

## **DIRECTORS' RESPONSIBILITY STATEMENT**

Mr Evgueni I. Ivanov, General Director of OJSC Polyus Gold confirms on behalf of the Board of Directors that:

(a) the consolidated financial statements for the year 2008, prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, give a true and fair view of the assets, liabilities, financial position and profit or loss of OJSC Polyus Gold and its consolidated subsidiaries (the "Polyus Group"); and

(b) the management report for the year 2008 includes a fair review of the development and performance of the business and the position of the Polyus Group, together with a description of the principal risks and uncertainties that it faces.

Neither OJSC Polyus Gold nor the directors accept any liability to any person in relation to the management report except to the extent that such liability could arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with Section 90A of the Financial Services and Markets Act 2000.

EVGUENI I. IVANOV

General Director

30 April 2009

## **Management report**

### **Management's discussion and analysis of financial condition and results of operations for 2008**

The following Management report (Management discussion and analysis of the Polyus Group's financial condition and results of operations) should be read in conjunction with the Polyus Group's consolidated financial statements and the related notes.

The Polyus Group is the largest gold producer in the Russian Federation and among the largest gold mining companies in the world, based on mineral resources and production volumes.

Polyus Gold Shares are traded on the leading Russian stock exchanges, MICEX and RTS. Polyus Gold's ADRs are listed on the main market of the London Stock Exchange and traded on the over-the-counter markets in the United States. Polyus Gold Shares are included in the key Russian stock exchange indices of MICEX and RTS, and international stock exchange indices such as FTSE Gold Mines and MSCI Emerging Markets. The Polyus Group produced 1.2 million troy ounces of gold in 2008.

The following discussion and analysis represents the management's opinion in relation to the Polyus Group's operating and financial results, including discussions of:

- key performance indicators;
- financial position as at 31 December 2008, 31 December 2007 and 31 December 2006;
- the Polyus Group's liquidity, solvency and capital sources;
- significant events affecting the Polyus Group's operating performance for these periods; and
- description of principal risks

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## 1. The Polyus Group's operating results

### 1.1 External market factors affecting the Polyus Group's financial results

The results of the Polyus Group are significantly affected by movements in average exchange rates between the USD and the RUB, and the price of commodities, such as gold, oil and steel.

The Polyus Group's revenue from gold sales is denominated in USD, whereas up to 80% of the Polyus Group's expenses are denominated in RUB, which means that movements in the RUB/USD exchange rate impact on the Polyus Group. Many costs included in the Polyus Group's cost of sales are also directly or indirectly impacted by the prices of oil and steel. Changes in oil prices impact the prices of heating oil, diesel fuel, gasoline and lubricants for mining and construction equipment. Steel forms the basis for the price of all rolled metal products, pipes, machinery and vehicles.

In the periods under discussion, prices for these products, and the RUB/USD exchange rate, demonstrated significant movements, which influenced the Polyus Group's financial results:

Average price/ rate	2008	2007	2006
Oil (Brent brand) (USD per barrel) <sup>(1)</sup> .....	98.7	72.5	65.1
Steel (hot rolled) (USD per tonne) <sup>(2)</sup> .....	924	645	575
Average USD/RUB rate .....	24.86	25.58	27.19
Period end USD/RUB rate.....	29.38	24.55	26.33

1. Source: Bloomberg.
2. Source: Metaltorg, spot price FOB Russia.

### Summary of performance results

The following table shows the summary of performance results of the Polyus Group's operations in 2008, 2007 and 2006 related to financial statements:

USD' 000	Years ended 31 December			2008	2007
	2008	2007 (restated) <sup>(1)</sup>	2006 (restated) <sup>(1)</sup>	against 2007	against 2006
				%	%
Gold sales .....	1,062,331	849,023	734,559	25.1	15.6
Other sales .....	24,987	18,096	18,127	38.1	(0.2)
Cost of gold sales .....	(558,118)	(449,216)	(426,527)	24.2	5.3
Cost of other sales .....	(25,061)	(25,866)	(18,816)	(3.1)	37.5
Gross profit.....	504,139	392,037	307,343	28.6	27.6
Gross profit on gold sales .	504,213	399,807	308,032	26.1	29.8
Gross profit margin .....	46.4%	45.2%	40.8%	–	–
Selling, general and administrative expenses	(134,960)	(261,776)	(79,678)	(48.4)	228.5
Profit before income tax ...	122,471	177,107	1,228,391	(30.8)	(85.6)
Pre-tax margin .....	11.3%	20.4%	163.2%	–	–
Income tax expense .....	(62,110)	(85,299)	(73,080)	(27.2)	16.7
Profit for the year .....	60,361	91,808	1,155,311	(34.3)	(92.1)
Net profit/(loss) attributable to minority interest.....	8,854	5,999	(414)	47.6	–
Net profit attributable to shareholders of the parent company.....	51,507	85,809	1,155,725	(40.0)	(92.6)
Net profit margin .....	5.6%	10.6%	153.5%	–	–
Earnings per share – basic and diluted (USD).....	0.29	0.49	0.75	(40.8)	(34.7)

1. Refer to Note 5 of consolidated financial statements for the year ended 31 December 2007 (approved on 3 February 2009).

The following table shows the summary of performance results of the Polyus Group's operations in 2008, 2007 and 2006 related to non-GAAP financial measures:

USD' 000	Years ended 31 December			2008	2007
	2008	2007	2006	against	against
		(restated) <sup>(1)</sup>	(restated) <sup>(1)</sup>	2007	2006
				%	%
Operating profit <sup>(2)</sup> .....	347,164	113,715	208,077	205.3	(45.3)
Operating profit margin....	31.9%	13.1%	27.6%	–	–
EBITDA <sup>(3)</sup>	436,470	331,154	300,686	31.8	10.1

1. Refer to Note 5 of consolidated financial statements for the year ended 31 December 2007 (approved on 3 February 2009).

2. Operating profit is calculated as Gross profit, less Selling, general and administrative expenses, Research and exploration expenses and Other expenses, net.

3. For details of EBITDA calculation refer to section 2.1 of this document.

## 1.2 Gold sales

The following table shows the results and breakdown of the Polyus Group's gold sales for the years ended 2008, 2007 and 2006:

USD' 000	Years ended 31 December			2008	2007
	2008	2007	2006	against	against
		(restated)	(restated)	2007	2006
				%	%
Gold sales					
(USD thousands).....	1,062,331	849,023	734,559	25.1	15.6
Gold sales (thousand troy ounces).....	1,226	1,210	1,216	1.3	(0.5)
In the domestic market (thousand troy ounces)	1,226	1,050	875	16.8	20.0
In the domestic market (%)	100	87	72	–	–
For export (thousand troy ounces).....	–	160	341	–	(53.1)
Weighted-average gold selling price (USD per troy ounce).....	867.3	701.7	604.1	23.6	16.2
Average evening fixing price in London (USD per troy ounce) <sup>(1)</sup>	872.0	695.4	603.5	25.4	15.2
Excess/(deficit) of average selling price over/(under) average evening fixing price (USD per troy ounce) .....	(4.7)	6.3	0.6	–	–

1. Source: LBMA

In 2008, the Polyus Group's revenue from gold sales reached a historical high level and was USD 1,062,331 thousand, an increase of 25.1% as compared to 2007.

The increase in revenue resulted primarily from favourable gold prices, as production and sales volumes in physical units remained relatively constant. In 2008, the Polyus Group produced 1,222 thousand troy ounces (38.0 tonnes) of refined gold, showing a slight growth over 2007 levels when it produced 1,214 thousand troy ounces (37.8 tonnes). The slight growth in production resulted from increased output at the Olimpiada mine, which became possible after Mill No.3 reached its' target production capacity in late 2008, and which was partly offset by the shut down of Mill. No.1 after the depletion of oxide ores at the Olimpiada deposit. Among the other factors that influenced the increase in output in 2008 were the increased average grade of the ore processed at the Kuranakh mine and acquisition of a new alluvial enterprise. The Polyus Group sold 1,226 thousand troy ounces in 2008, compared to 1,210 thousand troy ounces sold in 2007.

During 2008, the global gold price was rather volatile, reaching its highest level of USD 1,011.25 (London evening fixing) in March and the lowest of USD 712.5 in October. In the period under review, the average evening fixing price in London was USD 872.0, compared to USD 695.4 in the previous period. However, for the whole year, the global price of gold increased by only 3% between the start of the year and the end of the year, while it grew more than 30% during 2007. On 2 January 2008, the first business day in the market, the gold price was USD 846.75 per troy ounce, and on 30 December 2008, the last business day in the market, the gold price was USD 869.75 per troy ounce.

Following its policy to sell gold at spot market prices (without using any type of hedging instruments) the Polyus Group reflected the benefit of an increasing gold price in the financial results for 2008 in full. The average selling price in 2008 was USD 867.3 per troy ounce as compared to USD 701.7 per troy ounce in 2007.

In 2008, all the gold produced was sold in the domestic market, while in 2007 export accounted for 13% of sales in USD terms. The Polyus Group decided not to continue working under export contracts in the reporting period because export sales are less profitable due to transportation and other related expenses.

### 1.3 Cost of gold sales

The following table shows the results of the Polyus Group's cost of gold sales for the years ended 2008, 2007 and 2006:

USD '000	Years ended 31 December			2008	2007
	2008	2007 (restated)	2006 (restated)	against 2007	against 2006
				%	%
Cash operating costs <sup>(1)</sup>	587,332	442,224	348,212	32.8	27.0
Labour	207,403	144,008	104,358	44.0	38.0
Consumables and spares, out of which:	239,522	200,601	152,854	19.4	31.2
<i>Materials and spares</i>	150,503	137,956	103,617	9.1	33.1
<i>Fuel</i>	89,019	62,645	49,237	42.1	27.2
Utilities, out of which:	26,646	23,340	24,897	14.2	(6.3)
<i>Power</i>	25,753	19,494	14,617	32.1	33.4
<i>Other</i>	893	3,846	10,280	(76.8)	(62.6)
Tax on mining	72,588	51,138	42,361	41.9	20.7
Outsourced mining services	15,105	8,826	10,680	71.1	(17.4)
Refining costs	5,383	3,569	3,462	50.8	3.1
Sundry costs	20,685	10,742	9,600	92.6	11.9
Amortisation and depreciation of operating assets	98,999	87,196	73,718	13.5	18.3
Change in deferred stripping costs.....	(112,804)	(68,065)	5,230	65.7	-
Change in gold-in-process and refined gold	(6,879)	(12,621)	(7,951)	(45.5)	58.7
Change in provision for land restoration.....	(8,530)	482	7,318	-	(93.4)
Cost of gold sales	558,118	449,216	426,527	24.2	5.3

1. The presentation of cash operating costs is more detailed than that presented in the financial statements. The amounts are derived from the management accounts, and agree in total with the amounts presented in the financial statements.

In 2008, cost of gold sales increased by 24.2%, or USD 108,902 thousand, to USD 558,118 thousand.

#### *Cash operating costs*

The principal reason for the increase in cost of gold sales was the increase in cash operating costs within all the Polyus Group's production entities. During 2008, cash operating costs included in cost of sales were USD 587,332 thousand.

The largest item included in cash operating costs in 2008 and 2007 was labour expenses (35% of cash operating costs). Labour expenses for production staff were USD 207,403 thousand in 2008, an increase from USD 144,008 thousand in 2007. The 44% increase occurred mainly on account of the Krasnoyarsk business unit, including an accrued compensation payment relating to strong operational results.

The second largest item included in cash operating costs (26% of cash operating costs) was expenses for consumables and spares, which include materials and spares (parts for trucks, excavators and for construction machinery, expenses on rolled metal products and cables, technological materials for plants and other materials and spare parts used during the mining, concentration and smelting) and fuel.

The cost of materials and spare parts consumed in 2008 was USD 150,503 thousand as compared to USD 137,956 thousand in 2007, representing an increase of 9%. The increase was primarily the result of the growth in ore processing. The major contributor of the increase was the Olimpiada mine. The cost of a number of materials and spare parts, purchased by the Polyus Group in the reporting year also increased, primarily due to world-wide changes in underlying commodity prices (including oil products and hot rolled steel) especially in the first half of the year.

A significant portion of consumables and spares is fuel, mainly diesel oil, fuels and lubricants for trucks and excavators and fuel for oil-fired power plant operating at Nezhdaninskoye deposit and the diesel power plant at the Olimpiada mine. The Polyus Group total expenses on fuel grew by 42% from USD 62,645 thousand in 2007 to USD 89,019 thousand in 2008, consistent with growth in world prices for oil products.

As an example the Group provides a comparative table which shows the main consumables and spares procured by the Krasnoyarsk business unit, which cost of gold sales contributes for almost 54% of Group's cost of gold sales:

USD' 000	Unit of measurement	2008		2007	
		Volume	Cost, USD'000	Volume	Cost, USD'000
Spare parts for tipper trucks and digging machines			10,371		12,958
Grinding balls	Tonne	11,020	13,511	6,580	5,505
Pipes for current operations			1,212		1,198
Spare parts for road-building machines			3,428		1,787
Rolled metal products for current operations			1,859		784
Summer diesel fuel	Tonne	45,600	31,954	50,075	29,588
Winter diesel fuel	Tonne	30,400	24,182	33,952	22,740
Ai-80 gasoline	Tonne	360	316	360	289
Ai-92 gasoline	Tonne	420	417	300	285
Explosives			15,575		17,202
Cyanides	Tonne	19,565	62,232	8,639	18,377
<b>Total</b>			<b>165,057</b>		<b>110,713</b>

The purchase of consumables and spare parts by the Krasnoyarsk business unit in USD terms increased by 49% from USD 110,713 in 2007 to USD 165,057 in 2008. The volume of purchases in physical items increased primarily due to purchases of grinding balls and cyanides due to Mill No.3 achieving its project capacity of 5 mtpa, as well as purchases of gasoline for the construction on the Titimukhta and Blagodatnoye mines. In monetary terms the increase primarily reflected purchases of spare parts for road-building machines and rolled metal products. These increases were also due to construction works, including road building, carried out at the Krasnoyarsk business unit, which required additional machinery and spares. In 2008, an explosive workshop was constructed at the Olimpiada mine, which led to a reduction in explosives costs.

The following table shows costs per unit of consumables and spare parts procured by the Krasnoyarsk business unit:

USD' 000	Unit of measurement	2008	2007	2008 against 2007, %
Grinding balls	USD/tonne	1,226	837	46.5
Summer diesel fuel	USD/tonne	701	591	18.7
Winter diesel fuel	USD/tonne	795	670	18.7
Ai-80 gasoline	USD/tonne	877	804	9.1
Ai-92 gasoline	USD/tonne	994	951	4.6
Cyanides	USD/tonne	3,181	2,127	49.6

During the reporting period the prices for cyanides and grinding balls increased substantially. The growth of purchase prices for grinding balls resulted from a 43% increase in hot rolled steel prices. Rising costs for diesel fuel and gasoline reflected the global trend of oil products prices growth in the first half of 2008.

In 2008, due to the growth in the gold price, applied to a slightly increased sales volume, the Polyus Group paid USD 72,588 thousand in mining tax, which was USD 21,450 thousand more than in 2007. In accordance with Chapter 26 of the Tax Code of the Russian Federation, the tax on mining base includes concentrate or any other semi-product containing precious metal obtained by extraction of this metal from ore, alluvial or industrial deposits, such as the gold produced by the Polyus Group. Concentrates and other semi-products containing gold are subject to the tax at the rate equal to 6% of the cost of these semi-products. The cost is determined based on selling prices for the relevant tax period.

#### *Amortisation and depreciation of operating assets*

Amortisation and depreciation of operating assets included in cost of sales increased by 13.5% from USD 87,196 thousand in 2007 to USD 98,999 thousand in 2008. The increase was due to commissioning of new fixed assets, mainly in the Krasnoyarsk business unit. This amount included amortisation of the mineral rights in the amount of USD 15,842 thousand.

#### **1.4 Selling, general and administrative expenses**

The following table sets forth the selling, general and administrative expenses of the Polyus Group for the years ended 2008, 2007 and 2006:

USD '000	Years ended 31 December			2008	2007
	2008	2007 (restated)	2006 (restated)	against 2007 %	against 2006 %
Salaries	73,742	76,291	44,019	(3.3)	73.3
Taxes other than mining and income taxes	18,318	20,724	11,322	(11.6)	83.0
Professional services	13,321	8,288	6,820	60.7	21.5
Depreciation	3,782	3,969	4,759	(4.7)	(16.6)
Share option plan	-	132,548	-	-	-
Other	25,797	19,956	12,758	29.3	56.4
<b>Total</b>	<b>134,960</b>	<b>261,776</b>	<b>79,678</b>	<b>(48.4)</b>	<b>228.5</b>

During 2007, the Polyus Group's selling, general and administrative expenses decreased by 48% from USD 261,776 thousand in 2007 to USD 134,960 in 2008. This decrease was mainly a result of the absence in 2008 of expenses relating to the exercise of the share option plan in the amount of USD 132,548 thousand, reflected in 2007 administrative expenses, which more than offset increases in other costs.

#### *Salaries*

As a result of the consistent introduction of a cost-cutting programme, for the first time in its history the Polyus Group cut administrative staff labour costs on the year-to-year basis. These expenses decreased by USD 2,549 thousand or 3% from 2007 to USD 73,742 thousand in 2008.

#### *Taxes, other than mining and income taxes*

In addition to tax on mining and income taxes, the Polyus Group pays property tax, VAT (which for the purpose of this item only includes non-recoverable VAT), unified social tax and other taxes. In 2008, the Polyus Group paid USD 18,318 thousand in federal and regional taxes other than tax on mining and income tax, which was 12% less than in 2007, primarily due to a decrease of non-recoverable VAT. In 2007, the amount of non-recoverable VAT was significantly higher at CJSC Polyus (Krasnoyarsk business unit), because of contributions it made to the share capital of new subsidiaries in non-monetary form.

The amount of property tax increased substantially as a result of commissioning of property related to the new projects development and the modernization of existing production facilities.

The following table shows the components of taxes, other than mining and income taxes, for 2008, 2007 and 2006:

USD '000	Years ended 31 December			2008 against	2007 against
	2008	2007 (restated)	2006 (restated)	2007	2006
				%	%
Taxes, other than mining and income taxes .....	18,318	20,724	11,322	(11.6)	83.0
VAT .....	3,100	10,092	3,377	(69.3)	198.8
Property tax.....	11,561	8,231	5,135	40.5	60.3
Other taxes .....	3,657	2,401	2,810	52.3	(14.6)

#### *Professional services*

In 2008, professional services expenses increased by USD 5,033 thousand, from USD 8,288 thousand in 2007 to USD 13,321 thousand in 2008. The increase in professional services expenses was due to consulting services provided on a proposal to carve out the exploration assets.

#### *Other selling, general and administrative expenses*

Other selling, general and administrative expenses are presented with rent expenses, communication services, repair and maintenance costs. Rent expenses increased from USD 1,799 thousand in 2007 to USD 4,609 thousand in 2008, primarily as a result of the revision of terms of the rent agreement for the Moscow head office. The following table shows the components of other selling, general and administrative expenses for 2008, 2007 and 2006:

USD '000	Years ended 31 December			2008	2007
	2008	2007 (restated)	2006 (restated)	against 2007	against 2006
				%	%
Other	25,797	19,956	12,758	29.3	56.4
Rent expenses	4,609	1,799	1,445	156.2	24.5
Repair and maintenance	1,541	1,734	1,025	(11.1)	69.2
Communication services	1,749	1,278	1,415	36.9	(9.7)
Other	17,898	15,145	8,873	18.2	70.7

### 1.5 Research and exploration expenses

In 2008, research and exploration costs decreased by USD 1,258 thousand, or 20%, from USD 6,217 thousand in 2007 to USD 4,959 thousand in 2008, reflecting the Group's decision to substantially reduce exploration works due to the deterioration of global market conditions in the second half of the year.

### 1.6 Other expenses, net

In the period under review, other operating income was USD 5,569 thousand compared to USD 7,696 thousand in the previous period. In 2008, deferred consideration amounted to USD 3,152 thousand and other operating income totaled USD 2,417 thousand.—In 2007 other operating income comprised changes in the allowance for reimbursable VAT in the amount of USD 3,641 thousand and an interest payable written off as a result of an amicable settlement with a creditor totaling USD 4,055 thousand.

Other operating expenses increased by 26%, from USD 18,025 thousand in 2007 to USD 22,625 thousand in 2008. This was largely due to a significant increase in charity contributions to USD 7,135 thousand, changes in the allowance for obsolescence of inventories and inventories written off in the sum of USD 2,243, as well as changes in the allowance for reimbursable VAT totaling USD 7,078, which were partly offset by a substantial decrease in loss on disposal of property, plant and equipment (a decrease of USD 5,873), change in allowance for doubtful debts (a decrease of USD 1,337 thousand), tax fines and penalties (a decrease of USD 585 thousand) and other operating expenses (a decrease of USD 1,608 thousand).



### 1.7 Finance costs, income (loss) from investments and foreign exchange gain/(loss)

The following table sets forth the components of financial and investment activity in 2008, 2007 and 2006:

USD' 000	Years ended 31 December			2008	2007
	2008	2007 (restated)	2006 (restated)	against 2007	against 2006
				%	%
Finance costs .....	(4,417)	(6,629)	(6,453)	(33.4)	2.7
Income/(loss) from investments ....	(217,591)	61,537	1,102,111	–	(94.4)
Foreign exchange gain/(loss).....	(2,685)	8,484	(75,344)	–	–

In 2008, finance expenses decreased by approximately one third and amounted to USD 4,417 thousand. This was a result of redemption of short-term borrowings in the first half of the reporting year.

In 2008, the Polyus Group recognized a net loss from investments totaling USD 217,591 thousand.

During 2008, the Group incurred losses from investments in securities held for trading under asset management agreements by the Managing Company Rosbank. These investments are carried at fair value through profit and loss. As a result of significant declines in financial markets, a USD 178,377 thousand loss in the value of the securities was reflected in the Polyus Group consolidated income statement. Moreover, the Polyus Group holds an investment share in Management Company Rosfund which is accounted for as available-for-sale investments. During the year, the Polyus Group disposed of USD 51,230 thousand of its shares which resulted in a loss on disposal of investments in the amount of 16,230 thousand and cash proceeds of USD 35,000 thousand. The decrease in fair value of this investment is considered to be permanent, and impairment has been recognized through a reduction in the investment revaluation reserve and as investment impairment in the income statement in the sum of USD 100,090 thousand

In July 2008 the Polyus Group subsidiary OJSC Lenzoloto disposed of its 6.7% stake in OJSC Vysochaishy resulting in a gain of USD 30,000 thousand. In 2008 the Polyus Group also received interest income on bank deposits, loans under repurchase agreements and promissory notes for the total amount of USD 47,106 thousand as compared to USD 51,493 thousand in the previous period.

During 2008, as a result of exchange rate movements the Polyus Group recognized a foreign exchange loss of USD 2,685 thousand, USD 2,604 thousand of which related to investing activities, while in 2007 foreign exchange gain totaled USD 8,484 thousand.

### 1.8 Income tax

During 2008, the Polyus Group accrued USD 62,110 thousand in income tax, which was 27% less than in 2007. This was largely affected by the reduction in the statutory income tax rate from 24% to 20% starting from 1 January 2009, which led to a recalculation of deferred tax liabilities. The effective income tax rate (ratio of current and deferred tax expense to IFRS income before tax) in 2008 was 51%, whereas the statutory income tax rate in Russia established in 2008 was 24%. The difference between the statutory and the effective tax rates was mainly because of deferred tax assets not recognized on loss from investments under asset management agreements in the sum of USD 42,810 thousand, as well as a significant amount of non-deductible items for tax purposes and other permanent differences in the sum of USD 7,396 thousand. .

### 1.9 Other sales and cost of other sales

Revenue received by the Polyus Group from the sale of products other than gold and services grew by 38% in the reporting period and amounted to USD 24,987 compared to USD 18,096 thousand in the previous period. This revenue includes sales of electricity, rent services sales, revenue from transportation, handling and storage services, and other sales. The growth occurred mainly on account of sales of electricity, housing maintenance and gold mining under contractors' agreement. In 2008, other sales revenue was slightly lower than cost of their sales which resulted in a net loss from other sales in the amount of 74 thousand, compared to a net loss of USD 7,770 in 2007. Cost of other sales also included fuel and materials expenses and payroll costs in non-mining activities.

## 2. Non-GAAP financial measures

In its analysis of the Polyus Group's results, Polyus Gold uses key performance indicators which are not measures determined in accordance with IFRS.

### 2.1 EBITDA

"EBITDA" is defined by Polyus Gold as profit before finance costs, income tax, income (losses) from investments, depreciation, amortisation and interest, and is further adjusted by certain items included in the table below. As these line items are not of a recurring nature, Polyus Gold has made these adjustments in calculating EBITDA to provide a clearer view of the performance of its underlying business operations and to generate a metric that it believes will give greater comparability over time with peers in its industry. Polyus Gold believes that EBITDA is a meaningful indicator of its profitability and performance. This measure should not be considered as an alternative to profit for the year and operating cash flows based on IFRS and should not necessarily be construed as a comprehensive indicator of the Polyus Group's measure of profitability or liquidity.

The following table sets forth the Polyus Group's EBITDA for the years ended 31 December 2008, 2007 and 2006:

USD'000	Years ended 31 December		
	2008	2007 (restated)	2006 (restated)
Profit for the year .....	60,361	91,808	1,155,311
+ Income tax charged .....	62,110	85,299	73,080
+ Depreciation and amortisation for the year .....	86,927	82,066	79,025
+ Interest expense .....	4,417	6,629	6,453
– Interest payable written off.....	–	(4,055)	–
– Interest income .....	(47,106)	(51,493)	(107,616)
– Gain on disposal of investments.....	(13,770)	–	(980,462)
+ Loss/(gain) from investments in listed companies held for trading	178,377	(9,898)	(7,234)
+ Impairment of available-for-sale investments.....	100,090	–	–
– Foreign exchange (gain)/loss.....	2,685	(8,484)	75,344
+ Loss from disposal of property, plant and equipment and work-in-progress.....	548	6,421	1,494
+ Impairment of property, plant and equipment.....	1,831	313	383
+ Reversal of environmental obligations.....	–	–	2,094
+ Change of provision for VAT receivable .....	–	–	2,814
+ Charge from share option plan obligations .....	–	132,548	–
<b>EBITDA.....</b>	<b>436,470</b>	<b>331,154</b>	<b>300,686</b>

The Polyus Group's EBITDA in 2008 was USD 436,470 thousand, which was USD 105,316 thousand or 32% more than in 2007, reflecting growth in gold selling prices.

### 2.2 Total Cash Costs

The Polyus Group presents the financial items "total cash costs" ("TCC") and "total cash costs per troy ounce" which have been calculated and presented by management as TCC presentation is common industry practice. Although its calculations of these items may differ from those of its industry peers. These items are not IFRS measures. An investor should not consider these items in isolation or as alternatives to cost of sales, profit for the year attributable to shareholders of the parent company, net cash generated from operating activities or any other measure of financial performance presented in accordance with IFRS. The calculation of total cash costs may vary significantly among gold mining companies, and by themselves do not necessarily provide a basis for comparison with other gold mining companies.

Total cash costs are defined by the Polyus Group as cost of sales reduced by property, plant and equipment depreciation, provision for annual vacation payment, provision for land rehabilitation and adjusted by non-monetary changes in inventories and non-monetary changes in deferred stripping works. Total cash costs per troy ounce are the attributable total cash costs divided by the attributable troy ounce of gold sold.

The following table shows the Polyus Group's TCC for the years ended 31 December 2008, 2007 and 2006:

	Years ended 31 December			2008 against	2007 against
	2008	2007 (restated)	2006	2007	2006
			(restated)	%	%
Cost of gold sales (USD thousand) .....	558,118	449,216	426,527	24.2	5.3
– property, plant and equipment depreciation (USD thousand) .....	(98,999)	(87,196)	(73,718)	13.5	18.3
– provision for annual vacation payment (USD thousand) .....	(6,124)	(4,190)	(2,663)	46.2	57.3
– provision for land rehabilitation (USD thousand) .....	8,530	(482)	(7,318)	–	(93.4)
+ non-monetary changes in inventories <sup>(1)</sup> (USD thousand) .....	1,140	2,383	1,349	(52.2)	76.6
+ non-monetary changes in deferred stripping works <sup>(2)</sup> (USD thousand) .....	17,490	10,429	–	67.7	–
TCC (USD thousand) .....	480,155	370,160	344,177	29.7	7.5
Gold sales, thousand troy ounces .....	1,226	1,210	1,216	1.3	(0.5)
TCC, USD/oz .....	392	306	283	28.0	8.1
TCC, RUB/oz .....	9,737	7,825	7,695	24.4	1.7

1. “Non-monetary changes in inventories” is a calculation to estimate the non-cash portion of costs included in the change in the amount of inventory, primarily representing depreciation and amortisation.
2. “Non-monetary changes in deferred stripping works” is a calculation to estimate the non-cash portion of costs included in the change in the amount of deferred stripping costs, primarily representing depreciation and amortisation.

In 2008, TCC per troy ounce grew by 24% on a RUB basis and by 28% on a USD basis.

The increase in TCC was mainly due to the fact that cash operating costs increased by 33% for the year while the volume of sales accounted for on the basis of troy ounces changed insignificantly. See paragraph 1.3 above (“Cost of gold sales”).

### 2.3 Analysis of profitability indicators

Adjusted net profit is defined as net profit attributable to shareholders of the parent company adjusted for the charge from stock option plan obligations in 2007 and the gain on disposal of Gold Fields shares in 2006. Adjusted return on assets is calculated as the adjusted net profit divided by the average assets for the year. Adjusted return on equity is calculated as the adjusted net profit divided by the average equity attributable to shareholders of the parent for the year. Adjusted return on invested capital is calculated as the adjusted net profit divided by the sum of the average equity attributable to shareholders of the parent and average non-current and current loans and borrowings for year.

We have made these adjustments as these items are not of a recurring nature, to provide a clearer view of the performance of our underlying business operations and to generate a metric that we believe will give greater comparability over time with peers in our industry. Polyus Group believes that adjusted net profit, adjusted return on assets, adjusted return on equity and adjusted return on invested capital are meaningful indicators of its profitability and performance. These measures should not be considered alternatives to profit for the year and operating cash flows based on IFRS and should not necessarily be construed as a comprehensive indicator of Polyus Group's measure of profitability or as a measure of liquidity.

The following table shows the Polyus Group's calculation of adjusted net profit, adjusted return on assets, adjusted return on equity and adjusted return on invested capital for the years ended 31 December 2008, 2007 and 2006:

USD'000, unless otherwise indicated	Years ended 31 December			2008	2007
	2008	2007 (restated)	2006 (restated)	against	against
				2007	2006
				%	%
Net profit attributable to shareholders of the parent company .....	51,507	85,809	1,155,725	(40.0)	(92.6)
+ Charge from share option plan obligations.....	–	132,548	–	(100.0)	–
- Gain on disposal of investments.....	(13,770)	–	(980,462)	–	–
+ Loss/(gain) from investments in listed companies held for trading	178,377	(9,898)	(7,234)	–	36.8
+ Impairment of available-for-sale investments	100,090	–	–	100.0	–
<b>Adjusted net profit.....</b>	<b>316,204</b>	<b>208,459</b>	<b>168,029</b>	<b>51.7</b>	<b>24.1</b>
Assets (average for the year) .....	3,426,156	3,527,817	3,452,244	(2.9)	2.2
Equity attributable to shareholders of the parent (average for the year) .....	3,009,254	3,043,901	2,979,152	(1.1)	2.2
Non-current and current loans and borrowings (average for the year) .....	10,455	17,955	20,544	(41.8)	(12.6)
Adjusted return on assets, % .....	9.23	5.91	4.87	–	–
Adjusted return on equity, %.....	10.51	6.85	5.64	–	–
Adjusted return on invested capital, %.....	10.47	6.81	5.60	–	–

Adjusted return on assets equalled to 9.23 percentage points, adjusted return on equity equalled to 10.51 percentage points and adjusted return on invested capital equalled to 10.47 percentage points. In 2008 the asset base slightly decreased, while loans and borrowings were redeemed. At the same time, the Group's net profit adjusted for loss from investments showed a growth of 52%. This led to a considerable increase in profitability indicators.

### 3. Summary table of performance results by business units

The following table shows the Polyus Group's performance results by business units for the years ended 31 December 2008, 2007 and 2006:

	Years ended 31 December								
	2008			2007			2006		
	Revenue USD '000	Production 000 oz	Sales 000 oz	Revenue USD '000	Production 000 oz	Sales 000 oz	Revenue USD '000	Production 000 oz	Sales 000 oz
Krasnoyarsk business unit .....	761,318	873	877	603,649	861	856	516,076	854	855
Irkutsk hard rock business unit .....	21,466	25	25	23,231	32	33	18,517	32	31
Irkutsk alluvial business unit .....	154,906	181	181	124,111	179	179	103,984	172	172
Yakutia business unit .....	124,640	144	144	98,032	142	142	95,982	157	158
<b>Group total<sup>(1)</sup> .....</b>	<b>1,062,331</b>	<b>1,222</b>	<b>1,226</b>	<b>849,023</b>	<b>1,214</b>	<b>1,210</b>	<b>734,559</b>	<b>1,215</b>	<b>1,216</b>

1. Totals may not add due to the rounding error.

#### 3.1 Krasnoyarsk business unit (Olimpiada mine)

USD'000, unless otherwise indicated	2008
Revenue	761,318
Cost of sales	(298,903)
Gross profit	462,415
Gross profit margin	61%
TCC, USD per troy ounce	293

The Krasnoyarsk business unit is the Polyus Group's leading mining operation. The Krasnoyarsk business unit also acts as a distributing agent and sells its own gold and that of its subsidiaries-

Refined gold output at the Olimpiada mine totaled 873 thousand troy ounces (27.1 tonnes) in 2008, compared to 861 thousand troy ounces (26.8 tonnes) in 2007. The enhanced production was related to Mill No.3 achieving its

projected capacity of 5 mtpa as well as the processing of additional volumes of oxide ore from Vostochny Pit of Olimpiada mine and ore from the Olenye deposit which was mined in 2007.

In 2008, gold sales of the Krasnoyarsk business unit were USD 761,318 thousand, as compared to USD 603,649 thousand in 2007. In the reporting year the entity sold 877 thousand troy ounces (27.3 tonnes), which includes 873 thousand troy ounces (27.1 tonnes) produced during the year, as well as 4 thousand troy ounces (0.2 tonnes) of gold produced in the previous year.

In 2008, the Olimpiada mine was successfully transitioned to sulphide ores processing. Whereas in 2006 sulphide ores represented 71% of the total volume of ores processed, this figure increased to 84% in 2007 and to 94% in 2008.

Despite full conversion to the processing of sulphide ores in 2008, in the period under review the Krasnoyarsk business unit TCC indicator remains one of the lowest in the world gold industry. The gross profit margin in 2008 was 61%.

### 3.2 Irkutsk alluvial gold business unit (Alluvial deposits)

<u>USD'000, unless otherwise indicated</u>	<u>2008</u>
Revenue	163,024
Cost of sales	(137,591)
Gross profit	<u>25,434</u>
Gross profit margin	16%
TCC, USD per troy ounce	633

In 2008, gold production at the alluvial deposits in the Irkutsk region totaled 181 thousand troy ounces (5.6 tonnes), while in 2007 the alluvial deposits produced 179 thousand troy ounces (5.57 tonnes) of gold. The main factors that influenced alluvial gold production in the reporting period were organisational improvements within the Polyus Group's main alluvial enterprise and the acquisition of a new alluvial enterprise, as well as favorable weather conditions.

During the reporting period all of the gold produced by the Irkutsk alluvial business unit was sold. As a result, the positive gold price movements resulted in a 25% increase in revenues over the 2007 levels to USD 163,024 in 2008. The gross profit margin was 16%.

Alluvial deposits' TCC amounted to USD 633 per troy ounce in 2008, compared to USD 607 per troy ounce in 2007. The slight increase of 4% was principally due to increase of salaries and mining tax.

### 3.3 Yakutia business unit (Kuranakh mine)

<u>USD'000, unless otherwise indicated</u>	<u>2008</u>
Revenue	128,988
Cost of sales	(117,639)
Gross profit	<u>11,348</u>
Gross profit margin	9%
TCC, USD per ounce	681

In 2008, the Kuranakh mine in the Sakha Republic (Yakutia) produced 144 thousand troy ounces (4.5 tonnes) of refined gold, compared to 142 thousand troy ounces (4.4 tonnes) in 2007. A slight growth in production was due to an increase of the average gold grade in the ore processed from 1.37 to 1.44 grammes per tonne.

In 2008, the gold sales revenue of the Yakutia business unit totaled USD 124,640 thousand compared to USD 98,032 thousand in 2007. The revenue growth related mainly to the growth of the selling price. The gross profit margin equalled 9%.

The Kuranakh mine's TCC amounted to USD 681 per troy ounce in 2008, compared to USD 452 per troy ounce in 2007. Transportation costs represent a large part of the Yakutia business unit's TCC due to dispersion of deposits of the Kuranakh ore field. In 2008, the growth in prices for materials and spare parts for trucks led to a substantial increase in transportation costs and repair and maintenance costs. TCC also increased because of growth in labour and fuel costs.

The Kuranakh mill was commissioned in 1965 and is one of the oldest in the industry. Obsolescence of its production facilities have resulted in a gradual reduction of profitability. The Polyus Group is in the process of modernizing the mill in order to increase its capacity from 3.6 mtpa to 4.5 mtpa. The main stages of its modernization process are expected to be completed in the second quarter of 2009.

### 3.4 Irkutsk hard rock business unit (Zapadnoye mine)

<u>USD'000, unless otherwise indicated</u>	<u>2008</u>
Revenue	44,016
Cost of sales	(39,313)
Gross profit	<u>4,703</u>
Gross profit margin	11%
TCC, USD per troy ounce	895

In 2008, refined gold production of the Zapadnoye mine was 25 thousand troy ounces (0.767 tonnes), compared to 32 thousand troy ounces (1 tonne) in 2007. The main reasons for the reduction in output were decreases in the average gold grade of the ore processed and in the volumes of ore processed, the latter resulting from the impact of the modernization programme carried out with the aim of improving the plant's technological processes.

In the reporting period the Irkutsk hard rock business unit sold all the gold produced within the year.

Gold sales revenue decreased from USD 23,231 thousand in 2007 to USD 21,466 thousand in 2008 and the gross profit margin equalled 11%.

The Zapadnoye mine's TCC amounted to USD 895 per troy ounce in 2008, compared to USD 537 per troy ounce in 2007. The growth in TCC reflected an increase in labour and power expenses, growth of material expenses through inflation and an increase in repair and maintenance costs. The increase in costs was due to a decrease in the recovery rate of the ore processed and tariff growth. Although, a 2-weeks plant downtime due to roller engine breakage resulted in a decrease in production while the Group continued fixed costs accrual (fixed part of salaries, electricity costs). In addition, the Polyus Group reviewed the carrying amounts of the Irkutsk hard rock business unit's tangible assets to determine whether there is any indication that those assets are impaired. As the results of making an assessment of impairment the Polyus Group did not recognize any impairment losses specifically related to the Irkutsk hard rock business unit.

The Zapadnoye mill was commissioned in 2004 and the Polyus Group is in the process of improving mining technology at the mill. The Polyus Group believes that the application of modern technologies and transportation systems should allow the Zapadnoye mine to become a profitable enterprise in the near future.

#### 4. Review of financial sustainability and solvency

##### 4.1 Analysis of balance sheet items

The table below shows extracts of the Polyus Group's consolidated balance sheet as at 31 December 2008, 2007 and 2006:

USD '000	As at 31 December		
	2008	2007 (restated)	2006 (restated)
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment.....	1,772,319	1,783,432	1,395,605
Deferred stripping costs	163,988	82,061	10,382
Other non-current assets <sup>(1)</sup> .....	54,510	13,971	12,940
<b>Total non-current assets</b> .....	<b>1,990,817</b>	<b>1,879,464</b>	<b>1,418,927</b>
<b>Current assets</b>			
Inventories.....	233,001	224,209	169,471
Investments in securities and other financial assets.....	285,236	1,270,918	1,238,429
Cash and cash equivalents.....	398,826	226,174	294,197
Other current assets <sup>(2)</sup> .....	170,982	172,685	161,160
Total current assets.....	1,088,045	1,893,986	1,863,257
<b>TOTAL ASSETS</b> .....	<b>3,078,862</b>	<b>3,773,450</b>	<b>3,282,184</b>
<b>EQUITY AND LIABILITIES</b>			
Equity attributable to shareholders of the parent company.....			
Minority interest.....	2,756,733	3,261,774	2,826,027
	37,808	47,187	32,647
<b>TOTAL EQUITY</b> .....	<b>2,794,541</b>	<b>3,308,961</b>	<b>2,858,674</b>
<b>Total non-current liabilities</b> .....	<b>182,623</b>	<b>281,950</b>	<b>252,175</b>
<b>Current liabilities</b>			
Short-term borrowings.....	-	20,909	15,001
Trade and other payables and accrued expenses.....	83,527	105,583	70,513
Other current liabilities <sup>(3)</sup> .....	18,171	56,047	85,821
Total current liabilities.....	101,698	182,539	171,335
<b>TOTAL LIABILITIES</b> .....	<b>284,321</b>	<b>464,489</b>	<b>423,510</b>
<b>TOTAL EQUITY AND LIABILITIES</b> .....	<b>3,078,862</b>	<b>3,773,450</b>	<b>3,282,184</b>

1. Other non-current assets consist of investments in securities and other financial assets and the long-term portion of reimbursable value added tax.
2. Other current assets consist of reimbursable value added tax, accounts receivable, advances paid to suppliers, income tax receivable and other current assets.
3. Other current liabilities consist of contingent consideration on acquisition of subsidiaries, dividends payable, minority interest liability, income tax payable and other taxes payable.

#### 4.1.1 Assets

##### *Non-current assets*

The table below analyses the Polyus Group's property, plant and equipment at 31 December 2008, 2007 and 2006:

USD '000	Years ended 31 December		
	2008	2007 (restated)	2006 (restated)
Exploration and evaluation assets.....	214,920	301,238	133,811
Mining assets <sup>(1)</sup> .....	1,218,349	1,253,565	1,061,939
Building, structures and utilities.....	471,987	353,043	256,757
Machinery, equipment and transport.....	313,250	366,071	291,238
Mineral rights.....	433,112	534,451	513,944
Non-mining assets.....	39,814	41,084	37,350
Capital construction-in-progress .....	299,236	187,545	162,505
Total property, plant and equipment.....	1,772,319	1,783,432	1,395,605

In 2008, the Polyus Group's assets structure underwent significant change. Whereas in 2007 non-current assets accounted for 50% of all the assets, in 2008 their share reached 65%. This change was primarily due to an almost twofold increase in capitalised deferred stripping costs and a substantial reduction in current assets, mainly relating to decreases in securities investments.

In the period under review the Polyus Group was actively involved in construction and mine development works. As a result, the value of capital construction-in-progress showed a substantial increase, growing from USD 187,545 thousand in 2007 to USD 299,236 thousand in 2008. Mining assets account for the most significant group of assets in the Polyus Group. In the reporting year, the value of mining assets declined by 3% from USD 1,253,565 thousand in 2007 to USD 1,218,349 thousand in 2008. Additions and transfers from capital construction-in-progress were partly offset by re-estimation of decommissioning liability and disposals. Exploration and evaluation assets decreased by 29% and amounted to USD 214,920 thousand as of the year end. This was due to the reduction in exploration work, throughout the Polyus Group, as well as a transfer in assets from exploration to mining assets. The value of non-mining assets decreased by 3% and amounted to USD 39,814 thousand, principally due to exchange rate movements. Material RUB depreciation led to a net USD 344,839 thousand drop in the value of property, plant and equipment. As a result, the closing balance of the Polyus Group's property plant and equipment totaled USD 1,772,319 thousand as at 31 December 2008, compared to USD 1,783,432 thousand as at 31 December 2007.

Capitalised deferred stripping costs grew significantly from USD 82,061 thousand as at 31 December 2007 to USD 163,988 thousand as at 31 December 2008. This increase was due to continued stripping works and deferral of costs at the Krasnoyarsk business unit in respect of accessing the sulphide ore body after the depletion of the oxide ores of Olimpiada.

##### *Current assets*

Current assets of the Polyus Group decreased by 43% from USD 1,893,986 thousand as at 31 December 2007 to USD 1,088,045 thousand as at 31 December 2008, mostly due to a USD 985,682 decrease in investments in securities and other financial assets.

As at 31 December 2008, the value of short-term investments in securities and other financial assets totaled USD 285,236 thousand, compared to USD 1,270,918 thousand as at 31 December 2007. The major reason for the substantial decrease in short-term investments was a 48% decline in equity investments available-for-sale and a 78% decrease in investments in listed companies held for trading.

In 2008, available-for-sale investments included a share in Rosfund which declined by USD 191,803 thousand. During 2008, the Polyus Group disposed of USD 51,230 thousand of the share in Rosfund, which resulted in a loss of USD 16,230 thousand as well as a disposal of USD 5,558 thousand of investment revaluation reserve. The decrease in the fair value of this investment over the purchase price was also offset by investment revaluation reserve for the sum of USD 31,349 thousand. The further impairment was recognised as a loss from investments of USD 100,090 thousand.

Investments in listed companies held for trading are represented by financial assets under the trust management of Rosbank and are carried at fair value. In the beginning of 2008, their value totaled USD 187,628 thousand. During 2008, a significant part of these investments was withdrawn. The Polyus Group recognized losses from investments in listed companies held for trading in the amount of USD 178,377 thousand in the income statement. At the end 2008, the value of these investments totaled USD 40,628 thousand.



The Polyus Group sold certain promissory notes receivable during 2008. Thus, their value decreased by USD 74,937 thousand to USD 35,928 thousand as of the year end. In addition, by the end of 2008, the Polyus Group withdrew its investment bank deposits, disposed of loans under repurchase agreements and closed its investment deposit in Rosbank.

Released funds were partly used for the capital expenditure programme and working capital financing, repayment of borrowings, dividends payment, acquisition of stakes in subsidiaries, and partly deposited in current bank accounts. As a result of this redistribution the Group's cash and cash equivalents increased by 76% from USD 226,174 thousand at 31 December 2007 to USD 398,826 thousand 31 December 2008.

Inventories increased by 4% to USD 233,001 thousand as at 31 December 2008. Stores and materials (net of allowance for obsolescence), which accounted for 78% of the total inventories value at 31 December 2008, increased by 8% and equalled to USD 182,100 thousand as at 31 December 2008. The volumes of grinding balls, spare parts, and rolled metal products purchased for mining equipment, as well as cyanides, increased both in terms of volume and costs. This was because Mill No. 3 at the Olimpiada mine increased its capacity up to projected 5 mtpa, and the volumes of gasoline procured increased due to active construction works within the Polyus Group. At the same time, the cost of gold under processing fell from USD 54,961 thousand as at 31 December 2007 to USD 49,052 thousand as at 31 December 2008.

#### 4.1.2 *Capital and liabilities*

Since 1 January 2007, the Polyus Group has been financed by equity capital and has had no significant bank debt.

##### *Share capital and reserves*

As at 31 December 2008, share capital and reserves were USD 2,794,541 thousand, compared to USD 3,308,961 thousand as at 31 December 2007. This decline was primarily due to the reduction in translation and investment revaluation reserves. During 2008, the translation reserve decreased by USD 469,133 thousand due to the changes in the RUB/USD exchange rate. In addition, the investment revaluation reserve was eliminated as a result of the recognition of an impairment of available-for-sale investments in the sum of USD 36,907 thousand.

During 2008, the value of the Polyus Group treasury shares and additional paid-in capital decreased by USD 5,523 thousand and USD 1,510 thousand respectively. This was related to the acquisition of 95,314 treasury shares by management under the share option plan. As at 31 December 2008 the value of treasury shares was USD 724,927 thousand, and the additional paid-in capital totaled USD 2,116,655 thousand.

During the period, the Polyus Group's retained earnings decreased by USD 3,014 thousand, reflecting a net profit attributable to the parent company of USD 51,507 thousand less dividends paid of USD 22,258 thousand (in respect of 2007 results), adjustments in connection with the increase in the share capital of subsidiaries and change of shareholding structure of subsidiaries in a net amount of USD 32,263 thousand.

##### *Non-current liabilities*

In 2008, deferred tax liabilities which account for the largest portion of non-current liabilities totaled USD 148,244 thousand which is 26% less than in the previous year (USD 200,609 thousand). This change related to the partial tax recognition in the income statement for the period of USD 22,893 thousand, as well as exchange rate movements, which led to a decrease in deferred tax liabilities of USD 29,472 thousand. Environmental obligations decreased by 58% from USD 81,341 thousand as at 31 December 2007 to USD 34,379 thousand as at 31 December 2008. This was primarily due to a substantial re-estimation of decommissioning assets and provision for land restoration in the total amount of USD 48,305 thousand, as well as a weakening of the Russian rouble.

##### *Current liabilities*

In 2008, borrowings were all repaid. Trade payables decreased by USD 3,733 thousand to USD 17,918 thousand. Other payables and accrued expenses as at 31 December 2008 were USD 65,609 thousand compared to 83,932 thousand as at 31 December 2007. Accrued annual leave payments totaled USD 18,542 thousand at the end of the reporting period, compared to USD 16,482 thousand at the end of the previous period. The Polyus Group outstanding amounts on payroll settlements as of the year end were USD 37,159 thousand, reflecting a 32% increase over 2007 levels. The 44% increase mainly comes from the Krasnoyarsk business unit, where a bonus for successful achievement of operational targets was accrued. Other payables reduced by 68%, which was mostly due to settlement of outstanding accounts relating to the Rosbank asset management agreements and the final settlement of share option plan liabilities by Jenington.

Of the unsettled liabilities under the share option plan, 50% were partly settled, and the remaining 50% were cancelled and written through the income statement. At the beginning of the period these liabilities amounted to USD 5,357 thousand, which corresponds to the fair value of the option for 0.1% of the Polyus Gold Shares.

At a General Shareholders' meeting which took place on 26 June 2008, the decision was made to pay out dividends based on 2007 results. During 2008 the Group paid out USD 22,258 thousand as dividends to Polyus Gold shareholders.

In May 2008, Polyus Gold's subsidiary, CJSC Polyus, purchased 2.7% of OJSC Matrosov Mine shares in addition to its stake of 94.8% as of 31 December 2007. Thus, the total percentage of CJSC Polyus ownership in Matrosov Mine increased to 97.5%. Under Russian legislation, the Polyus Group was obliged to make an offer to purchase the remaining shares held by Matrosov Mine's minority shareholders. Following a squeeze-out offer made in July 2008, CJSC Polyus consolidated 100% of OJSC Matrosov Mine shares in October 2008. During the year 2008, the Polyus Group also consolidated its stake in OJSC Aldanzoloto GRK (as at 31 December 2007 CJSC Polyus ownership in OJSC Aldanzoloto GRK totaled 99.37%). Thus, accumulated reserve on contingent consideration on acquisition of subsidiaries was redeemed by the end of the reporting year. Following the transaction, the Polyus Group recognized a decrease in minority interest in the amount of USD 10,073 thousand in its consolidated statement of changes in equity for the year ended 31 December 2008.

Current tax liabilities as at 31 December 2008 were USD 18,171 thousand, which is 46% less than at 31 December 2007. The decrease mainly occurred on account of income tax and VAT liabilities. Current income tax liabilities reduced by 89% from USD 12,663 thousand to USD 1,344 thousand as a result of significant amounts of current income tax prepaid in the Krasnoyarsk business unit. The amount of VAT payable decreased by 81% to USD 1,417 thousand, compared to USD 7,420 thousand in the previous period, which resulted mainly from reduction in non-recoverable items as compared to the previous year. This was partly offset by a substantial increase in social tax liabilities mainly caused by compensations payable liability accrued by 31 December 2008.

#### 4.2 Cash flow analysis

The following table shows extracts of the Polyus Group's consolidated cash flow statement for the years ended 31 December 2008, 2007 and 2006:

USD '000	Years ended 31 December		
	2008	2007 (restated)	2006 (restated)
<b>Operating activities</b>			
<b>Profit before income tax</b> .....	<b>122,471</b>	<b>177,107</b>	<b>1,228,391</b>
Adjustments <sup>(1)</sup> .....	308,564	159,594	(918,134)
<b>Operating profit before working capital changes</b> .....	<b>431,035</b>		
.....		<b>336,701</b>	<b>310,257</b>
Changes in working capital .....	(145,947)	(40,197)	(69,771)
<b>Cash flows from operations</b> .....	<b>285,088</b>	<b>296,504</b>	<b>240,486</b>
Interest paid .....	(2,434)	(1,671)	(3,552)
Income tax paid .....	(90,421)	(50,187)	(89,897)
<b>Net cash generated from operating activities</b> .....	<b>192,233</b>	<b>244,646</b>	<b>147,037</b>
<b>Investing activities</b>			
Capital expenditures, acquisition of subsidiaries and deferred stripping costs <sup>(2)</sup> .....	(629,842)	(459,394)	(625,005)
Other investments spendings/proceeds <sup>(3)</sup> .....	700,728	90,648	1,320,495
<b>Net cash (used in)/generated from investing activities</b> .....	<b>70,886</b>	<b>(368,746)</b>	<b>695,490</b>
<b>Net cash generated from/(used in) financing activities</b> .....	<b>(43,588)</b>		
.....		<b>42,337</b>	<b>(632,895)</b>
Effect of translation to presentation currency....	(46,879)	13,740	56,157
<b>Net (decrease)/increase in cash and cash equivalents</b> .....	<b>172,652</b>	<b>(68,023)</b>	<b>265,789</b>
<b>Cash and cash equivalents at beginning of the year</b> .....	<b>226,174</b>		
.....		<b>294,197</b>	<b>28,408</b>
<b>Cash and cash equivalents at end of the year</b> .....	<b>398,826</b>	<b>226,174</b>	<b>294,197</b>

- Adjustments for non-cash items include: the share option plan, amortisation and depreciation, expensed stripping costs, finance costs, loss on disposal of property, plant and equipment, change in allowance for doubtful debts, impairment of advances paid to suppliers (reversed)/recognised, change in provision for land restoration, impairment of property, plant and equipment, change in allowance for reimbursable value added tax, income from investments, foreign exchange (gain)/loss, net and other items.
- Capital expenditures, acquisition of subsidiaries and deferred stripping costs include purchases of property, plant and equipment, acquisition of shares in subsidiaries, deferred stripping costs capitalised, proceeds from sale of property, plant and equipment and proceeds from sale of shares in subsidiaries.
- Other investments spendings/proceeds include repayment of contingent consideration, proceeds from sale of shares in Gold Fields, dividends received, interest received, purchase of promissory notes and other financial assets and proceeds from sale of promissory notes and other financial assets.

In 2008, the Polyus Group generated income before tax of USD 122,471 thousand. Operating profit before working capital changes amounted to USD 431,035 thousand, which was 28% higher than in the previous year. In the reporting period, net cash provided by operating activities decreased by USD 52,413 thousand to USD 192,233 thousand. The decrease in net cash inflow from operations resulted mainly from a substantial increase in current income tax expense and working capital financing. The increase of the latter costs was a result of increased prices on fuel, materials and spares, as well as an increase in the physical volume of purchases.

During 2008, the Polyus Group substantially increased its capital expenditures, acquisition of subsidiaries and deferred stripping costs. In the period under review these expenses totaled USD 629,842 thousand, compared to USD 459,394 thousand in the previous period. However, while capital expenditures were high, the Polyus Group had cash inflow from investments as it closed its positions on the Rosbank promissory notes and a number of deposits and trust management contracts for a total amount of USD 664,151 thousand. As a result, in 2008 the Polyus Group received USD 70,886 thousand in investment activities, while in 2007 it used USD 368,746 thousand in investment activities. Total change of net cash flows from investment activities was USD 439,632 thousand.

Cash outflow from financing activities in the year ended 31 December 2008 totaled USD 43,588 thousand compared to cash received from financing activities in the amount of USD 42,337 thousand in the year ended 31 December 2007. The major cash outflows during the reporting year were repayment of borrowings and dividend payments. In 2008, the Polyus Group repaid the loan obtained by its associated company OJSC SVMC for the total amount of USD 19,034 thousand. In accordance with the General Shareholders meeting decision, in 2008 the Group paid out dividends based on year 2007 results. This resulted in a cash outflow of USD 24,266 thousand.

#### 4.3 Capital expenditures, acquisitions of subsidiaries and deferred stripping costs

Capital expenditures represent the Polyus Group's purchase of property, plant and equipment adjusted for the proceeds from the sale of property, plant and equipment. The Polyus Group also presents capitalised deferred stripping costs and the acquisition of subsidiaries adjusted for the repayment of contingent consideration and proceeds from the disposal of such subsidiaries.

The following table shows the Polyus Group's capital expenditures, acquisition of subsidiaries and deferred stripping costs for the years ended 31 December 2008, 2007 and 2006:

USD'000	Years ended 31 December		
	2008	2007 (restated)	2006 (restated)
+ Purchase of property, plant and equipment .....	481,504	382,802	267,551
– Proceeds from sale of property, plant and equipment .....	(5,747)	(17,952)	(12,030)
<b>Net capital expenditures</b>	<b>475,757</b>	<b>364,850</b>	<b>255,521</b>
Acquisition of subsidiaries, net of cash acquired, and increase of ownership in subsidiaries .....	39,156	-	307,667
+ Repayment of contingent consideration on acquisition of subsidiaries .....	19,616	38,228	61,817
– Proceeds from disposal of subsidiary, net of cash disposed of .....	-	(1,320)	-
<b>Acquisition of subsidiaries, net of adjustments above</b>	<b>58,772</b>	<b>36,908</b>	<b>369,484</b>
+ Deferred stripping costs capitalised	95,313	57,636	-
+ Interest expenses capitalised .....	-	-	-
<b>Total capital expenditures, acquisition of subsidiaries and deferred stripping costs .....</b>	<b>629,842</b>	<b>459,394</b>	<b>625,005</b>

In 2008, the Polyus Group spent USD 629,842 thousand on total capital expenditures, acquisition of subsidiaries and deferred stripping costs. This was 37% more than in 2007, mostly due to an increase in the amounts expended on purchase of property, plant and equipment, acquisition of subsidiaries as well as deferred stripping costs capitalisation. In the reporting period, the Polyus Group continued implementing its extensive capital expenditures programme and spent USD 475,757 thousand on property, plant and equipment, including equipment for mills under construction, mining and construction equipment and rolled metal products. The largest share of the Group's capital expenditures was spent on the development of the Blagodatnoye project, reconstruction of Mill No.1 at Olimpiada to process Titimukhta ores and Olimpiada transition to sulphide ores processing as well as modernization programme carried out at the Kuranakh mine. During the period under review, the Group spent USD 39,156 thousand on acquisitions and increased ownership in its subsidiaries, mainly consolidating 100% interest in OJSC Matrosov Mine. In 2008, stripping costs capitalised were USD 95,313 thousand, compared to USD 57,636 thousand in 2007, due to the costs incurred on deferred stripping relating to the transition of production from oxide ores to sulphide ores at the Olimpiada mine.

#### **4.4 Cash sources and cash expenditure and impairment**

At the beginning of 2008, the Polyus Group's available highly liquid asset position totaled USD 1,497 million, which included USD 1,271 million of short-term investments and USD 226 million of cash and cash equivalents. By the end of the year, the Group's highly liquid asset position was reduced by USD 813 million and amounted to USD 684 million. We have prepared an analysis of the liquid asset movement for the year in a format that differs from IFRS, as we believe it provides useful information in a combined format for users. This format should not be considered as an alternative to IFRS. The table below shows liquid asset sources, outflows and impairment of investments during 2008

USD million	Cash	ST investments	
<b>1. Total cash and short-term investments at the beginning of the year, of which:</b>			<b>1,497</b>
<b>1.1 Cash and cash equivalents at 1 January 2008</b>	<b>226</b>		
<b>1.1 Short-term investments at 1 January 2008</b>		<b>1,271</b>	
<i>Movement in short-term investments during the year:</i>		<i>(634)</i>	
<i>1.1.1 Disposal of bank deposits classified as investments</i>		<i>(277)</i>	
<i>1.1.2 Proceeds from investments in listed companies held for trading (Rosbank MC)</i>		<i>(160)</i>	
<i>1.1.3 Proceeds from investments in listed companies held for trading (AKB Rosbank)</i>		<i>(37)</i>	
<i>1.1.4 Proceeds from Rosbank promissory notes</i>		<i>(125)</i>	
<i>1.1.5 Disposal of available-for-sale investments (part of Rosfund Share)</i>		<i>(35)</i>	
<b>2. Cash sources raised during the year</b>	<b>272</b>		
<b>2.1 Cash sources from investing activities</b>	<b>80</b>		
2.1.1 Interest received	44		
2.1.2 Proceeds from sale of Vysochaishy	30		
2.1.3 Proceeds from sale of property, plant and equipment	6		
<b>2.2 Cash sources from operating activities</b>	<b>192</b>		
2.2.1 Net inflow before working capital changes	431		
2.2.2 Increase in inventories	(102)		
2.2.3 Increase in VAT reimbursable	(49)		
2.2.4 Income tax paid	(90)		
2.2.5 Other, net	2		
<b>3. Cash expenditure during the year</b>	<b>(687)</b>		
<b>3.1 Cash expenditure in investing activities</b>	<b>(643)</b>		
3.1.1 Purchase of property, plant and equipment	(482)		
3.1.2 Deferred stripping at the Olimpiada mine	(95)		
3.1.3 Increase of ownership in OJSC Matrosov Mine and OJSC Aldanzoloto GRK	(39)		
3.1.4 Repayment of contingent consideration on acquisition of subsidiaries	(20)		
3.1.5 Other, net	(7)		
<b>3.2 Cash expenditure in financing activities</b>	<b>(44)</b>		
3.2.1 Repayment of borrowings	(19)		
3.2.2 Dividends paid	(22)		
3.2.3 Other, net	(3)		
<b>4. Foreign exchange loss due to RUB depreciation</b>	<b>(47)</b>		
<b>5. Total cash and short-term investments before impairment and foreign exchange.....</b>			<b>1,035</b>
<b>6. Impairment of investments in listed companies held for trading</b>		<b>(178)</b>	
<b>7. FOREX loss on investments in listed companies held for trading</b>		<b>(10)</b>	
<b>8. Impairment of available-for-sale investments</b>		<b>(100)</b>	
<b>9. Loss on sale of Shares of Rosfund</b>		<b>(16)</b>	
<b>10. Investments revaluation reserve</b>		<b>(37)</b>	
<b>11. Other</b>		<b>(10)</b>	
<b>12. Total cash and short-term investments at the end of the year</b>			<b>684</b>
<b>12.1 Cash and cash equivalents</b>	<b>399</b>		
<b>12.2 Short-term investments in securities</b>		<b>285</b>	

*Section 1.1* presents movements in short-term investments during the year as a result of converting funds from a number of investment instruments held by the Group, namely bank deposits, equity investments under asset management of AKB Rosbank and Rosbank Management Company, promissory notes and available-for-sale investments represented by a Share in Rosfund. As Polyus Gold considers short-term investments as highly liquid assets, these movements do not influence the total position of the Group's highly liquid assets.

During the year Polyus Gold generated USD 272 million of cash, out of which USD 80 million related to investing activities and USD 192 million represents the net cash flow from operations.

Total cash spending in 2008 equaled USD 687 million. The cash spent was used in investing and financing activities. Cash spent on investing activities was mainly represented by capital expenditures, consolidation 100% stakes in OJSC Matrosov Mine and OJSC Aldanzoloto GRK and cash deferred stripping costs at the Olimpiada mine. Cash spent by the Group in financing activities represents primarily repayment of borrowings received and dividends payment based on 2007 results.

Due to adverse movements in the RUB/USD exchange rate, the Polyus Group incurred a foreign exchange loss of USD 47 million. As a result, by the end of the year the cash position of the Polyus Group before impairment totaled USD 1,035 million.

Following the deterioration of the global financial markets, investments in various securities had to be marked to market such that the Polyus Group recognized an impairment of investments in the amount of USD 351 million. As a result, the highly liquid asset position at the end of 2008 totaled USD 684 million (represented by USD 399 million of cash and cash equivalents and by USD 285 million of short-term investments in securities).

## **5. Description of principal risks**

The activities of the Polyus Group (hereinafter the Company) are associated with a number of risks that may affect the Company's production and financial results. Whilst the current global financial crisis has added further risks to those traditionally faced by the mining industry, the Company believes that gold mining companies, in general, are in a better position to weather such additional risks than producers of other metals.

The Company is committed to achieving successful development, not least through ensuring an effective risk management system designed to achieve optimal results, an efficient distribution of resources, and a strengthening of the Company's competitiveness. Successful risk management requires, amongst other things, the identification and assessment of potential threat parameters, and the development of measures aimed at the regulation of risk levels. The Company has developed internal documents governing the process through which risks should be managed. Such documents require that each business unit has a designated risk manager, develops a list of basic risks, and takes measures aimed at lowering risk levels.

### **5.1 Risks connected with the financial and economic crisis**

#### *Risks associated with failures to perform under existing agreements and of securing new equipment and material supply agreements*

One of the consequences of the global financial crisis is a material drop in the financial status or credit ratings of a number of enterprises in Russia and internationally that manufacture and supply spare parts and equipment. Any possible suspension of their activities would increase the risk of them failing to perform their contractual obligations, possibly resulting in the late delivery of equipment and materials. Further failures to observe the Company's logistic schedules may affect the launch time of new production capacities and the fulfilment of the Company's production plans.

To attempt to mitigate the risk of late delivery, the Company monitors the financial status of its major counterparties on a regular basis and takes measures to increase the number of actual, and potential, counterparties with which it conducts business.

#### *Risks associated with insufficient credit resources*

The Company currently has no significant debts payable and is currently facing high prices and demand for gold. Coupled with ample liquidity reserves in the form of the Company's own money resources, the Company believes it has a sufficient level of capital to continue the current activities of the Company's enterprises and to fulfil

currently approved plans aimed at the expansion of production capacities and production volumes. However, the global financial crisis has resulted in little, if any, access to the capital markets and increased costs associated with securing credit resources. This may lead to adjustments in the implementation times for a number of major projects.

*Risk of the government's rejection to take part in the implementation of projects*

As a result of the current economic recession, it is likely that the Government of the Russian Federation will have to revisit the priorities of the Investment Fund project with due regard for its social consequences and regional effects.

The absence of accurate forecasts with regard to the economic development rate and the indefinite macroeconomic trends may lead to a partial reduction of the investment budget and may limit the Government's ability to co-finance a number of the Company's projects, which may lead to such projects being indefinitely postponed.

## **5.2 Risks characteristic of mining industry enterprises**

### ***Operational risks***

*Ore and mineral reserves are difficult to quantify, actual volumes may be inaccurate and are therefore subject to significant correction*

The Company's activities are heavily reliant upon its available stocks and resources. The evaluation of the ore and mineral reserves depends to a certain extent on the statistic conclusions made on the basis of the results of restricted volumes of drilling and other analyses that may turn out to be incorrect. Ore and mineral reserves evaluation and classification may also be affected by the changes in the end product prices. If the quantity and quality of the explored reserves are not confirmed the production efficiency may deteriorate as a result of labor consuming mining operations.

The Company engages independent experts to conduct audits on prospective and existing deposits and to provide reports on the results of the exploration activity, mineral and ore resources and reserves.

*Risks connected with mining and production activity*

The Company's production activities are carried out in remote regions which are subject to severe climatic conditions. As a result, the delivery of equipment, technological materials and spare parts is more difficult, thus affecting production costs. Mining machinery, transport and new technologies, including those developed by the Company, are used for operations in areas which have complicated geological and climatic conditions.

There are increased risks of flooding, pit slope and rim slide, accidents caused by the use of the mining transport equipment and preparation and performance of explosion works in the pit, reduction of gold production due to adverse weather conditions and problems in the power supply facilities and recovery plants. These risks could result in suspended ore production and recovery, increased costs, health, safety and environmental issues and affect the Company's production activities.

The Company aims to mitigate the risks associated with stalled and unplanned production activity through various processes, including probability analysis and effective risk management. Such risk management includes the identification of potential threat parameters, the identification of defined risk categories and the adoption of measures designed to prevent accidents and emergencies. A risk reduction programme is also currently in the process of being developed.

*Risks associated with the implementation of investment projects*

The implementation of the Company's investment projects is subject to market, technical, production and operational risks.

Market risks induced by the changes in the price of gold, exchange rates and inflation may affect the implementation of such projects. Technical, production and operational risks include construction delays, malfunction due to errors in the design, construction or installation, which may lead to higher costs and affect the Company's results.

To reduce these project risks the Company has developed a procedure for a careful and comprehensive study, selection and analysis of investment projects offered for implementation. Each project is subject to approval by the Company's Investment Committee, which is constituted by members with expertise in economics, production and law. Control over investment projects is exercised at all the stages of implementation.

### *Risks connected with acquisition and merger transactions*

The Company actively looks for opportunities to invest in the gold mining industry both in Russia and abroad. Such acquisitions and mergers inevitably entail a variety of risks. To reduce the risks connected with any acquisition and merger transactions the Company conducts a comprehensive analysis of the pending transactions and an assessment of the consequences with due regard for the political, economic, ecological and social factors.

### **5.3 Financial Risks**

#### *Inflation and market risks*

Increased inflation induced by the current economic climate may have an adverse impact on the Company's financial results. Costs which are subject to inflationary changes are denominated in Russian rubles and, in particular, include: materials and utilities, wages and services. Furthermore, increasing tariff rates of the natural monopolies may result in increased costs.

In order to reduce the impact of increasing tariff rates, the Company seeks to develop and modernize its own energy-generating facilities and to purchase and consume energy resources based on long – term fixed-price contracts. Prospective inflationary changes are also considered as a part of the analysis when planning budget and costs of implementing investment projects.

The Company's income is sourced from gold sales effected both through long-term contracts and at spot prices. Gold prices are quoted in international markets in US dollars. Accordingly, the economic results of the Company calculated in the national currency depend, to a considerable extent, on the fluctuations in gold prices and the ruble/dollar exchange rates. The gold market is cyclical and sensitive to any economic changes. The price of gold is subject to substantial fluctuations under the influence of factors beyond control of the Company. A substantial continued price reduction may result in profitability reduction of the gold exploration and extraction activities. In the current economic climate, gold is used to hedge potential losses in currency and capital markets. Therefore currently the level of demand for gold remains stable and maintains high rates of price indexes. The observable ruble devaluation results in increasing the ruble equivalent of income of the Company and partially compensates for losses generated by inflation-related price growth. Nevertheless, in the future, as the market conditions change, possible exchange rate and inflation adjustments may result in an adverse impact on the financial standing and performance of the Company.

#### *Liquidity Risk*

Management of liquidity risk is intended to maintain a sufficient level of monetary resources to fund production-, management-, and investment-related needs, to ensure stability of compliance with the financial obligations of the Company and to develop the appropriate capital structure. The Company monitors on a regular basis the following risks: production levels, operational expenditures, prices of raw materials, volumes of floating assets and capital expenditure. The enterprises of the Company implement a co-ordinated and automatic program of cash asset record-keeping. The measures taken to regulate liquidity risk enable the Company to maintain its competitiveness and long-term financial solvency.

### **5.4 Regulatory Risks**

*The activities of the Company may be adversely impacted by the failure to obtain, or the termination or non-renewal of its licenses.*

The ability of the Company to carry out its activities depends on its licenses, in particular those licenses relating to the use of mineral resources, as well as on being able to obtain new licenses and complying with their terms. The terms of the license agreements require the Company to comply with a number of industrial standards, employ qualified personnel, ensure that the necessary equipment and operation quality control systems are available, maintain relevant documentation and provide information to the licensing authorities when requested. Failure to comply with such terms may result in the termination of the licenses critical to the operations of the Company or confer obligations on the Company, which may decrease its profitability.

The Company is focused on improving the system control over compliance with license agreements and industrial standard requirements. Any comments or reports made by state regulatory and supervisory authorities as a result of inspections of operative and industrial activities of the Company are scrutinized.

#### *Tax Legislation Risks*



As with all Russian mining companies, the Company pays a significant amount of taxes. The tax obligations of the Company can result in uncertainties due to the imperfection of tax legislation. The risks include: ambiguous interpretation of law, inconsistent application of legislation, amendments to tax legislation or practice change. Such risks may result in fines, penalties and other sanctions. One of tasks of managing the risks of the Company is to promptly identify, assess and eliminate the risks. The current level of tax risks faced by the Company is regarded as immaterial.

*Changes of Environmental Legislation*

The Company's activities are subject to environmental control and regulation as a result of the use of environmentally hazardous substances, as well as ejecting operational waste and hazardous substances into the environment, soil disturbance, potential harm to wildlife and other factors.

The Company aims to comply with its environmental obligations and follows the principles and requirements of Russian and international standards, agreements, conventions and protocols. The task of enhancing efficiency of Company performance is intended, among other things, to reduce emissions of hazardous substances and develop waste disposal sites. The changes in environmental legislation and introduction of stricter licensing requirements may result in additional expenditures to change industrial process and increase in environmental charges.