	2007
Advances paid to suppliers and prepaid expenses	1,870	1,284
Other accounts receivable from third parties	209	479
Other accounts receivable from related parties	-	31
Advances paid to related parties	54	-
Less: allowance for doubtful accounts	(90)	(36)
Total	**2,043**	**1,758**

For details relating to other accounts receivable from related parties refer to Note 31.

Ageing of past due but not impaired other accounts receivable from third and related parties is as follows:

	2008	2007
30-60 days	-	-
60-90 days	-	1
90-120 days	-	-
120+ days	-	45
Total	**-**	**46**

Movement in the allowance for doubtful accounts:

	2008	2007
Balance at the beginning of the year	36	6
Impairment losses recognized on other receivables	90	36
Amounts written off as uncollectible	(36)	-
Amounts recovered during the year	-	-
Impairment losses reversed	-	(6)
Balance at the end of the year	**90**	**36**

Change in other accounts receivable and prepaid expenses includes non-cash transaction in the amount of 36 million RUB related to derecognition of receivables against previously recognized allowance.

The receivable impaired as at 31 December 2008 was aged 120+ days (31 December 2007: 120+ days).

Carrying value of other accounts receivable approximates their fair value.

In millions of Russian rubles

11. VALUE ADDED TAX RECOVERABLE AND OTHER TAXES RECEIVABLE

Value added tax recoverable and other taxes receivable as at 31 December 2008 and 2007 consisted of the following:

	2008	2007
VAT recoverable	1,484	1,580
Other taxes receivable	5	10
Total	**1,489**	**1,590**

12. SHORT-TERM INVESTMENTS

Short-term investments as at 31 December 2008 and 2007 consisted of the following:

	Interest rate	Maturity	2008	2007
Short-term deposit in bank	8.5%	March 2009	1,140	-
Short-term deposit in bank	4%	March 2009	323	-
Short-term deposit in bank	8.2%	February 2009	161	-
Short-term deposit in bank	8.8%	May 2008	-	750
Short-term deposit in bank	9.1%	May 2008	-	540
Total short- term deposits in banks			**1,624**	**1,290**
Promissory notes receivable from third parties	0%	December 2009 (2007: April 2008)	19	12
Less: provision for doubtful promissory notes receivable			(19)	-
Unsecured RUB loans given to third parties	0%	February 2008	-	3
Total short-term loans and notes receivable			**-**	**15**
Total			**1,624**	**1,305**

Promissory notes receivable from third parties represent promissory notes received from DVI Volga. The promissory notes are unsecured and non-interest bearing.

As at 31 December 2008 short-term deposits in banks (Note 34) were denominated in EUR (31 December 2007: in RUB). During 2008 the Group recognized foreign currency income in the total amount of 266 million RUB as an exchange difference arising from deposits denominated in the currencies other than RUB.

In millions of Russian rubles

13. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as at 31 December 2008 and 2007 consisted of the following:

	2008	2007
Petty cash and cash in stores	148	67
Cash at banks	660	632
Cash in transit	529	1,241
Short-term deposits (Note 34)	4,111	440
Total	**5,448**	**2,380**

As at 31 December 2008 and 2007 the fair value of cash and cash equivalents is equal to their carrying value.

Cash in transit represents cash collected from the Group’s stores and not yet deposited into the bank account at the year end.

Cash equivalents earn interest ranging from 0.1% to 7%.

14. SHARE CAPITAL

Fully paid issued ordinary shares

As at 1 January 2007 the Company had 29,953,645,400 issued ordinary shares with a par value of 0.05 RUB per share.

As at 29 June 2007 the shareholders of OJSC “Company M.video” approved a reverse share split of 1:200. As at 19 September 2007 the Company registered this change with the appropriate governmental agencies and changed the charter and share registry from 29,953,645,400 shares at 0.05 RUB per share to 149,768,227 shares at 10 RUB per share.

As at 1 November 2007 the Company issued 30,000,000 additional ordinary shares at 10 RUB per share. Changes in the charter were not registered until 15 February 2008.

As at 31 December 2008 the Company had 179,768,227 ordinary shares in issue each having par value of 10 RUB per share.

Authorized ordinary shares

As at 1 January 2007 the Company had 30,120,705,400 authorized ordinary shares with a par value of 0.05 RUB per share. As part of the reverse share split (as explained above), all previously authorized shares with a par value of 0.05 RUB per share were withdrawn. Subsequent to this, fully paid issued ordinary shares were equal to the number of authorized ordinary shares. Authorized ordinary shares were reduced to 149,768,227.

As at 6 September 2007 the shareholders of OJSC “Company M.video” approved an additional 60,000,000 authorized ordinary shares at 10 RUB per share, of which 30,000,000 were issued and fully in preparation for the initial public offering which was closed on 1 November 2007. Changes in the charter were registered as at 19 September 2007.

As at 31 December 2008 the Company had 209,768,227 of authorized ordinary shares each having par value of 10 RUB per share.

In millions of Russian rubles

Dividends

No dividends have been paid or declared by the Company during the years ended 31 December 2008 and 2007. In accordance with the Russian legislation, dividends may only be declared to the shareholders of the Company from accumulated undistributed and unreserved earnings as shown in the Company's Russian statutory financial statements. OJSC "Company M.video" had 154 million RUB (unaudited) of undistributed and unreserved earnings as at 31 December 2008 (31 December 2007: 22 million RUB, unaudited).

15. INCOME TAX

The Group's income tax expense for the years ended 31 December 2008 and 2007 was as follows:

	2008	2007
Current tax expense	(1,358)	(908)
Deferred tax benefit	246	321
Total income tax expense	**(1,112)**	**(587)**
Income tax recognized in equity	**7**	**12**

The tax effect on the major temporary differences that give rise to the deferred tax assets and liabilities as at 31 December 2008 and 2007 is presented below:

	2008	2007
Deferred tax assets		
Provision for obsolete and slow-moving inventory	301	235
Bonuses allocated to inventories	225	-
Deferred revenue	101	73
Accrued expenses	71	137
Difference in depreciable value of property, plant and equipment	58	37
Salary-related accruals	54	59
Accrual for unused vacation	23	17
Allowance for doubtful debt	22	22
Adjustment on unrealized profit	22	41
Losses due to inventory shortages	-	74
Other items	38	28
Total	**915**	**723**
Deferred tax liabilities		
Difference in depreciable value of property, plant and equipment	277	358
Forward exchange contracts	164	-
Adjustment on supplier allowances and other adjustments on accounts payable	5	108
Other items	-	41
Total	**446**	**507**

In millions of Russian rubles

The statutory tax rate effective in the Russian Federation during years 2008 and 2007 was 24%. According to Federal Law No. 224-FZ dated 26 November 2008 the changes were made to Tax Code of the Russian Federation and corporate profit tax rate was reduced to 20%. As at 31 December 2008 the Group measured deferred tax liabilities and deferred tax assets using tax rate 20% (2007: 24%), which is the rate expected to be applied in the period in which the liability is settled or the asset is realized.

The taxation charge for the year is different from that which would be obtained by applying the statutory income tax rate to the net income before income tax. Below is a reconciliation of theoretical income tax expense at the statutory rate of 24% to the actual expense recorded in the Group's income statement:

	2008	**2007**
Profit before income tax expense	2,368	1,236
Theoretical income tax expense at statutory rate of 24%	(568)	(296)
Adjustments due to:		
Losses due to inventory shortages	(280)	(82)
Other non-deductible expenses, net	(170)	(149)
Income tax provisions	-	(55)
Income tax expense on dividends (9%)	-	(5)
Reduction in tax rate (from 24% to 20%)	(94)	-
Income tax expense	**(1,112)**	**(587)**

Taxable temporary differences in relation to investments in subsidiaries for which deferred tax liabilities have not been recognized as at 31 December 2008 amounted to 479 million RUB (31 December 2007: 344 million RUB). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not be reversed in the foreseeable future.

16. LONG-TERM LOANS AND BORROWINGS

Long-term loans and borrowings as at 31 December 2008 and 2007 consisted of the following:

	Interest rate	**Maturity**	**2008**	**2007**
Secured third parties loan from bank (EUR)	11.25%	March 2010	2,114	-
Secured third parties loan from bank (RUB)	13.75%	March 2010	1,000	-
Secured third parties loan from banks	2.74% to 4.5% + EURIBOR (1m) and (3m)	January - March 2009	-	2,127
Total			**3,114**	**2,127**

As at 31 December 2008 the loans and borrowings have been secured by the Group's inventory (2007: property, plant and equipment and inventory, refer to Notes 6 and 8).

In millions of Russian rubles

Sberbank

The long-term debt to Sberbank is represented by the loan received in September 2008 denominated in Rubles. The loan matures in March 2010, interest rate is 13.75% (fixed). As of 31 December 2008 the outstanding balance was 1,000 million RUB. Loan is secured by the Group’s inventory for the total amount of 927 million RUB.

The second part of the long-term debt to Sberbank is represented by the loans received in September 2008 denominated in EUR. The loans mature in March 2010, interest rate is 11.25% (fixed). As at 31 December 2008 the outstanding balance was 2,114 million RUB. Loans are secured by the Group’s inventory for the total amount of 1,970 million RUB.

17. TRADE ACCOUNTS PAYABLE

Trade accounts payable as at 31 December 2008 and 2007 consisted of the following:

	2008	2007
Trade accounts payable to third parties	14,816	9,109
Trade accounts payable to related parties	62	67
Total	**14,878**	**9,176**

Trade accounts payable are non-interest bearing and are normally settled between 30 and 90 days, depending on individual supplier terms.

For terms and conditions relating to related party payables refer to Note 31.

18. OTHER PAYABLES AND ACCRUED EXPENSES

Other payables and accrued expenses as at 31 December 2008 and 2007 consisted of the following:

	2008	2007
Letters of credit payable	508	-
Accrued salaries and bonuses	311	239
Accrued rent and utilities	120	-
Accrued unused vacation	113	70
Accrued consulting fees	74	-
Accounts payable for property, plant and equipment	-	213
Other current liabilities to related parties	32	20
Other payables and accrued expenses	151	58
Total	**1,309**	**600**

As at 31 December 2008 the Group has letters of credit payable to Uralsib bank issued by order of the Group for the benefit of suppliers of certain parcels of goods. Annual interest rate for these liabilities is 1.75%. Letters of credit payable are secured by the Group’s inventory in amount of 3,661 million RUB (2007: nil million RUB).

In millions of Russian rubles

19. BONDS PAYABLE

Bonds payable as at 31 December 2008 and 2007 consisted of the following:

	2008	2007
Corporate bonds	**-**	**118**

In 2008 the Group settled the remaining amount of RUB denominated non-collateralized bonds issued in November 2006 which had the maximum term of 3 years. The bonds had par value of 1,000 RUB and the coupon interest rate paid on the bonds fixed at 10% for the first year only, after which the Group set a new coupon interest rate. After the setting of the revised coupon rate, the bondholders had the option to either retain or redeem bonds held. As at 18 November 2007 the coupon interest rate was set at 9.5% for a period of 12 months.

20. VALUE ADDED TAX AND OTHER TAXES PAYABLE

Taxes payable as at 31 December 2008 and 2007 consisted of the following:

	2008	2007
Payroll taxes	79	59
VAT payable	13	18
Other taxes payable	46	21
Total	**138**	**98**

21. SHORT-TERM LOANS AND BORROWINGS

Short-term loans and borrowings as at 31 December 2008 and 2007 consisted of the following:

	Interest rate	2008	2007
Secured third parties credit facilities (EUR)	2.74% +EuroLIBOR (3m)	1,624	-
Secured third parties credit facilities (EUR)	3.1% + EURIBOR (1m)	1,242	-
Secured third parties credit facilities (EUR)	9.5%	622	-
Secured third parties credit facilities (USD)	5%+USDLibor (3m)	441	-
Secured third parties credit facilities (USD)	8% to 8.5%	-	1,963
Secured third parties credit facilities (EUR)	7.39% to 7.84%	-	602
Total principal amount of short-term loans		3,929	2,565
Interest payable		14	-
Total		**3,943**	**2,565**

As at 31 December 2008 the loans and borrowings have been secured by the Group's inventory (2007: property, plant and equipment and inventory, refer to Notes 6 and 8).

In millions of Russian rubles

MDM Bank

The short-term debt to MDM Bank is mainly represented by short-term portion of the long-term credit line received in September 2006, denominated in EUR (limit is 39.2 million EUR). The loan matures in February-March 2009. Interest rate is 2.74% + EuroLIBOR (3m). As at 31 December 2008 the outstanding liability was 1,624 million RUB. Credit line is secured by the Group's inventory for the total amount of 1,856 million RUB.

Rosbank

The short-term debt to Rosbank is mainly represented by credit line received in June 2008, denominated in EUR (limit is 63 million EUR). The loan matures in February 2009. Interest rate is 9.5% (fixed). As at 31 December 2008 the outstanding liability was 622 million RUB. Loans are secured by the Group's inventory for 1,110 million RUB.

MCB

The short-term debt to MCB is mainly represented by the loans received in April and December 2008, denominated in Rubles. The loans mature in January, February, July and December 2009 with interest rates ranging from 5% + USDLibor (3m). As at 31 December 2008 the outstanding liability was 441 million RUB. Loans are secured by the Group's inventory for a total amount of 508 million RUB.

Raiffaisen Bank

The short-term debt to Raiffaisen Bank is mainly represented by a loan received in August 2008, denominated in EUR. The loan matures in July 2009; interest rate is 3.1% + EURIBOR (1m). As at 31 December 2008 the outstanding liability was 1,242 million RUB. Loans are secured by the Group's inventory for a total amount of 31 million RUB.

22. DEFERRED REVENUE

Deferred revenue as at 31 December 2008 and 2007 consisted of the following:

	2008		2007	
	Customer loyalty program "M.video Bonus"	**Other programs**	**Customer loyalty program "M.video Bonus"**	**Other programs**
As at 1 January	-	305	-	73
Revenue deferred during the year	157	392	-	305
Revenue released to the consolidated income statement	(44)	(305)	-	(73)
Total	**113**	**392**	**-**	**305**

Other programs represent primarily sales of gift cards to the Group's customers.

In millions of Russian rubles

23. PROVISIONS

Provisions as at 31 December 2008 and 2007 consisted of the following:

	Non-current		Current	
	2008	**2007**	**2008**	**2007**
Warranty provision – in respect of additional service agreements (ASA) (i)	114	65	150	97
Warranty provision – repair of goods (ii)	5	3	10	7
Total	**119**	**68**	**160**	**104**

The movement in provisions during the years ended 31 December 2008 and 2007 is represented as follows:

	Warranty – ASA	Warranty – Repair of goods
Balance as at 1 January 2007	-	10
Additional provisions recognized	162	-
Balance as at 1 January 2008	162	10
Additional provisions recognized	102	5
Balance as at 31 December 2008	**264**	**15**

(i) The warranty provision in respect of additional service agreements represents management's best estimate of the future outflow of economic benefits that will be required under the Group's 2, 3 and 5 year additional service agreements. A Group entity sells the additional service agreements directly to customers, however, a back-to-back agreement entered into between the Group entity and a related party during the year ended 31 December 2007 transfers the obligations under the additional service agreement from the group to the related party. For this reason an equal corresponding non-current and current asset has been recognized by the Group, and disclosed within other assets. The estimate has been made on the basis of historical warranty trends and may vary as a result of events affecting product quality.

(ii) The warranty provision in respect of repair of goods represents management's best estimate of the future outflow of economic benefits that will be required to service goods sold for which there is no supplier service centre in the Russian Federation.

The amount of 97 million RUB relating to the short-term portion of the warranty provision in respect of additional service agreements as at 31 December 2007, as well as corresponding asset, were reclassified from non-current to current assets of the consolidated balance sheet.

24. REVENUE

Revenue for the years ended 31 December 2008 and 2007 consisted of the following:

	2008	**2007**
Retail revenue (including internet)	68,131	48,410
Wholesale revenue	3,350	3,900
Other	5	7
Total	**71,486**	**52,317**

In millions of Russian rubles

Retail revenue includes sales of ASA certificates in the amount of 1, 820 million RUB for year 2008 (2007 – 801 million RUB).

25. COST OF SALES

Cost of sales for the years ended 31 December 2008 and 2007 consisted of the following:

	2008	2007
Cost of goods and services	56,409	41,943
Inventory losses	711	401
Change in allowance for obsolete and slow-moving inventory	531	243
Supplier bonuses	(4,041)	(2,235)
Total	**53,610**	**40,352**

Transportation expenses incurred in 2007 with relation to goods delivered from suppliers outside the Russian Federation to the Group's warehouse in Moscow in the amount of 399 million RUB were reclassified from selling, general and administrative expenses to cost of sales as part of the net cost of merchandise inventory sold (see also Notes 3 and 26).

26. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the years ended 31 December 2008 and 2007 consisted of the following:

	2008	2007
Payroll and related taxes	4,386	3,058
Lease expenses	3,101	1,940
Advertising and promotional expenses	2,462	1,646
Transportation	1,081	732
Warehouse services	1,090	794
Depreciation, amortization and impairment loss	863	523
Security	463	295
Service centre	356	247
Consulting services	346	162
Utilities expense	274	222
Bank charges	267	189
Repairs and maintenance	266	184
Packaging and raw materials	203	153
Travel	167	96
Communication	151	91
Legal and audit expenses	100	24
Bad debt expense	90	53
Other	405	324
Total	**16,071**	**10,733**

Payroll and related taxes include 532 million RUB contribution to the state pension fund (2007: 244 million RUB) and social and medical insurance in the amount of 162 million RUB (2007: 218 million RUB).

In millions of Russian rubles

Transportation expenses incurred in 2007 with relation to goods delivered from suppliers outside the Russian Federation to the Group's warehouse in Moscow in the amount of 399 million RUB were reclassified from selling, general and administrative expenses to cost of sales as part of the net cost of merchandise inventory sold (see also Notes 3 and 25).

27. OTHER OPERATING INCOME

Other operating income for the years ended 31 December 2008 and 2007 includes commissions received from banks on loans provided to customers, goods delivery, income from leases and sub-leases of retail space and other items. Other operating income for the year ended 31 December 2008 included foreign currency income in the amount of 153 million RUB (31 December 2007: 47 million RUB).

28. OTHER OPERATING EXPENSES

Other operating expenses for the year ended 31 December 2008 mainly consisted of allowance for doubtful loans receivable in the amount of 12 million RUB (31 December 2007: 31 million RUB) and other individually insignificant items.

Exchange difference arising from foreign currency borrowings incurred in 2007 in the amount of 72 million RUB was reclassified from "Other operating expenses" to "Finance cost, net" (see also Notes 2 and 29).

29. FINANCE COSTS, NET

Net amount of finance costs for the years ended 31 December 2008 and 2007 consisted of the following:

	2008	2007
Interest on bank loans	631	505
Coupon yield on corporate bonds	10	171
Exchange difference from foreign currency borrowings	887	72
Interest on non-bank loans	-	78
Interest income	(226)	-
(Gain)/loss on realized forward contracts	(148)	53
Change in fair value of forward contracts	(789)	(31)
Total	**365**	**848**

Exchange difference arising from foreign currency borrowings incurred in 2007 in the amount of 72 million RUB was reclassified from "Other operating expenses" to "Finance cost, net" (see also Notes 2 and 28).

In millions of Russian rubles

30. SHARE-BASED PAYMENTS

Employee share option plan

The Group has an ownership-based compensation scheme for executives and senior employees of the Group. In accordance with the provisions of the plan, as approved by the Board of Directors at a Board meeting held on 28 June 2007, 1,498,682 of the Company's existing ordinary shares were set aside by the controlling shareholder. Executives and senior employees (35 persons in total) have been granted the right to purchase ordinary shares at an exercise price of 10 RUB per ordinary share. Before the options are exercised, dividends are accrued to current shareholders.

Each employee share option allows the recipient to purchase one ordinary share of Open Joint Stock Company "Company M.video" from the M.video Investment Ltd. (BVI). The proceeds from the purchase is payable to the existing shareholder. No amounts are paid or payable by the recipient on receipt of the option. The options carry neither rights to dividends nor voting rights. Employees must be employed at the vesting date to exercise his or her right unless the Board of Directors waives this condition. Options may be exercised within 30 days from the date of vesting.

The number of options granted per employee has been determined by the Chief Executive Officer and approved by the Board of Directors.

Long-term incentive plan – Series one

Under the series one of the Company's long-term incentive plan (LTIP) as at 1 October 2007 35 persons became members of the plan and 622,500 shares were committed, which represented 42% of the shares designated for the LTIP. In 2008 prior to the first vesting date (1 April 2008), 123,000 shares were forfeited. Of the remaining 499,500 granted shares, 166,500 shares which vested on 1 April 2008 (tranche one) were exercised. Then, before 31 December 2008 10,000 more shares were forfeited. Below is the summary of the arrangements that were in existence as at 31 December 2008:

Option series	Number	Grant date	Vesting date	Expiry date	Exercise price (RUB)	Fair value at grant date (RUB)
Issued 1 October 2007	161,500	1 October 2007	1 April 2009	30 April 2009	10	164.67
Issued 1 October 2007	161,500	1 October 2007	1 April 2010	30 April 2010	10	165.66

As at the end of the comparative reporting period the following share-based payments arrangements under LTIP Series one were in existence:

Option series	Number	Grant date	Vesting date	Expiry date	Exercise price (RUB)	Fair value at grant date (RUB)
Issued 1 October 2007	207,500	1 October 2007	1 April 2008	30 April 2008	10	163.92
Issued 1 October 2007	207,500	1 October 2007	1 April 2009	30 April 2009	10	164.67
Issued 1 October 2007	207,500	1 October 2007	1 April 2010	30 April 2010	10	165.66

In millions of Russian rubles

The weighted average fair value of the share options granted under LTIP Series one as at 31 December 2008 is 165.17 RUB (2007: 164.75 RUB). Options were priced using the Black Scholes pricing model. Where relevant, the model has reflected management's best estimate of the future volatility of the Company's share price, expected dividend yield, risk-free interest rates and expected staff turnover. Management draws upon a variety of external sources to aid in the determination of the appropriate data to use in such situations.

Inputs into the model	**LTIP 1 share options vested on 1 April 2009**	**LTIP 1 share options vested on 1 April 2010**
Grant date share price, RUB	173.40	173.40
Exercise price, RUB	10	10
Expected volatility	20.68%	20.68%
Option life (years)	1.50	2.50
Dividend yield	0%	0%
Risk-free interest rate	10%	10%

The expected volatility was determined based on the ending weekly share price for the period 1 November 2007 (listing date) to 31 December 2007. The expected volatility is equal to the historical volatility due to the brief history of trading activity and lack of comparable industry data.

An expense of 37 million RUB has been recognized during the year ended 31 December 2008 in respect of share-based payments (31 December 2007: 26 million RUB). This expense relates to equity-settled share-based payments. The expense has been disclosed within selling, general and administrative expense in the line item "payroll and related taxes" (Note 26). The corresponding entry has been reflected within retained earnings.

Long-term incentive plan – Series two

As at 31 March 2008 the Board of Directors approved the adoption of Series two of the LTIP for selected members of the Group's management team. As at 1 April 2008 46 persons became members of the plan and 756,000 of the shares designated for the LTIP were committed. This allocation forms part of the initial 1,498,682 of the Company's existing shares which were set aside prior to the Initial Public Offering. Under the terms of Series two of the LTIP, the vesting period is three years with 33.33% of the shares to vest each April following the grant date. Participants are able to exercise their 33.33% entitlement within 30 days of each vesting period by paying 10 RUB per share to the operator of the program after the vesting date. The participant must be employed at the anniversary date to exercise his or her right unless the Board of Directors waives this condition.

Further, before 31 December 2008 99,000 shares of LTIP series two were forfeited.

Below is the summary of the arrangements that were in existence as at 31 December 2008:

Option Series two	**Number**	**Grant date**	**Vesting date**	**Expiry date**	**Exercise price (RUB)**	**Fair value at grant date (RUB)**
Issued 1 April 2008	219,000	1 April 2008	1 April 2009	30 April 2009	10	168.28
Issued 1 April 2008	219,000	1 April 2008	1 April 2010	30 April 2010	10	169.69
Issued 1 April 2008	219,000	1 April 2008	1 April 2011	30 April 2011	10	170.39

In millions of Russian rubles

No share based arrangements under LTIP Series two were in existence during comparative reporting period.

The weighted average fair value of the share options granted under LTIP Series two as at 31 December 2008 was 169.45 RUB. Options were priced using the Black-Scholes pricing model.

Inputs into the model	**LTIP 2 share options vested on 1 April 2009**	**LTIP 2 share options vested on 1 April 2010**	**LTIP 2 share options vested on 1 April 2011**
Grant date share price, RUB	177.45	177.45	177.45
Exercise price, RUB	10	10	10
Expected volatility	26.85%	26.85%	26.85%
Option life years	1	2	3
Dividend yield	0%	0%	0%
Risk-free interest rate	10%	10%	10%

The expected volatility was determined based on the ending weekly share price for the period 1 November 2007 (listing date) to 1 April 2008. The expected volatility is equal to the historical volatility due to the brief history of trading activity and lack of comparable industry data.

An expense of 50 million RUB has been recognized during the year ended 31 December 2008 in respect of share-based payments under the Company’s LTIP Series two (2007: nil). This expense relates to equity-settled share-based payments and has been included into selling, general and administrative expense in the line item “payroll and related taxes” (Note 26).

The following reconciles the outstanding share options granted under the employee share plan at the beginning and end of the financial year 2008:

	LTIP Series 1		**LTIP Series 2**	
	Number of options	**Weighted average exercise price (RUB)**	**Number of options**	**Weighted average exercise price (RUB)**
Balance as at 1 January 2007	-	-	-	-
Granted during the period	622,500	10	-	-
Balance as at 31 December 2007	622,500	10	-	-
Balance as at 1 January 2008	622,500	10	-	-
Granted during the period	-	-	756,000	10
Forfeited during the period	(133,000)	10	(99,000)	10
Exercised during the period	(166,500)	10	-	-
Expired during the period	-	-	-	-
Balance as at 31 December 2008	323,000	10	657,000	10
Exercisable at the end of the financial year	-	-	-	-

The services received in respect of the share-based payments discussed above do not qualify for recognition as assets.

The equity settled share-based payments made during the year did not result in a dilution of shares due to reasons outlined above.

In millions of Russian rubles

Balance at the end of the financial year

The share options outstanding at the end of the financial year 2008 have an exercise price of 10 RUB (2007: 10 RUB), and the weighted average remaining contractual life is 396 days (2007: 486 days).

31. RELATED PARTIES

Related parties include shareholders, key management, entities under common ownership and control, and entities over which the Group has significant influence.

The consolidated financial statements include the financial statements of OJSC "Company M.video" and its subsidiaries which are listed in Note 1. Intra-group balances and transactions are not presented for purposes of this disclosure.

The following table provides the total amount of transactions, which have been entered into with related parties for the relevant financial year (for information regarding outstanding balances as at 31 December 2008 and 2007, also refer to Notes 10, 17, 18):

	2008	2008	31 December 2008		2007	2007	31 December 2007	
Sales to / purchases from related party	**Sales to related parties**	**Purchases from related parties**	**Amounts owed by related parties**	**Amounts owed to related parties**	**Sales to related parties**	**Purchases from related parties**	**Amounts owed by related parties**	**Amounts owed to related parties**
Entities under common control								
LLC "Noviy Format"	-	404	-	20	-	25	-	-
LLC "Universal service"	-	366	-	29	-	91	-	67
Transservice Group of Companies, LLC "Technovideo Service", LLC "Transservice-95"	28	268	50	3	21	195	28	-
LLC "Avto-Express"	-	144	-	7	-	125	-	10
LLC "Private Security Agency Bars-SB"	2	134	4	-	1	100	3	-
LLC "Avtoritet"	1	52	-	3	-	36	-	-
LLC "Bars"	-	11	-	-	-	15	-	-
LLC "Company Profi Center"	-	7	-	-	-	-	-	-
LLC "MV. Stil"	1	-	-	-	-	-	-	-
LLC "PSK Logistic Service"	-	-	-	-	-	1,379	-	10
LLC "Olga-Alternativa"	-	-	-	-	-	12	-	-

	2008		31 December 2008		2007		31 December 2007	
Loans from/to related party	**Interest income**	**Interest expense**	**Amounts owed by related parties**	**Amounts owed to related parties**	**Interest income**	**Interest expense**	**Amounts owed by related parties**	**Amounts owed to related parties**
Entities under common control:								
Goodhall Ltd	-	-	-	-	-	45	-	-
Velga Ltd	-	-	-	-	-	33	-	-
LLC "Noviy Format"	-	-	-	-	2	-	-	-

The ultimate parent entity

M.video Investment Ltd. (BVI) is the ultimate shareholder of the Group.

There were no transactions between the Group and the ultimate parent during the year ended 31 December 2008.

Immediate parent entity

Svece Ltd owns 69.9626% of the ordinary shares of OJSC "Company M.video" as at 31 December 2008 and 2007.

Refer to Note 1 for additional information on the ultimate controlling party of the Group and the share-based payment transactions involving the immediate parent entity.

Terms and conditions of transactions with related parties

Related parties may enter into transactions, which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. Outstanding balances at the year end are unsecured and settlement occurs in cash. There have been no guarantees provided or received for any related party accounts receivable or payables. For the year ended 31 December 2008, the Group has not recorded any impairment of accounts receivable relating to amounts owed by related parties (2007: nil). This assessment is undertaken each financial year through examining the financial position of the related party and the market in which the related party operates.

Transactions with other related parties

The nature of transactions with related parties is as follows:

- LLC "Olga Alternativa" – for the period ended 31 December 2007 the transaction related to the purchase of leasehold improvements;
- LLC "Bars" – provided courier services to the Group;
- LLC "Private Security Agency Bars – SB" – provided store and head office security services;
- LLC "Noviy Format" – for the period ended 31 December 2007 the transaction related to rental of property; for the period ended 31 December 2008 the transaction related to purchase of the buildings;
- Transservice Group of Companies – provided after sale and other servicing of the Group's merchandise;
- LLC "Avtoritet" – provided the brand name "Smart-on" to the Group under a license agreement and two trading premises in Moscow under a lease agreement;
- LLC "Avto-Express" – provided a car leasing service to the Group and logistic services;
- LLC "PSK Logistics service" – is a merchandize supplier for the Group;
- LLC "Universal Service" – provided after sale servicing and other related servicing of merchandize sold in connection with additional service agreements;
- LLC "Company Profi Center" – provided servicing of inventories;
- LLC "MV. Stil" – provided rent services;
- Goodhall Ltd – provided financing to the Group;
- Velga Ltd – provided financing to the Group.

In millions of Russian rubles

Compensation of key management personnel of the Group

The remuneration of directors and other members of key management during the year was as follows:

	2008	**2007**
Short-term benefits*	143	116
Share-based payments	35	13
Total	**178**	**129**

*Short-term benefits include salaries, bonuses, annual leave, medical and insurance expenses.

As at 31 December 2008 payable to key management personnel amounted 32 million RUB (2007 – nil).

The number of key management positions increased from 15 in 2007 to 16 in 2008 due to appointment of one independent director.

The Group did not provide any post employment, termination, or other long-term benefits to key management personnel during the period other than contributions to state pension fund and the social funds as a part of payments of unified social tax on salaries and bonuses. Unified social tax paid relating to compensation of key management personnel amounted to 4 million RUB and 3 million RUB respectively for the years ended 31 December 2008 and 2007 and is included in the amounts stated above.

32. OPERATING LEASE ARRANGEMENTS

The Group has entered into commercial leases for the rental of retail properties, warehouses and office space. These leases have terms ranging between 1 and 14 years. The majority of the lease contracts contain escalation clauses. Certain lease contracts stipulate terms requiring the Group to pay the higher of minimum lease payments or a percentage of revenue. The amounts paid in excess of the minimum lease payments are disclosed as contingent rentals below. The Group does not have an option to purchase the leased premises at the expiration of the lease period.

<u>Payments recognized as an expense</u>

	2008	**2007**
Minimum lease payments	3,101	1,930
Contingent rentals	-	10
	3,101	**1,940**

<u>Non-cancellable operating lease commitments</u>

Future minimum rentals payable under non-cancelable operating leases for premises occupied as at 31 December 2008 and 2007 are as follows:

	2008	**2007**
Within one year	3,471	2,320
After one year but not more than five years	12,608	7,212
More than five years	5,467	5,751
	21,546	**15,283**

In millions of Russian rubles

Future minimum rentals payable under committed, non-cancelable future store operating leases for premises as at 31 December 2008 and 2007 are as follows:

	2008	2007
Within one year	470	439
After one year but not more than five years	1,409	1,998
More than five years	2,354	2,527
	4,233	**4,964**

Future minimum rental payments will be subject to value added tax.

33. COMMITMENTS AND CONTINGENCIES

Operating environment

The Group sells products that are more sensitive to changes in general economic conditions that impact consumer spending. Future economic conditions and other factors, including consumer confidence, employment levels, interest rates, consumer debt levels and availability of consumer credit could reduce consumer spending or change consumer purchasing habits. A general slowdown in the Russian economy or in the global economy, or an uncertain economic outlook, could adversely affect consumer spending habits and the Group's operating results.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The ongoing global financial crisis has resulted in capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Russia. While the Russian Government has introduced a range of stabilization measures aimed at providing liquidity and supporting refinancing of foreign debt for Russian banks and companies, there continues to be uncertainty regarding the access to capital and cost of capital for the Group and its counterparties, which could affect the Group's financial position, results of operations and business prospects. Although any further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable, the management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

Taxation and regulatory environment

Russian tax, currency and customs legislation is subject to frequent changes and varying interpretations. Management's interpretation of such legislation in applying it to business transactions of the Group may be challenged by the relevant authorities enabled by law to impose fines and penalties. Recent events within the Russian Federation suggest that the tax, customs or other relevant government authorities are taking a more assertive position in their interpretation of the legislation and assessments made and as a result, it is possible that the transactions that have not been challenged in the past may be challenged in the future. Generally, fiscal periods remain open to review by the tax authorities in respect of taxes for the three calendar years preceding the year of tax review. Under certain circumstances reviews may cover longer periods. The Group believes it has provided adequately for all tax liabilities based on its understanding of the tax legislation.

Management reviews the Group's compliance with applicable tax regulations and current interpretations. Furthermore, management regularly assesses the potential financial exposure relating to tax contingencies for which the three year tax inspection right has expired but, which, under certain circumstances, may be challenged by regulatory bodies. From time to time potential exposures and contingencies are identified and at any point in time a number of such open tax positions may exist. As at 31 December 2007 the management has recorded a provision of 87 million RUB for income tax and 7 million RUB for other tax contingencies in these consolidated financial statements. During 2008 the Group has not made any changes to its provisions and has not identified any other material contingencies which have not been in existence as at the end of the previous annual period. No tax provisions were utilized during the year ended 31 December 2008.

Russian transfer pricing legislation introduced on 1 January 1999 provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all controllable transactions, provided that the transaction price differs from the market price by more than 20%. Controllable transactions include transactions with interdependent parties, as determined under the Russian Tax Code, and all cross-border transactions (irrespective of whether performed between related or unrelated parties), transactions where the price applied by a taxpayer differs by more than 20% from the price applied for similar transactions by the same taxpayer within a short period of time, and barter transactions. There is no formal guidance as to how these rules should be applied in practice. The arbitration court practice in this respect is contradictory.

Tax liabilities from inter-company transactions are determined using actual transaction prices. It is possible with the evolution of the interpretation of the transfer pricing rules in the Russian Federation and the changes in the approach of the Russian tax authorities, that such transfer prices could potentially be challenged in the future. Given the brief nature of the current Russian transfer pricing rules, the impact of such challenge cannot be reliably estimated, however, it may be significant to the financial condition and operations of the Group.

The Group has identified other possible tax contingencies in respect of issues unrelated to customs (see below) or transfer pricing. No provision has been recorded in respect of these issues. The range of potential exposures and details of individual tax positions have not been disclosed to avoid prejudicing the Group's position.

Customs

As is common in the business, the Group or an affiliated party negotiates and confirms with overseas representatives of foreign manufacturers, the quantity, price and attributes of the foreign manufactured goods, but the goods may be procured through parties both affiliated and unaffiliated with the Group.

Subject to the above, during the year ended 31 December 2008, the Group purchased a significant portion of its foreign manufactured goods on the territory of the Russian Federation from Russian legal entities, including Russian wholesalers or resellers, which may or may not have imported the goods into Russia directly. As the Group was not involved in clearing customs for the goods purchased on the territory of Russia, management can not be certain that the entities which imported the goods into Russia were in full compliance with the applicable regulations of the Russian customs code. During the year the relative proportion of direct imports from foreign manufacturers and purchases from the Russian subsidiaries of foreign manufacturers have been increasing and the purchases from Russian wholesalers and resellers decreasing.

In millions of Russian rubles

As described above in *Taxation and regulatory environment section*, the relevant authorities are taking a more assertive position in their interpretation of the applicable laws. Under Russian law a company in possession of goods that were imported with proven violations of the customs law may be subject to significant administrative or civil penalties and/or confiscation of the goods, if it was involved in, aware of, or should have known that violation of the customs code were occurring. To date, the Group has not been subject to any notification of violations of the customs code.

Management believes that the Group entities were acting in compliance with all applicable tax and legal requirements in respect of imported products, were not involved, not aware and could not be expected to know of any significant violations of the applicable customs code by the Russian wholesalers or resellers. Accordingly, management did not recognize any provisions in respect of such contingencies in these consolidated IFRS financial statements and determined that with current limitations in access to customs clearance documents it is not practicable to estimate the likely potential financial effect, if any, of such contingent liabilities.

License Agreements

As at 31 December 2008, the Group had a total commitment of approximately 1 million EUR per annum for technical support services with respect to existing SAP licenses and software. The Group uses SAP software for finance and human resources.

Further, as at 31 December 2008, the Group had finished the third year of a five year contract with Microsoft for Microsoft Office software right. The contract is structured in a way that allows the Group to prepay one year at a time. The total commitment for the remainder of the contract, including license fees and annual support, is 35 million RUB. The total commitment is split as follows:

2009 FY	17.5 million RUB;
2010 FY	17.5 million RUB.

Litigation

In the normal course of business, the Group is subject to proceedings, lawsuits, and other claims. While such matters are subject to other uncertainties, and outcomes are not predictable with assurance, the management of the Group believes that any financial impact arising from these matters would not be material to its financial position or annual operating results.

Environmental matters

The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental obligations. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental matters.

Guarantees

The Group had no outstanding guarantees issued by the Group entities or other parties for the benefit of the Group entities as at 31 December 2008 and 2007.

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial liabilities, other than derivatives, comprise loans and borrowings, trade and other payables. The main purpose of these financial liabilities is to raise finance for the Group's operations. The Group has trade and other receivables and cash and short-term deposits that arrive directly from its operations. The Group also enters into derivative transactions.

The main risks arising from the Group's financial instruments are foreign currency risk, interest rate risk, credit risk and liquidity risk.

The Group's senior management oversees the management of these risks. The Group's senior management provides assurance to the Group's Board of Directors that the Group's financial risk-taking activities are governed by appropriate policies and procedures and that financial risks are identified, measured and managed in accordance with the Group's policies. All derivative activities for risk management purposes are carried out by specialist teams that have the appropriate skills, experience and supervision.

The Board of Directors reviews and agrees policies for managing each of these risks which are summarized below.

Capital risk management

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance. No changes were made in objectives, policies or processes during the year ended 31 December 2008 and 31 December 2007.

The capital structure of the Group consists of debt, which includes borrowings (Notes 16 and 20), cash and cash equivalents (Note 13), short-term investments (Note 12) and equity attributable to equity holders of the parent, comprising issued capital, additional paid in capital and retained earnings.

The primary objective of the Group's capital management program is to maximize shareholder value while minimizing the risks associated with the loan portfolio. The consumer electronics business is a cyclical business and as such requires short term fluctuations in capital to purchase goods to satisfy the seasonal demand. The Group uses a combination of long-term loans, short term loans and supplier credit terms to meet the seasonal capital needs. The store expansion program adds to the capital needs as the capital and pre-opening costs associated with the new stores puts additional pressure on the Group's financial resources. While the Group has not established any formal policies regarding debt to equity proportions the Group reviews the capital needs of the Group periodically to determine actions to balance its overall capital structure through shareholders' capital contributions or new share issues, return of capital to shareholders as well as the issue of new debt or the redemption of existing debt.

Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognized, in respect of each class of financial asset, financial liability and equity instrument are disclosed in Note 3 to the consolidated financial statements.

In millions of Russian rubles

Categories of financial instruments

The carrying values of financial assets and liabilities grouped by each category of financial instruments were as follows:

	2008	2007
Financial assets		
Fair value through profit or loss (FVTPL)	821	32
Loans and receivables (including cash and cash equivalents)	7,424	4,239
Financial liabilities		
Fair value through profit or loss (FVTPL)	-	16
Liabilities carried at amortized cost	23,244	14,586

Foreign currency risk management

Foreign currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Group has transactional currency exposures. Such exposures arise from: (1) purchases by an operating unit with delayed credit terms in currencies other than the unit's functional currency. The Group does not attempt to hedge this risk, as individually these amounts are too small to warrant hedges and the payment dates are too frequent to attempt to do a collective hedge; (2) long-term loans which are denominated in Euros. The Group uses forward exchange contracts to eliminate the currency exposures on loan repayments. The forward exchange contracts must be in the same currency as the foreign currency item. The Group does not designate forward contracts as hedges for accounting purposes.

The Group does not have transactional currency exposure relating to revenue as sales occur on the territory of the Russian Federation and are denominated in RUB.

The carrying amount of the Group's foreign monetary assets and liabilities denominated in foreign currencies which goes in line with exchange rate variations (including the Group's forward contracts carried at fair value) at the reporting date are as follows:

	Liabilities		Assets	
	2008	2007	2008	2007
USD	885	2,810	1,798	43
EUR	6,589	3,899	4,456	48

<u>Foreign currency sensitivity analysis</u>

The Group is mainly exposed to the currencies of the United States of America (USD) and the European zone (EUR).

The following table demonstrates the sensitivity to reasonably possible changes in the US dollar and euro, with all other variables held constant, of the Group's profit before tax due to changes in the fair value of monetary assets and liabilities. Effect on profit includes the result of changes in the fair value of forward contracts. Although the derivatives have not been designated in a hedge relationship, they act as a commercial hedge for certain foreign currency borrowing transactions and will produce offsetting gains or losses on settlement.

In millions of Russian rubles

	USD		EUR	
	Changes in exchange rate, %	**Effect on income before income tax**	**Changes in exchange rate, %**	**Effect on income before income tax**
2008	+20%	127	+20%	151
	-20%	(127)	-20%	(151)
2007	+10%	(274)	+5%	(195)
	-10%	274	-5%	195

Forward foreign exchange contracts

The following table details the forward foreign currency contracts outstanding at the reporting date:

	Foreign currency		Contract value		Fair value	
	2008	**2007**	**2008**	**2007**	**2008**	**2007**
Buy EUR	218	74	8,103	2,643	1,425	48
Sell EUR	140	-	5,216	-	(698)	-
Buy USD	15	80	364	2,015	94	(32)
Sell USD	22	-	643	-	-	-

Interest rate risk management

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long-term obligations with floating interest rates. The Group manages its interest rate risk by having a balanced portfolio of fixed and variable interest rate loans and borrowings.

The following table sets out the carrying amount, by maturity, of the Group's financial instruments that are exposed to interest rate risk:

31 December 2008	**Within 1 year**	**1-2 years**	**More than 2 years**	**Total**
Floating rate				
2.74% + EuroLIBOR (3m)	1,624	-	-	**1,624**
5% + USD LIBOR (3m)	441	-	-	**441**
EURIBOR (1m) + 3.1%	1,242	-	-	**1,242**
Total	**3,307**	**-**	**-**	**3,307**

31 December 2007	**Within 1 year**	**1-2 years**	**More than 2 years**	**Total**
Floating rate				
EURIBOR (1m), (3m)+ 2.74% to 4.5%, 7.39% to 9.5% Secured bank loans	2,683	2,127	-	**4,810**
Total	**2,683**	**2,127**	**-**	**4,810**

In millions of Russian rubles

The following table demonstrates the sensitivity to a reasonably possible change in interest rates of the Group's profit before tax. The analysis below has been determined based on the exposure to interest rates for the Group's financial instruments at the balance sheet date assuming that year end debt levels are constant over the year.

	Increase / decrease in basis points	Profit/loss before tax
2008		
Changes in the floating interest rates	25	8
	50	17
	100	33

	Increase / decrease in basis points	Profit/loss before tax
2007		
Changes in the floating interest rates	25	5
	50	11
	100	21

Credit risk management

Credit risk refers to the risk that counterparty may default on its contractual obligations resulting in financial loss to the Group. Financial assets which are potentially subject the Group to credit risk consist primarily of trade and other receivables as well as cash in current and deposit accounts with banks and other financial institutions.

The Group trades only with recognized, creditworthy third parties who are registered in the Russian Federation. The policy is that all customers who are granted credit terms have a history of purchases from the Group, employ individuals who are known to the Group and can demonstrate they have the financial resources to cover their limits. The Group also requires these customers to provide certain documents such as incorporation documents and financial statements.

Trade accounts receivable consist of a large number of customers. Ongoing credit evaluation is performed on the financial condition of accounts receivable.

As at 31 December 2008, the Group does not have significant credit risk exposure to any single counterparty in respect of trade accounts receivable. Concentration of credit risk in respect of trade accounts receivable did not exceed 5% of gross monetary assets at any time during the year.

The credit risk on liquid funds (see the table below) and derivative financial instruments is managed by Group treasury. The management believes that credit risk on investments of surplus funds is limited because counterparties are financial institutions with high credit ratings assigned by international credit rating agencies.

In millions of Russian rubles

The table below shows the balances of 6 major counterparties as at the balance sheet date:

			Carrying amount	
Counterparty	**Currency**	**Rating**	**2008**	**2007**
Gazprombank	EUR,USD,RUB	BBB-	3,994	201
Uralsib	EUR	BB-	1,300	1,290
Moscow Commercial Bank	USD	BBB-	441	-
Renaissance Capital	RUB	BB-	-	102
Russian Standard Bank	RUB	BB-	-	57
Alfa Bank	RUB	BB-	-	52

The carrying amount of financial assets recorded in the consolidated financial statements, which is net of impairment losses, represents the Group’s maximum exposure to credit risk.

As at 31 December 2008 and 31 December 2007 the Group does not have financial guarantees provided on behalf of other entities. There were no other concentrations of credit risk as at 31 December 2008.

Liquidity risk management

The Group’s treasury monitors the risk of a shortage of funds using a recurring liquidity planning tool. This tool considers the maturity of both its financial investments and financial assets (e.g. accounts receivable, other financial assets) and projected cash flows from operations.

The Group’s objective is to maintain a continuity of funding and flexibility through the use of bank overdrafts and bank loans. Each year the Group analyzes its funding needs and anticipated cash flows, so that it can determine its funding obligations. The seasonality of the business, the store expansion plan and the anticipated working capital requirements form the basis of the evaluation. The Group uses long-term instruments (loans and borrowings) to cover a significant proportion of the base liquidity needs. The Group uses short-term loans and bank overdrafts to cover seasonality needs. Every quarter the Group updates its liquidity needs and secures facilities with several banks to ensure that the Group has a sufficient amount of approved undrawn borrowing facilities. As at 31 December 2008, the Group had available 9,833 million RUB (31 December 2007: 11,178 million RUB) of uncommitted standby borrowing facilities. The Group can formally apply for additional tranches of debt and the bank will provide additional funding provided all conditions precedent had been met. Approximately 56% of the Group’s debt will mature in more than one year from 31 December 2008 (31 December 2007 – 47%).

The table below summarizes the maturity profile of the Group’s financial liabilities as at 31 December 2008 and 2007 based on contractual undiscounted payments:

31 December 2008	**Less than 3 months**	**3-12 months**	**1-5 years**	**Total**
Interest bearing loans and borrowings	2,729	1,283	3,565	7,577
Trade accounts payable	14,878	-	-	14,878
Other accounts payable and accrued expenses	1,309	-	-	1,309
Forward exchange contract	-	-	-	-
Total	**18,916**	**1,283**	**3,565**	**23,764**

In millions of Russian rubles

31 December 2007	Less than 3 months	3-12 months	1-5 years	Total
Interest bearing loans and borrowings	-	2,829	2,311	5,140
Trade accounts payable	9,176	-	-	9,176
Other accounts payable and accrued expenses	599	1	-	600
Forward exchange contract	16	-	-	16
Total	**9,791**	**2,830**	**2,311**	**14,932**

Fair value of financial instruments

Set out below is a comparison by class of the carrying amounts and fair value of the Group's financial instruments that are carried in the consolidated financial statements:

	Carrying amount		Fair value	
	2008	2007	2008	2007
Financial assets				
Cash and short-term deposits	7,072	3,685	7,072	3,685
Long-term loans and notes receivable	5	5	5	5
Forward contracts	821	32	821	32
Trade accounts receivable	138	76	138	76
Other accounts receivable	209	474	209	474
Financial liabilities				
Interest-bearing loans and borrowings:				
Floating rate borrowings	(3,308)	(2,127)	(3,306)	(2,083)
Fixed rate borrowings	(3,749)	(2,683)	(3,749)	(2,683)
Forward contracts	-	(16)	-	(16)
Trade payables	(14,878)	(9,176)	(14,878)	(9,176)
Other payables	(1,309)	(600)	(1,309)	(600)

The fair value of the financial assets and liabilities are included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than forced or liquidating sale. The following methods and assumptions were used to estimate the fair values:

- Cash and short-term deposits, trade and other receivables, trade and other payables approximate their carrying amounts largely due to the short-term maturities of these instruments;
- Long-term loans and notes receivable are evaluated by the Group based on parameters such as interest rate, specific risk factors and individual creditworthiness of the counteragent. Based on this evaluation allowances are taken into account for the expected losses of these receivables. As at 31 December 2008 and 2007, the carrying amounts of such receivables, net of allowances, approximate their fair values;
- The fair value of borrowings such as bank loans and other financial indebtedness are estimated by discounting future cash flows using rates currently available for debt of similar terms and remaining maturities;
- The fair value of forward foreign currency exchange contracts is based on forward exchange rates.