**SEVERSTAL-AUTO GROUP**

**INTERNATIONAL FINANCIAL REPORTING STANDARDS**

**CONSOLIDATED FINANCIAL STATEMENTS AND AUDITORS' REPORT**

**31 December 2004**

## Contents

**Section page numbers**

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# AUDITORS' REPORT

**TO THE SHAREHOLDERS**
**OF OPEN JOINT – STOCK COMPANY "SEVERSTAL - AUTO"**

1 We have audited the accompanying consolidated balance sheet of open joint – stock company "Severstal-auto" and its subsidiaries (the "Group") as of 31 December 2004 and the related consolidated statements of income, of cash flow and of changes in shareholders' equity for the year then ended. These financial statements (as set out on pages 2 to 31) are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2 We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3 In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2004, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers

Moscow, Russian Federation
10 March 2005

*(in millions of Russian Roubles)*

| | Note | RR million At 31 December 2004 | RR million At 31 December restated 2003 | Supplementary information US$ million At 31 December 2004 | Supplementary information US$ million At 31 December restated 2003 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Non-current assets:** | | | | | |
| Property, plant and equipment | 5 | 9,854 | 9,059 | 356 | 307 |
| Development costs | 6 | 543 | 207 | 20 | 7 |
| Goodwill | 7 | 1,484 | 1,484 | 53 | 50 |
| Financial assets | 8 | 84 | 50 | 3 | 2 |
| Other non-current assets | 9 | 231 | 251 | 8 | 8 |
| **Total non-current assets** | | **12,196** | **11,051** | **440** | **374** |
| **Current assets:** | | | | | |
| Inventories | 10 | 3,448 | 3,197 | 124 | 109 |
| Accounts receivable and prepayments | 11 | 2,145 | 1,680 | 77 | 57 |
| Other current assets | 12 | 53 | 93 | 2 | 3 |
| Cash and cash equivalents | 13 | 982 | 595 | 35 | 20 |
| **Total current assets** | | **6,628** | **5,565** | **238** | **189** |
| **Total assets** | | **18,824** | **16,616** | **678** | **563** |
| **LIABILITIES AND EQUITY** | | | | | |
| **Equity:** | | | | | |
| **Capital and reserves attributable to the Company's equity holders:** | 14 | | | | |
| Share capital | | 474 | 377 | 17 | 13 |
| Share premium | | 4,259 | 2,885 | 153 | 98 |
| Additional paid-in capital | | 1,438 | 1,438 | 52 | 49 |
| Retained earnings | | 2,210 | 1,541 | 80 | 52 |
| **Total capital and reserves attributable to the Company's equity holders** | | **8,381** | **6,241** | **302** | **212** |
| Minority interest | | 3,154 | 3,159 | 114 | 107 |
| **Total equity** | | **11,535** | **9,400** | **416** | **319** |
| **Non-current liabilities:** | | | | | |
| Long-term borrowings | 15 | 1,782 | 2,007 | 64 | 68 |
| Long-term taxes payable | 16 | 286 | 387 | 10 | 13 |
| Post-retirement benefit obligations | 17 | 18 | - | 1 | - |
| Deferred income on government grant | 18 | 291 | 105 | 10 | 4 |
| Deferred income tax liabilities | 28 | 1,162 | 1,121 | 42 | 38 |
| **Total non-current liabilities** | | **3,539** | **3,620** | **127** | **123** |
| **Current liabilities:** | | | | | |
| Accounts payable | | 1,448 | 1,364 | 52 | 46 |
| Advances received and other payables | 19 | 1,001 | 983 | 36 | 33 |
| Taxes payable | 16 | 372 | 362 | 13 | 12 |
| Warranty and other provisions | 20 | 99 | 89 | 4 | 3 |
| Short-term borrowings | 21 | 830 | 798 | 30 | 27 |
| **Total current liabilities** | | **3,750** | **3,596** | **135** | **121** |
| **Total liabilities** | | **7,289** | **7,216** | **262** | **244** |
| **Total liabilities and equity** | | **18,824** | **16,616** | **678** | **563** |

General Director
V.A. Shvetsov

Chief Financial Officer
N.A. Sobolev

10 March 2005

The accompanying notes are an integral part of the consolidated financial statements.

*(in millions of Russian Roubles)*

| | | RR million | | Supplementary information US$ million | |
|---|---|---|---|---|---|
| | | Year ended 31 December | | Year ended 31 December | |
| | | | restated | | restated |
| | Note | 2004 | 2003 | 2004 | 2003 |
| Sales | 22 | 23,029 | 19,385 | 799 | 632 |
| Cost of sales | 23 | (17,446) | (14,758) | (605) | (481) |
| **Gross profit** | | **5,583** | **4,627** | **194** | **151** |
| Distribution costs | 24 | (856) | (707) | (30) | (23) |
| General and administrative expenses | 25 | (2,011) | (1,790) | (70) | (58) |
| Other operating income/(expenses) | 26 | 50 | (203) | 2 | (7) |
| **Operating income** | | **2,766** | **1,927** | **96** | **63** |
| Interest expense | | (423) | (481) | (15) | (16) |
| Net foreign exchange (loss)/gain | | (40) | 14 | (1) | - |
| Gains on forgiveness of tax debt | | - | 23 | - | 1 |
| **Income before taxation** | | **2,303** | **1,483** | **80** | **48** |
| Income tax expense | 28 | (631) | (386) | (22) | (12) |
| **Income for the year** | | **1,672** | **1,097** | **58** | **36** |
| **Attributable to:** | | | | | |
| Equity holders of the Company | | 1,342 | 900 | 47 | 30 |
| Minority interest | | 330 | 197 | 11 | 6 |
| | | **1,672** | **1,097** | **58** | **36** |
| Weighted average number of shares outstanding during the year (thousands) | 29 | 24,445 | 22,074 | 24,445 | 22,074 |
| Earnings per share (in RR and US$) – basic and fully diluted | 29 | 54.90 | 40.77 | 1.9 | 1.4 |

*(in millions of Russian Roubles)*

| | Note | RR million 2004 | RR million 2003 restated | Supplementary US$ million 2004 | Supplementary US$ million 2003 restated |
|---|---|---|---|---|---|
| | | Year ended 31 December | | Year ended 31 December | |
| **Cash flows from operating activities** | | | | | |
| Income before taxation | | **2,303** | **1,483** | **80** | **48** |
| Adjustments for: | | | | | |
| Depreciation | 5 | 596 | 568 | 21 | 19 |
| Provision for impairment of receivables | 11 | 5 | 2 | - | - |
| Gains on forgiveness of tax debt | | - | (23) | - | (1) |
| Excess of acquired share over purchase consideration | 7 | (121) | - | (4) | - |
| Interest expense | | 423 | 481 | 15 | 16 |
| Provisions movements | | 106 | (13) | 3 | - |
| Retirement benefit obligation | 17 | 18 | - | 1 | - |
| Fair value losses/(gains) on financial assets at fair value through profit or loss | | 11 | (4) | - | - |
| Loss on sale of property, plant and equipment | 26 | 44 | 13 | 1 | - |
| **Operating cash flows before working capital changes** | | **3,385** | **2,507** | **117** | **82** |
| Increase in accounts receivable and prepayments | | (470) | (536) | (16) | (17) |
| Increase in inventories | | (348) | (769) | (12) | (25) |
| Decrease in other current assets | | 12 | 99 | - | 3 |
| (Decrease)/increase in accounts payable, advances received and other payables | | (205) | 373 | (7) | 12 |
| (Decrease)/increase in taxes payable, other than income tax | | (151) | 79 | (5) | 3 |
| **Cash provided from operations** | | **2,223** | **1,753** | **77** | **58** |
| Income tax paid | | (562) | (530) | (20) | (17) |
| Interest paid | | (236) | (159) | (8) | (5) |
| **Net cash provided from operating activities** | | **1,425** | **1,064** | **49** | **36** |
| **Cash flows from investing activities:** | | | | | |
| Purchase of property, plant and equipment | | (1,374) | (1,027) | (48) | (33) |
| Proceeds from the sale of property, plant and equipment | | 10 | 16 | - | 1 |
| Development costs capitalised | 6 | (335) | (207) | (12) | (7) |
| Increase in stake in subsidiary | 7 | (214) | - | (7) | - |
| Purchase of other non-current assets | | (44) | (23) | (2) | (1) |
| **Net cash used in investing activities:** | | **(1,957)** | **(1,241)** | **(69)** | **(40)** |
| **Cash flows from financing activities:** | | | | | |
| Proceeds from borrowings | | 9,811 | 7,245 | 342 | 236 |
| Repayment of borrowings and long-term taxes payable | | (10,182) | (7,869) | (354) | (256) |
| Contribution from shareholders | | - | 748 | - | 24 |
| Proceeds from subsidiary's share issue | | - | 350 | - | 11 |
| Proceeds from parent company share issue | 14 | 1,471 | - | 51 | - |
| Proceeds from government grant | 18 | 186 | 105 | 6 | 3 |
| Dividends paid | | (367) | - | (13) | - |
| **Net cash provided from financing activities** | | **919** | **579** | **32** | **18** |
| **Net increase in cash and cash equivalents** | | **387** | **402** | **15** | **14** |
| **Cash and cash equivalents at the beginning of the year** | 13 | **595** | **193** | **20** | **6** |
| **Cash and cash equivalents at the end of the year** | 13 | **982** | **595** | **35** | **20** |

The accompanying notes are an integral part of the consolidated financial statements.

*(in millions of Russian Roubles)*

| | Note | Share capital | Share premium | Additional paid-in-capital | Retained earnings | Attributable to equity holders of the Company | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|---|
| **Balance at 31 December 2002** | | **377** | **2,885** | **1,019** | **641** | **4,922** | **2,332** | **7,254** |
| Net income for the year | | - | - | - | 886 | 886 | 191 | 1,077 |
| Additional share capital issue of subsidiary | | - | - | 419 | - | 419 | 1,063 | 1,482 |
| Share of net assets acquired from minority shareholders | | - | - | - | - | - | (433) | (433) |
| **Balance at 31 December 2003** | | **377** | **2,885** | **1,438** | **1,527** | **6,227** | **3,153** | **9,380** |
| Change in accounting policy | 3.2 | - | - | - | 14 | 14 | 6 | 20 |
| **Restated balance at 31 December 2003** | | **377** | **2,885** | **1,438** | **1,541** | **6,241** | **3,159** | **9,400** |
| Net income for the year | | - | - | - | 1,342 | 1,342 | 330 | 1,672 |
| Additional share issue | 14 | 97 | 1,374 | - | - | 1,471 | - | 1,471 |
| Dividends for 2003 | 14 | - | - | - | (375) | (375) | - | (375) |
| Interim dividends for 2004 | 14 | - | - | - | (298) | (298) | - | (298) |
| Share of net assets acquired from minority shareholders | 7 | - | - | - | - | - | (335) | (335) |
| **Balance at 31 December 2004** | | **474** | **4,259** | **1,438** | **2,210** | **8,381** | **3,154** | **11,535** |

| | Share capital | Share premium | Additional paid-in-capital | Retained earnings | Attributable to equity holders of the Company | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|
| **Supplementary information US$ million** | | | | | | | |
| **Balance at 31 December 2003** | **13** | **98** | **49** | **52** | **212** | **107** | **319** |
| Change in accounting policy | - | - | - | - | - | - | - |
| **Restated balance at 31 December 2003** | **13** | **98** | **49** | **52** | **212** | **107** | **319** |
| **Balance at 31 December 2004** | **17** | **153** | **52** | **80** | **302** | **114** | **416** |

## 1 The Severstal-auto Group and its operations

OAO "Severstal-auto" (the "Company") and its subsidiaries' (the "Group") principal activities are the manufacture and sale of vehicles, including automotive components, assembly kits, and engines. The Group's manufacturing facilities are primarily based in the City of Ulyanovsk and the Nizhny Novgorod Region in Russia.

OAO "Severstal-auto" was incorporated as an open joint stock company in the Russian Federation in March 2002 by OAO "Severstal" (the predecessor) by contributing its controlling interests in OAO "UAZ" and OAO "ZMZ", which were acquired through purchases close to the end of 2000, in exchange for the Company's share capital.

The Company's parent is Newdeal Investments Limited which holds 87.69% of the Company's share capital. At the balance sheet date Alexei Mordashov controlled 100% of the share capital of Newdeal Investments Limited.

The registered office of the Company is Prospect Pobedy, 33, Cherepovets, Vologda Region, 162614, Russian Federation.

These consolidated financial statements have been approved for issue by General Director on 10 March 2005.

## 2 Basis of presentation of the financial statements

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

The Group companies maintain their accounting records in Russian Roubles ("RR") and prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation. These financial statements are based on the statutory records, with adjustments and reclassifications recorded for the purpose of fair presentation in accordance with IFRS.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, financial assets are shown at fair value. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.22.

### *Accounting for the effect of inflation*

Prior to 1 January 2003 the adjustments and reclassifications made to the statutory records for the purpose of IFRS presentation included the restatement of balances and transactions for the changes in the general purchasing power of the RR in accordance with IAS 29 ("Financial Reporting in Hyperinflationary Economies"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflationary has ceased, effective from 1 January 2003 the Group no longer applies the provisions of IAS 29. Accordingly, the amounts expressed in the measuring unit current at 31 December 2002 are treated as the basis for the carrying amounts in these financial statements.

### *Supplementary information*

U.S. Dollar ("US$") amounts shown in the accompanying consolidated financial statements are translated from the RR as a matter of arithmetic computation only, at the official rate of the Central Bank of the Russian Federation at 31 December 2004 of RR 27.75 = US$1 (at 31 December 2003 of RR 29.45 = US$1). The statement of income and cash flow statement have been translated at the average exchange rates during the year. The difference was recognized in equity. The US$ amounts are presented solely for the convenience of the reader, and should not be construed as a representation that RR amounts have been or could have been converted to the US$ at this rate, nor that the US$ amounts present fairly the financial position and results of operations and cash flows of the Group in accordance with IFRS.

Exchange restrictions and currency controls exist relating to converting the RR into other currencies. The RR is not freely convertible in most countries outside of the Russian Federation.

*(in millions of Russian Roubles)*

## 3 Summary of significant accounting policies

### 3.1 Early adoption of standards

In 2003 the Group early adopted all the applicable IFRS which are relevant to its operations. None of the new standards or interpretations, issued up to the date of signing these financial statements, are expected to have any effect of the Group's financial statements.

### 3.2 Change in accounting policy

From 1 July 2004 the Company changed its accounting policy regarding interest on borrowings. Borrowings costs that are directly attributable to the acquisition, construction or production of qualifying asset are capitalized as part of the cost of that asset.

Management believes that capitalization of borrowings costs within qualifying asset results in the financial statements providing more reliable and relevant information about the effects of transactions.

The change in accounting policy resulted in:

| | Year ended 31 December 2004 | Six month ended 30 June 2004 | Year ended 31 December 2003 |
|---|---|---|---|
| Increase in property, plant and equipment | 46 | 32 | 26 |
| Increase in retained earnings | 25 | 17 | 14 |
| Increase in equity attributable to minority | 10 | 8 | 6 |
| Increase in deferred income tax liabilities | 11 | 7 | 6 |
| Decrease in interest expenses | (20) | (6) | (26) |
| Increase in deferred income tax expenses | 5 | 1 | 6 |
| Increase in minority share of profit for the period | 4 | 2 | 6 |
| Increase in basic and diluted earnings per share | 0.45 | 0.14 | 0.63 |

There was no impact on opening retained earnings at 1 January 2003 from change of accounting policy.

### 3.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from these of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from these of segments operating in other economic environments.

## 3 Summary of significant accounting policies (continued)

### 3.4 Group accounting

***Subsidiary undertakings***

Subsidiary undertakings, which are those entities in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over the operations, are included into the consolidated financial statements. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All intergroup transactions, balances and unrealised gains on transactions between the Group's companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Minority interest at the balance sheet date represents the minority shareholders' portion of the fair values of the identifiable assets and liabilities of the subsidiaries at the acquisition date, and the minorities' portion of movements in those subsidiaries' equity since the date of the combination. Minority interest is presented within equity.

***Purchases of subsidiaries from parties under common control***

Purchases of subsidiaries from parties under common control are accounted for using the predecessor cost method.

The assets and liabilities of the subsidiary transferred under common control are recorded in these financial statements at the historical cost of the predecessor. Related goodwill inherent in the predecessor's original acquisition is also recorded in these financial statements.

These financial statements, including corresponding figures, are presented as if the subsidiary had been accounted for under the purchase method from the date it was originally acquired by the predecessor.

### 3.5 Property, plant and equipment

Property, plant and equipment is recorded at purchase or construction cost. Before 31 December 2002 property, plant and equipment were recorded at purchase or construction cost restated to the equivalent purchasing power of the RR. At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's net selling price and its value in use. The carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) in the consolidated statement of income. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the assets recoverable amount.

Depreciation is calculated on the amounts of property, plant and equipment on a straight-line basis. The depreciation periods, which approximate to the estimated useful economic lives of the respective assets, are as follows:

| | Number of years |
|---|---|
| Buildings | 35 to 45 |
| Plant and machinery | 15 to 25 |
| Other | 5 to 12 |

Repair and maintenance expenditure is expensed as incurred. Major renewals and improvements are capitalised and the assets replaced are retired. Gains and losses arising from the retirement of property, plant and equipment are included in the consolidated statement of income as incurred.

Assets under construction and land owned by the Group are not depreciated.

## 3 Summary of significant accounting policies (continued)

### 3.6 Intangible assets

***Goodwill***

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is tested annually in December for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. When shares are acquired from minority shareholders, the management use carrying values of the underlying net identifiable assets for the purposes of the goodwill computation.

Any excess of the Group's share of the net identifiable assets over the cost of an acquisition is recognized immediately in the statement of income.

Goodwill is allocated to cash generating units for the purposes of impairment testing, namely the two major subsidiaries: OAO "UAZ" and OAO "ZMZ".

***Research and development costs***

Research expenditure is recognised as an expense as incurred. Costs incurred for development projects are recognised as intangible assets if, and only if it is probable that the future economic benefits that are attributable to the asset will flow to the Group and the cost of the asset can be measured reliably. Development costs with a finite useful life that have been capitalized are amortized from the commencement of commercial production on a straight-line basis over the period of their expected benefits. Development costs with indefinite useful life are tested for impairment at each balance sheet date.

### 3.7 Investments

***Financial assets at fair value through profit or loss***

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. These financial assets are classified in this category if acquired principally for the purpose of selling or if so designated by management. Assets in this category are classified as non current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation at each reporting date.

All purchases and sales of financial assets at fair value through profit or loss are recognised on the settlement date, which is the date that the investment is delivered to or by the Group. The fair value of financial assets that are not traded in an active market is determined by using valuation techniques. Estimated discounted cash flows are used to determine fair value for the remaining financial assets. Realised and unrealised gains and losses arising from changes in the fair value of these financial assets are included in the statement of income in the period in which they arise.

### 3.8 Inventories

Inventories are recorded at the lower of cost and net realisable value. Cost of inventory is determined on the weighted average basis. The cost of finished goods and work in progress comprises raw material, direct labour, other direct costs and related production overhead (based on normal operating capacity), but excludes borrowing costs and administrative overheads. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses. Provision is made for potential losses on obsolete or slow-moving inventories taking into account their expected use and future realisable value.

## 3 Summary of significant accounting policies (continued)

### 3.9 Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the market rate of interest for similar borrowers, less provision for impairment and includes value added taxes. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers. The amount of the provision is recognised in the statement of income.

### 3.10 Value added tax

Value added tax (VAT) related to sales is payable to tax authorities upon collection of receivables from customers. Input VAT is reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases, which have not been settled at the balance sheet date (VAT deferred) is recognised in the consolidated balance sheet on a net basis and disclosed separately from the actual VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT. The related VAT deferred liability is maintained until the debtor is written off for statutory accounting purposes when it becomes due.

### 3.11 Cash and cash equivalents

Cash comprises cash on hand and demand deposits. Cash equivalents comprise short-term investments with less than 3 months of maturity since inception, which are readily converted to cash, are not subject to significant risk of changes in value.

### 3.12 Borrowings and restructured taxes

Borrowings are recognised initially at their fair value (which is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price), net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised as interest expense over the period of the borrowings. Borrowing costs are expensed in the period when incurred except for those, which are directly attributable to the acquisition, construction or production of a qualifying asset. Such borrowing costs are capitalised as part of cost of asset when it is probable that they will result in future economic benefits to the company and costs can be measured reliably. This accounting policy has been applied in 2004 retrospectively (Note 3.2).

Accrued interest is recorded within the relevant borrowing.

Restructured taxes are recognised initially at their fair value (which is determined using the prevailing market rate of interest for a similar instrument). In subsequent periods, restructured taxes are stated at amortised cost.

### 3.13 Provision for warranties

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

The Group recognises the estimated liability to repair or replace products sold, but that are still under warranty at the balance sheet date. This provision is calculated based on past history of the level of repairs and replacements. Estimated costs of future product warranties are fully provided for at the time of the sale of products.

## 3 Summary of significant accounting policies (continued)

### 3.14 Deferred income taxes

Deferred tax assets and liabilities are calculated in respect of temporary differences using the balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. A deferred tax asset is recorded only to the extent that it is probable that a taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

### 3.15 Employee benefits

***Social costs***

The Group incurs employee costs related to the provision of benefits such as health services and recreational activities. These amounts principally represent an implicit cost of employees and, accordingly, have been charged to other operating expenses in the consolidated statement of income.

***Pension costs***

In the normal course of business Group companies contribute to the Russian Federation state pension scheme on behalf of their employees. Mandatory contributions to the governmental pension scheme are expensed when incurred.

One subsidiary of the Group, OAO “ZMZ”, operates a voluntary pension scheme, a defined benefit plan. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors, such as age, years of service and compensation.

The liability recognised in the balance sheet in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by management using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to income over the employees’ expected average remaining working lives.

Past service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in services for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

### 3.16 Government grant

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate. Government grants relating to the purchase of property, plant and equipment are included in non current liabilities as deferred government grant and are credited to the income statements on a straight line basis over the expected lives of the related assets.

## 3 Summary of significant accounting policies (continued)

### 3.17 Use of bills of exchange and promissory notes

The Group uses third party bills of exchange in its operations. Bank promissory notes received are included in the balance sheet within cash and cash equivalents.

### 3.18 Shareholders' equity

***Share capital***

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recognised as a share premium.

***Dividends***

Dividends are recognised as a liability and deducted from equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are authorised for issue.

### 3.19 Revenue recognition

Revenues on sales of vehicles, engines, automotive components and other products are recognised when goods are dispatched to customers as this is the date that the risks and rewards of ownership are transferred to the customers.

Sales of services are recognised in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Sales are shown net of VAT and discounts, and after eliminating sales within the Group.

### 3.20 Earnings per share

Basic earnings per share is determined by dividing the net income attributable to ordinary shareholders by the weighted average number of participating shares in issue during the reporting year.

### 3.21 Foreign currency transactions

Monetary assets and liabilities, which are held by Group entities and denominated in any currency other than RR (i.e. foreign currencies) are translated into RR at the exchange rates prevailing at the balance sheet date. Foreign currency transactions are accounted for at the exchange rate prevailing at the date of the transaction. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currency are recognised in the statement of income.

### 3.22 Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

## 3 Summary of significant accounting policies (continued)

### 3.22 Critical accounting estimates and judgements (continued)

***Estimated impairment of goodwill***

The Group tests annually whether the goodwill has suffered any impairment, in accordance with the accounting policy stated in Note 3.6. The recoverable amounts of cash generating units have been determined, based on value-in-use calculations. These calculations require the use of estimates.

If the operating margin would be 20% lower, or the estimated pre-tax discount rate applied to the individual segments' cash flows would be 20% higher, than management has assumed in its impairment testing the carrying value of the goodwill relating to either segment would remain unchanged.

If the actual operating margin had been higher or the pre-tax discounted rate lower than management's estimates, the Group would not be able to reverse any impairment losses that arose on goodwill.

***Remaining useful life of property, plant and equipment***

Management assesses the remaining useful life of property, plant and equipment in accordance with the current technical conditions of assets and estimated period when these assets will bring economic benefit to the Group.

If the estimated remaining useful life of buildings had been 20% higher or lower than management estimates, then the carrying value of buildings would be RR 94 higher or RR 141 lower accordingly. If the estimated remaining useful life of plant and equipment had been 20% higher or lower than management estimates, then the carrying value of plant and equipment would be RR 151 higher or RR 232 lower accordingly.

***Income tax***

Judgement is required in determining provision for income taxes. The Group recognises liabilities for taxes based on estimates of whether additional taxes will be due. Where the final outcome of various tax matters is different from the amounts that were initially recorded, such differences will impact income tax and deferred tax provision in the period in which such determination is made.

***Capitalisation of development costs***

The Group capitalises development costs in accordance with the accounting policy stated in Note 3.6. Judgement is required to assess the probability that future economic benefits that are attributable to these assets will flow to the Group. If management assumptions at 31 December 2004 of the degree of certainty attached to the flow of future economic benefits are not fulfilled, all development costs, which do not meet recognition criteria would reduce the operating income by RR 543 at 31 December 2004.

***Warranty provision***

Judgement is required in determining warranty provision. The Group recognises liabilities for warranty based on estimates of whether additional liability to repair or replace products sold which are still under warranty at the balance sheet date. This provision is calculated based on the past history of the level of repairs and replacements. If the revised warranty expense incurred during 2004 had been 50% higher than actual, the Group would need to reduce its income attributable to the equity holders of the Company by RR 46.

### 3.23 Comparatives

The Group previously disclosed advances paid to suppliers of property, plant and equipment within 'property, plant and equipment'. Management believes that their inclusion in 'other non-current assets' is a fairer representation of these advances.

*(in millions of Russian Roubles)*

## 4 Balances and transactions with related parties

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

### 4.1 Balances and transactions with related parties

Balances with related parties of the Group as at 31 December 2004 and 2003 consist of the following:

| | **Newdeal Investments Limited** | **Other Severstal group companies** | **Total** |
|---|---|---|---|
| Nature of the relationship | Parent company | Significant influence of management | |
| **Balances** | | | |
| **At 31 December 2004** | | | |
| Accounts receivable and prepayments | - | 7 | 7 |
| Accounts payable | - | 55 | 55 |
| **At 31 December 2003** | | | |
| Accounts receivable and prepayments | - | 14 | 14 |
| Borrowings issued | - | 7 | 7 |
| Borrowings received | 1,340 | - | 1,340 |
| Accounts payable | - | 39 | 39 |
| Advances received and other payables | - | 19 | 19 |

Transactions with related parties of the Group for the year ended 31 December 2004 and 31 December 2003 consist of the following:

| | | | |
|---|---|---|---|
| **Transactions** | | | |
| **Year ended 31 December 2004** | | | |
| Purchases | - | 942 | 942 |
| Interest accrued | 39 | - | 39 |
| Borrowings repaid | 1,379 | - | 1,379 |
| **Year ended 31 December 2003** | | | |
| Purchases | - | 721 | 721 |
| Sales revenue | - | 1 | 1 |
| Interest accrued | 40 | - | 40 |
| Borrowings obtained | 1,300 | - | 1,300 |

*(in millions of Russian Roubles)*

## 4 Balances and transactions with related parties (continued)

### 4.2 Directors' compensation

Compensation paid to key management and directors for their services in full or part time executive management positions is made up of a contractual salary and a performance bonus depending on operating results.

Additional fees, compensation and allowances to directors for their services in that capacity, and also for attending board meetings and board committees' meetings were not paid.

Total key management and directors' compensation included in general and administrative expenses in the statement of income amounted to RR 71 for the year ended 31 December 2004 (2003: RR 89).

## 5 Property, plant and equipment

Property, plant and equipment and related accumulated depreciation consist of the following:

| | Land and Buildings | Plant and equipment | Other | Assets under construction | Total |
|---|---|---|---|---|---|
| Cost | | | | | |
| Balance at 31 December 2002 | 4,626 | 4,334 | 453 | 522 | 9,935 |
| Additions | - | - | - | 819 | 819 |
| Disposals | (25) | (18) | (2) | - | (45) |
| Transfers | 139 | 395 | 225 | (759) | - |
| **Balance at 31 December 2003** | **4,740** | **4,711** | **676** | **582** | **10,709** |
| Additions | - | - | - | 1,445 | 1,445 |
| Disposals | (10) | (51) | (36) | - | (97) |
| Transfers | 62 | 898 | 171 | (1,131) | - |
| **Balance at 31 December 2004** | **4,792** | **5,558** | **811** | **896** | **12,057** |
| Accumulated Depreciation | | | | | |
| Balance at 31 December 2002 | (389) | (623) | (86) | - | (1,098) |
| Depreciation expense for 2003 | (177) | (309) | (82) | - | (568) |
| Disposals | 2 | 3 | 11 | - | 16 |
| **Balance at 31 December 2003** | **(564)** | **(929)** | **(157)** | **-** | **(1,650)** |
| Depreciation expense for 2004 | (175) | (328) | (93) | - | (596) |
| Disposals | 1 | 25 | 17 | - | 43 |
| **Balance at 31 December 2004** | **(738)** | **(1,232)** | **(233)** | **-** | **(2,203)** |
| Net Book Value | | | | | |
| **Balance at 31 December 2002** | **4,237** | **3,711** | **367** | **522** | **8,837** |
| **Balance at 31 December 2003** | **4,176** | **3,782** | **519** | **582** | **9,059** |
| **Balance at 31 December 2004** | **4,054** | **4,326** | **578** | **896** | **9,854** |

Bank borrowings are secured on properties as at 31 December 2004 to the value of RR 1,596 (31 December 2003: RR 1,548); see Note 21. During the year the Group capitalised borrowing costs for RR 20 (31 December 2003: RR 26) in the cost of the qualifying assets (see Note 3.2).

The Group owns the land on which factories and buildings, comprising the principal manufacturing facilities of the Group, are situated. At 31 December 2004 cost of the land amounts to RR 896.

*(in millions of Russian Roubles)*

## 6 Development costs

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Expenditures related to settling production of diesel engine | 154 | - |
| Development of diesel engine funded by government grant | 114 | 53 |
| Improvement of diesel engine funded by internal financing | 32 | 21 |
| Improvement of four-cylinder petrol engine | 80 | 46 |
| Improvement of vehicles and engines to satisfy Euro-2 requirements | 52 | 32 |
| Development of a new off-road vehicle (UAZ Patriot) | 34 | 13 |
| Improvement of some vehicle component parts | 39 | 26 |
| Development of new light commercial vehicle (UAZ-2360) | 14 | 7 |
| Other | 24 | 9 |
| | **543** | **207** |

Development projects expenditures capitalized by the Group were in development phase as at 31 December 2004. No amortization was accumulated as at the end of the year and charged to the cost of sales.

## 7 Goodwill

Goodwill arose first on the original purchase of controlling stakes in OAO "UAZ" and OAO "ZMZ" and then on increases of holding stakes in OAO "UAZ" in 2003 and OAO "ZMZ" in 2004. Goodwill is attributable to the profitability of the acquired businesses and the synergies expected to arise following the Group's acquisition of OAO "UAZ" and OAO "ZMZ".

| | OAO "UAZ" | OAO "ZMZ" | Total |
|---|---|---|---|
| **Cost** | | | |
| Balance at 31 December 2002 | 907 | 277 | 1,184 |
| Purchased goodwill | 300 | - | 300 |
| **Balance at 31 December 2003** | **1,207** | **277** | **1,484** |
| Excess of acquired share over purchase consideration | - | (121) | (121) |
| Write off excess of acquired share over purchase consideration | - | 121 | 121 |
| **Balance at 31 December 2004** | **1,207** | **277** | **1,484** |

In 2003 OAO "UAZ" made a rights issue to existing shareholders amounting to RR 2,475. Not all minority shareholders exercised their rights and the remaining shares were purchased by the holding company. As a result OAO "Severstal-auto" stake in total share capital of OAO "UAZ" increased to 66% and goodwill arose on the acquisition in the amount of RR 300.

In 2004 the holding stake in OAO "ZMZ" was further increased by step acquisition from 66% to 72% of total share capital.

| | |
|---|---|
| Step increase in % of ownership | 6.29% |
| Purchase consideration | 214 |
| Share of net assets acquired from minority shareholders | (335) |
| **Excess of acquired share in the net identifiable assets and liabilities over purchase consideration** | **(121)** |

The Company was able to increase the ownership in this subsidiary by acquiring shares from minority shareholders who, having lost significant influence, sold their shares at favourable prices for the Company.

## 7 Goodwill (continued)

***Impairment tests for goodwill***

The Group tested its goodwill for impairment at 31 December 2004. Goodwill is allocated to the Group's cash generating units (CGUs) according to business segments namely the two major subsidiaries: OAO "UAZ" (vehicle segment) and OAO "ZMZ" (engine segment).

The recoverable amount of a CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Management has based the CGU's cash flow projections on three key assumptions related to the operating margin, growth rate and discount rate specific to each CGU. Management determined budgeted operating margin based on past performance for the last two years (i.e. since the beginning of the Group's operations) and its expectations for the market development. For the vehicle segment these include continued strong demand for quality vehicles in the niche markets in which the segment operates, and the segment's sales price advantage over its foreign competition in those markets. For the engine segment these include the consolidation of its position as the dominant supplier of car engines to the Russian market, and its capability to upgrade its products in line with expected increases in regulations over emission levels. Cash flows beyond the five-year period are extrapolated using the estimated growth rates of 7.7% for vehicle segment and 8.7% for engine segment; these growth rates do not exceed the long-term average growth rate for the automotive business in which the CGUs operate. The discount rates used 19% for vehicle segment and 18.9% for engine segment are pre-tax and reflects specific risks relating to the relevant segments. Management believes that any reasonably possible change in the key assumptions described above would not cause the carrying amount of goodwill related to vehicle and engine segments to exceed their recoverable amounts.

As a result of the above testing no impairment provision was deemed necessary at 31 December 2004.

The Group has changed its accounting policy in respect of goodwill (see Note 3.1) with the early adoption of IFRS 3 "Business Combinations" from 1 January 2003. From this date the Group ceased amortization of positive goodwill. Excess of the acquired share in the net fair value of identifiable assets and liabilities over purchase consideration (negative goodwill) is written off to the statement of income immediately as incurred.

Excess of the acquired share in the net fair value of identifiable assets and liabilities over purchase consideration arose in 2002 when companies financed by OAO "Severstal" purchased additional ordinary shares of OAO "ZMZ". Subsequently, in April and May 2003 these shares were transferred to the Group. As a result, the share of the Group in OAO "ZMZ" increased from 47% to 66%, or from 63% to 88% of ordinary share capital. This purchase has been treated as a transaction between entities under common control, and, as such, corresponding figures for minority interest, negative goodwill, intergroup liability and retained earnings, have been presented as if the transactions had occurred at the dates when companies financed by OAO "Severstal" purchased interests in OAO "ZMZ".

## 8 Financial assets

Non current financial assets comprise principally non-marketable equity securities, which are not publicly traded or listed on the Russian stock exchange and, due to the nature of the local financial markets, it is not possible to obtain current market value for these investments. For these investments, fair value is estimated by reference to the discounted operating cash flows of the investee. The carrying value of these assets is approximately equal their fair value.

## 9 Other non-current assets

Other non-current assets consist mainly from advances made to suppliers of property plant and equipment. As 31 December 2004 amount of advances paid for property, plant and equipment was RR 160 (31 December 2003: RR 208).

*(in millions of Russian Roubles)*

## 10 Inventories

Inventories consist of the following:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Raw materials | 2,402 | 2,384 |
| Less: obsolescence provision | (162) | (98) |
| | 2,240 | 2,286 |
| Work in progress | 621 | 511 |
| Less: NRV provision | (20) | - |
| | 601 | 511 |
| Finished products | 619 | 400 |
| Less: NRV provision | (12) | - |
| | 607 | 400 |
| | **3,448** | **3,197** |

Obsolescence provision relates only to raw materials. As at 31 December 2004 finished products in the amount of RR 73 and work in progress in the amount of RR 42 were recorded at net realisable value. As at 31 December 2003 there are no finished products and work in progress recorded at net realisable value. The cost of inventories recognised as expense and included in cost of sales amounted to RR 11,916 (2003: RR 10,679). Inventories of RR 887 (2003: RR 1,183) have been pledged as security for borrowings, see Note 21.

## 11 Accounts receivable and prepayments

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Trade receivables | 1,182 | 785 |
| Less: provision for impairment | (27) | (14) |
| | 1,155 | 771 |
| Other receivables | 358 | 323 |
| Less: provision for impairment | (19) | (27) |
| | 339 | 296 |
| Advances to suppliers | 264 | 212 |
| Less: provision for impairment | (5) | (5) |
| | 259 | 207 |
| VAT recoverable, net | 384 | 347 |
| Prepayments | 8 | 59 |
| | **2,145** | **1,680** |

Included within net VAT recoverable is RR 166 of deferred VAT payable (2003: RR 115).

Foreign currency denominated net trade receivables:

| Currency | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Euro | 92 | 25 |
| US$ | 76 | 166 |
| | **168** | **191** |

The carrying value of accounts receivable and prepayments as at 31 December 2004 and 2003 is approximately equal their fair value.

**Non-cash settlements**

In the year ended 31 December 2004 RR 479 (approximately 2% of total sales) of the Group's settlements of accounts receivable were settled by means of mutual settlements, and RR 210 (approximately 1% of total sales) by means of third-party bills of exchange. In the year ended 31 December 2003 RR 487 (approximately 3% of total sales) of the Group's settlements of accounts receivable were settled by means of mutual settlements, and RR 460 (approximately 2% of total sales) were settled by means of third-party bills of exchange.

*(in millions of Russian Roubles)*

## 12 Other current assets

Other current assets represent mainly by bills of exchange of third parties with a turnover period of less than a year and are classified as short-term investments. They have been purchased for further settlements for supply of components.

## 13 Cash and cash equivalents

Cash and cash equivalents comprise the following:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Cash on hand and balances with banks | 298 | 45 |
| Letters of credit | 239 | 237 |
| Cash deposits | 345 | 205 |
| Short-term bank promissory notes | 100 | 108 |
| | **982** | **595** |

Cash deposits of RR 345 held by a Group at 31 December 2004 bear interest of 5.5% per annum. Cash and cash equivalents of RR 637 held by the Group are not interest bearing. Letters of credit was established for suppliers of equipment.

Foreign currency denominated cash balances consist of the following:

| Currency | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Euro | 237 | 214 |
| US$ | 5 | 4 |
| | **242** | **218** |

The carrying value of cash and cash equivalents as at 31 December 2004 and 2003 is approximately equal their fair value.

## 14 Shareholders' equity

The value of share capital issued and fully paid up consists of the following shares:

| | Number of outstanding ordinary shares (thousands) | Share capital, RR | Share premium, RR | Additional paid-in capital, RR | Total share capital, RR |
|---|---|---|---|---|---|
| At 31 December 2003 | 22,074 | 377 | 2,885 | 1,438 | 4,700 |
| At 31 December 2004 | 29,800 | 474 | 4,259 | 1,438 | 6,171 |

In May 2003, the General Shareholders' Meeting decided to increase the Company's authorised share capital by 60,000,000 ordinary shares.

Nominal value of all shares is 12.5 roubles per share. Statutory share capital of the Company totalled RR 374 (31 December 2003: RR 276).

On 10 September 2004 the Federal Commission of Securities Market registered the issue of 7,726 thousand ordinary shares of the Company at a nominal value of 12.5 roubles per share. The issue started in June 2004 in the form of a rights issue at 190.71 roubles per share. Transaction costs incurred of RR 2 were deducted from the proceeds.

The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the net profit. For the year ended 31 December 2004, the net statutory profit for the Company as reported in the published annual statutory reporting forms was RR 2,068.

The Company declared dividends of RR 375 or 17 roubles per ordinary share for the year ended 31 December 2003 and RR 298 or 10 roubles per ordinary share of interim dividends for nine months ended 30 September 2004.

*(in millions of Russian Roubles)*

## 15 Long-term borrowings

In January 2004 the Company has issued rouble-denominated non-convertible bonds for RR 1,500 payable in three years time with a coupon payable every six months of 11.25% per annum. Transaction costs incurred on the bond placement of RR 15 were deducted from proceeds received. The funds received were lent on to subsidiaries at similar terms.

As at 31 December 2003 long-term loans contain a 5-years 10%-interest rouble denominated loan from Severstal Group in the amount of RR 1,300. During 2004 the loan was fully settled ahead of payment schedule.

Interest accrued for the loan received from the major shareholder was payable together with the principle amount of the loan, and therefore considered as long-term as at 31 December 2003. RR 79 of interests was paid earlier than initially agreed with the lender.

During the year ended 31 December 2004 the Group received Euro denominated loan from Sberbank amounting to RR 297 with effective floating interest rate of EuroLIBOR + 4.35% for purchase of equipment for a painting workshop. The loan is repayable in 9 equal semi-annual instalments starting from July 2005. The short-term part of this loan of RR 33 was classified as short-term borrowings.

As at 31 December 2004 and 2003 long-term loan balances included RR 28 of bills of exchange issued by the Group to third parties with a redemption date in February 2007.

Long-term debt is repayable as follows:

| | **31 December 2004** | **31 December 2003** |
|---|---|---|
| 1 to 2 years | 66 | 165 |
| 2 to 3 years | 1,584 | - |
| 3 to 4 years | 66 | 1,842 |
| 4 to 5 years | 66 | - |
| | **1,782** | **2,007** |

As at 31 December 2004 and 2003 the carrying value of these liabilities approximates their fair value.

*(in millions of Russian Roubles)*

## 16 Taxes payable

### Current taxes payable

Current taxes payable comprise the following:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Current portion of taxes restructured to long-term | 193 | 101 |
| Value-added tax | 64 | 10 |
| Payments to the Pension Fund and other social taxes | 57 | 90 |
| Personal income tax | 24 | 36 |
| Tax penalties and interest | 4 | 4 |
| Property tax | 3 | 16 |
| Income tax | 1 | 80 |
| Other taxes | 26 | 25 |
| **Total** | **372** | **362** |

The Group had no tax liabilities past due at 31 December 2004 and 2003.

### Long-term taxes payable

Long-term taxes payable comprise various taxes payable other than income tax to the Russian Government which were previously past due and which have been restructured to be repaid over a period of up to 10 years following the application of various Government Resolutions including No. 410 dated 23 May 2001 "On making changes and amendments to the Russian Government Resolution No. 1002 dated 3 September 1999 "Terms of the restructuring of payables to the Federal Budget"", as described below. The carrying value of this debt and its maturity profile is as follows:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Current | 193 | 101 |
| 1 to 2 years | 133 | 143 |
| 2 to 3 years | 131 | 109 |
| 3 to 4 years | 21 | 95 |
| 4 to 5 years | 1 | 23 |
| Thereafter | - | 17 |
| **Total restructured** | **479** | **488** |
| Less: current portion of taxes payable | (193) | (101) |
| **Long-term portion of restructured taxes** | **286** | **387** |

In the event that the Group companies fail to make current tax payments and payments of restructured tax liabilities by the end of each quarter, the Ministry of Taxes and Duties may, within one month, recommend to the Government to cancel the restructuring agreement and call-in the entire liability.

Both OAO "UAZ" and OAO "ZMZ" are in compliance with the terms of the restructuring of the federal, regional and local tax debts at 31 December 2004. Management is confident that these companies will continue to abide by the terms of the restructuring.

As at 31 December 2004, fair value of these liabilities was estimated to be RR 340 (31 December 2003: RR 465) using a current market interest rate of 11.3 % (31 December 2003: 11.5%).

*(in millions of Russian Roubles)*

## 17 Post-retirement benefits

OAO "ZMZ" provides post retirement benefits in the form of a lump sum payment on retirement and quarterly cash payments to their retirees via the non-state pension fund "Stalfond". The benefit amount is determined by key management. The entitlement to benefits (cash payments) ceases when the retirees die. To date it has been an unfunded plan, with no assets specifically allocated to cover the scheme liabilities. The scheme's retirement age is the State retirement age (55 for females and 60 for males). The last actuarial valuation was performed by management in December 2004, with measurement date 1 January 2004.

The amounts recognised in the balance sheet are determined as follows:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Present value of unfunded obligations | 146 | 140 |
| Unrecognised past service cost | (128) | (140) |
| **Liability in the balance sheet** | **18** | **-** |

The amounts recognised in the statement of income are as follows:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Recognised actuarial gain | 9 | - |
| Current service cost | 6 | - |
| Amortisation of past service cost | 12 | - |
| Interest cost | 10 | - |
| **Total included in labour expenses (Note 27)** | **37** | **-** |

Deferred past service cost will be amortised over the employees' average remaining working life of 12 years.

Movements in the net liability recognised in the balance sheet are as follows:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| At the beginning of the period | - | - |
| Total expense as above | 37 | - |
| Contributions paid | (19) | - |
| **Net liability at the end of the year** | **18** | **-** |

The principal actuarial assumptions used were as follows:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Withdraw Rate | 3% | 3% |
| Interest | 9% | 9% |
| Salary growth | 6% | 6% |

## 18 Deferred income on government grant

In May 2003 the Group won a government grant for a total of RR 500 for the development of a new diesel engine during the years 2003 - 2007. As at 31 December 2004 the Group has received RR 291 of this grant. RR 149 has been used for purchase of new equipment required for research and development works and RR 114 has been spent on the development of the diesel engine and has been capitalized as development costs in the balance sheet as at 31 December 2004. To fulfil the terms of the grant the Group should sell during the period from 2005 to 2007 developed new diesel engines in the amount of RR 4,000. If sales target is not met, the Group would have to pay a fine to the government equal to 20% of the difference between the volume designated and sales made. The grant will be recognised as revenue to match the depreciation costs of equipment purchased for development works and development expenditures capitalized in the balance sheet. Depreciation of the grant will commence when the Group meets all conditions attached to the grant. Management consider that the Group is in compliance with the terms of the grant and will not need to return cash received.

*(in millions of Russian Roubles)*

## 19 Advances received and other payables

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Dividends payable | 309 | 3 |
| Advances from customers | 225 | 287 |
| Salaries payable | 180 | 255 |
| Vacation accrual | 107 | 187 |
| Bonus accrual | 92 | 35 |
| Payable for bills | 66 | 205 |
| Other | 22 | 11 |
| **Total** | **1,001** | **983** |

### Non-cash settlements

In the year ended 31 December 2004 RR 649 (approximately 4% of total purchases) of the Group's settlements of accounts payable and accrued charges were settled by means of third-party bills of exchange and RR 479 (approximately 4% of total purchases) by means of mutual settlements with suppliers. In the year ended 31 December 2003 RR 535 (approximately 4% of total purchases) of the Group's settlements of accounts payable and accrued charges were settled by means of third-party bills of exchange and RR 487 (approximately 4% of total purchases) by means of mutual settlements with suppliers.

## 20 Warranty and other provisions

During 2004 and 2003 the following movements of the warranty provision took place:

| | Warranty | Tax claims | Total |
|---|---|---|---|
| Balance at 31 December 2002 | 102 | - | 102 |
| Additional provision | 50 | 6 | 56 |
| Utilised in the year | (69) | - | (69) |
| **Balance at 31 December 2003** | **83** | **6** | **89** |
| Additional provision | 109 | 1 | 110 |
| Utilised in the year | (100) | - | (100) |
| **Balance at 31 December 2004** | **92** | **7** | **99** |

The Group gives one-year warranty on certain products and undertakes to repair or replace items that fail to perform satisfactorily. A provision of RR 92 (31 December 2003: RR 83) has been recognised at 31 December 2004 for expected warranty claims based on past experience of the level of repairs and replacements.

## 21 Short-term borrowings

As at 31 December 2004 and 2003 short-term borrowings consist of bank loans amounting to RR 752 and RR 796 respectively and interest on loans amounting to RR 78 and RR 2 respectively.

As at 31 December 2004 short-term debt comprises a total of rouble-denominated loans at effective fixed interest rates 8 - 11% during the year. Included within short-term borrowings a loan amounting to RR 199 was obtained to finance a letter of credit of OAO "UAZ". As at 31 December 2003 short-term debt comprises a total of rouble-denominated loans at effective fixed interest rates 10 – 13.75 % during the year ended 31 December 2003.

As at 31 December 2004 and 2003 loans for RR 1,016 and RR 1,242 respectively, inclusive of short-term borrowings, are guaranteed by collateral of inventories and equipment, see Notes 5, 10.

*(in millions of Russian Roubles)*

## 22 Sales

Sales were as follows:

| | 2004 | 2003 |
|---|---|---|
| Vehicles | 10,310 | 9,418 |
| Engines | 7,870 | 6,256 |
| Automotive components | 3,493 | 2,816 |
| Assembly kits | 506 | 244 |
| Other sales | 850 | 651 |
| | **23,029** | **19,385** |

## 23 Cost of sales

The components of cost of sales were as follows:

| | 2004 | 2003 |
|---|---|---|
| Materials and components used | 12,618 | 10,252 |
| Labour costs | 3,416 | 3,048 |
| Production overheads | 1,236 | 1,123 |
| Depreciation | 504 | 469 |
| Change in finished goods and work in progress | (328) | (134) |
| | 17,446 | 14,758 |

## 24 Distribution costs

Distribution costs comprise:

| | 2004 | 2003 |
|---|---|---|
| Transportation | 441 | 404 |
| Materials | 114 | 103 |
| Check and inspection performed by dealers | 93 | - |
| Labour costs | 80 | 68 |
| Advertising | 75 | 100 |
| Other | 53 | 32 |
| | **856** | **707** |

## 25 General and administrative expenses

General and administrative expenses comprise:

| | 2004 | 2003 |
|---|---|---|
| Labour costs | 1,200 | 1,016 |
| Services provided by third parties | 225 | 286 |
| Taxes other than on income | 133 | 164 |
| Insurance | 93 | 15 |
| Depreciation | 92 | 99 |
| Materials | 82 | 48 |
| Fire brigade and security costs | 36 | 39 |
| Training costs | 32 | 33 |
| Transportation | 24 | 21 |
| Provision for impairment of receivables | 5 | 2 |
| Other | 89 | 67 |
| | **2,011** | **1,790** |

*(in millions of Russian Roubles)*

## 26 Other operating (income)/expenses - net

The components of other operating (income)/expenses were as follows:

| | 2004 | 2003 |
|---|---|---|
| Social expenses | 78 | 106 |
| Loss on disposals of property, plant and equipment | 44 | 13 |
| Charity | 36 | 44 |
| Fair value losses/(gains) financial assets at fair value through profit or loss | 11 | (4) |
| Research and development expenses | 8 | 53 |
| Provisions and settlements of claims and similar charges | 1 | 6 |
| Excess of acquired share over purchase consideration | (121) | - |
| Gain on disposal of materials | (55) | (58) |
| Write-off of payables | (10) | (5) |
| Other | (42) | 48 |
| | **(50)** | **203** |

## 27 Expenses by nature

Labour expenses included in different captions of the consolidated statement of income were as follows:

| | 2004 | 2003 |
|---|---|---|
| Cost of sales | 3,416 | 3,048 |
| Administrative expenses | 1,200 | 1,016 |
| Distribution costs | 80 | 68 |
| | **4,696** | **4,132** |

Labour expenses comprise wages, salaries, bonuses, payroll taxes, vacation and salary accruals.

Depreciation included in different captions of the consolidated statement of income was as follows:

| | 2004 | 2003 |
|---|---|---|
| Cost of sales | 504 | 469 |
| Administrative expenses | 92 | 99 |
| | **596** | **568** |

Materials included in different captions of the consolidated statement of income were as follows:

| | 2004 | 2003 |
|---|---|---|
| Cost of sales | 12,618 | 10,252 |
| Distribution costs | 114 | 103 |
| Administrative expenses | 82 | 48 |
| | **12,814** | **10,403** |

*(in millions of Russian Roubles)*

## 28 Income tax expense

| | 2004 | 2003 |
|---|---|---|
| Income tax expense – current | 590 | 479 |
| Deferred tax expense/(credit) – origination and reversal of temporary differences | 41 | (93) |
| **Income tax expense** | **631** | **386** |

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated companies as follows:

| | 2004 | 2003 |
|---|---|---|
| **Income before taxation** | **2,303** | **1,483** |
| Theoretical tax charge at the statutory rate of 24% | 553 | 356 |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| Tax penalties and interest | 27 | 23 |
| Gain on forgiveness of tax debts | - | (6) |
| Other | 51 | 13 |
| **Income tax expense** | **631** | **386** |

In general during the 2004 the Group was subject to tax rates of 24% on taxable profits. Deferred tax assets/liabilities are measured at the rate of 24% as at 31 December 2004 and 2003.

| | 31 December 2002 | Movement in the year | 31 December 2003 | Movement in the year | 31 December 2004 |
|---|---|---|---|---|---|
| **Tax effects of deductible temporary differences:** | | | | | |
| Accounts receivable | 37 | (7) | 30 | (5) | 25 |
| Inventories | - | 36 | 36 | (36) | - |
| Financial assets | 3 | (3) | - | 1 | 1 |
| Pension fund liabilities | - | - | - | 4 | 4 |
| Accounts payable and provisions | 97 | (34) | 63 | 4 | 67 |
| Other non-current assets | - | 9 | 9 | (9) | - |
| **Total deferred tax assets** | **137** | **1** | **138** | **(41)** | **97** |
| **Tax effects of taxable temporary differences:** | | | | | |
| Property, plant and equipment | (1,224) | (35) | (1,259) | 15 | (1,244) |
| Long-term liabilities | (115) | 115 | - | - | - |
| Inventories | (11) | 11 | - | (15) | (15) |
| Other non-current assets | (1) | 1 | - | - | - |
| **Total deferred tax liability** | **(1,351)** | **92** | **(1,259)** | **-** | **(1,259)** |
| **Total net deferred tax (liability)/assets** | **(1,214)** | **93** | **(1,121)** | **(41)** | **(1,162)** |

In the context of the Group's current structure, tax losses and current tax assets of the different companies may not be set off against current tax liabilities and taxable profits of other companies and, accordingly, taxes may accrue even where there is a net consolidated tax loss. The deferred tax assets will be realised in different periods than the deferred tax liabilities will be settled. Management believes that there will be sufficient taxable profits available at the time the temporary differences reverse to utilise the deferred tax assets.

Deferred income tax liabilities of RR 249 (31 December 2003: RR 166) have not been recognised for the withholding tax and other taxes that would be payable on the unremitted earnings of subsidiaries. Such amounts are permanently reinvested. Unremitted earnings totalled RR 4,144 at 31 December 2004 (31 December 2003: RR 2,767).

*(in millions of Russian Roubles)*

## 29 Earnings per share

Earnings per share is calculated by dividing the income attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

| | 2004 | 2003 |
|---|---|---|
| Weighted average number of ordinary shares in issue (thousands) | 24,445 | 22,074 |
| Income attributable to equity holders of the Company | 1,342 | 900 |
| Basic/diluted earnings per share (in roubles per share) | 54.90 | 40.77 |

## 30 Segment information

**Primary reporting format – business segments**

At 31 December 2004, the Group is organised as two main business segments:
(1) manufacture and sale of vehicles and
(2) manufacture and sale of engines.

Other Group operations are not sufficiently significant to record as separate reportable segments.

The segment results for the year ended and balances at 31 December 2004 are as follows:

| | Vehicles segment | Engines segment | Unallocated | Group |
|---|---|---|---|---|
| Sales | 12,639 | 10,712 | - | 23,351 |
| Inter-segmental sales | (14) | (308) | - | (322) |
| **Net sales** | **12,625** | **10,404** | - | **23,029** |
| Segment results / operating income | 807 | 1,959 | - | 2,766 |
| Interest expense | | | | (423) |
| Net foreign exchange loss | | | | (40) |
| Income tax expense | | | | (631) |
| **Income for the year** | | | | **1,672** |
| Segment assets | 10,224 | 8,562 | 38 | 18,824 |
| Segment liabilities | 4,294 | 2,712 | 283 | 7,289 |
| Capital expenditures | 873 | 880 | - | 1,753 |
| Depreciation | 422 | 174 | - | 596 |
| Non-cash expenses other than depreciation | 207 | 43 | - | 250 |

*(in millions of Russian Roubles)*

### 30 Segment information (continued)

The segment results for the year ended and balances as at 31 December 2003 are as follows:

| | Vehicles segment | Engines segment | Unallocated | Group |
|---|---|---|---|---|
| Sales | 11,035 | 9,099 | - | 20,134 |
| Inter-segmental sales | - | (749) | - | (749) |
| **Net sales** | **11,035** | **8,350** | **-** | **19,385** |
| Segment results / operating income | 428 | 1,499 | - | 1,927 |
| Interest expense | | | | (481) |
| Net foreign exchange gain | | | | 14 |
| Gains of forgiveness of tax debt | | | | 23 |
| Income tax expense | | | | (386) |
| **Income for the year** | | | | **1,097** |
| Segment assets | 9,061 | 7,555 | - | 16,616 |
| Segment liabilities | 3,230 | 2,603 | 1,383 | 7,216 |
| Capital expenditures | 512 | 745 | - | 1,257 |
| Depreciation | 421 | 147 | - | 568 |
| Non-cash expenses other than depreciation | 253 | 44 | - | 297 |

Inter-segment transfers or transactions are entered into under the normal commercial terms and conditions that would also be available to unrelated third parties.

**Secondary reporting format – geographical segments**

The Group's sales are mainly within Russia and in CIS countries.

Geographical reportable segments by location of customers are as follows:

| **Sales** | **2004** | **2003** |
|---|---|---|
| Domestic | 19,435 | 16,963 |
| Export to CIS | 2,473 | 1,630 |
| Export to other countries | 1,121 | 792 |
| **Total** | **23,029** | **19,385** |

All assets of the Group are located in the Russian Federation.

## 31 Contingencies, commitments and operating risks

### 31.1 Contractual commitments and guarantees

As at 31 December 2004 the Group had contractual commitments of RR 34 for the purchase of property, plant and equipment from third parties (2003: RR 123).

As at 31 December 2004 one subsidiary of the Group, OAO "UAZ", had contractual commitment of RR 2,775 (equivalent of 100 million US dollars) to deliver assembly kits to Ukraine.

### 31.2 Taxation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal period remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2004 management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these consolidated financial statements.

### 31.3 Dependency on a limited number of suppliers and customers

The Group is dependent on a relatively limited number of suppliers for several raw materials and components used in the manufacturing of its products. Consequently, there is a risk that the Group may not be able to negotiate favourable terms, ensure adequate quality of its raw material and components and the performance of its business segments could be affected.

The engine business segment sells 61% (2003: 56%) of its production to one customer – OAO "GAZ". Consequently, the segment performance, results of operation and prospects are highly dependent on the continued relationship with this customer.

### 31.4 Insurance policies

The Group holds insurance policies in relation to its operating assets and vehicles and all events subject to mandatory insurance. The Group is subject to political, legislative, tax and regulatory developments and risks, which are not covered by insurance. No provisions for self-insurance are included in the consolidated financial statements and the occurrence of significant losses and impairments associated with facilities could have a material effect on the Group's operations.

### 31.5 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 regulations. As obligations are determined, they are recognised immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

*(in millions of Russian Roubles)*

## 31 Contingencies, commitments and operating risks (continued)

### 31.6 Legal proceedings

During the year ended 31 December 2004, the Group was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated financial statements.

### 31.7 Operating environment of the Group

The Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

Whilst there have been improvements in the economic trends, the future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory, and political developments.

## 32 Principal subsidiaries

The principal subsidiaries consolidated within the Group and the degree of control exercised by OAO "Severstal-auto" are as follows:

| | | | 31 December 2004 | | 31 December 2003 | |
|---|---|---|---|---|---|---|
| Entity | Country of Incorporation | Activity | % of total share capital | % of ordinary shares | % of total share capital | % of ordinary shares |
| OAO "Ulyanovsky Avtomobilny Zavod" | Russia | Manufacture and sale of passenger automobiles, light trucks and minibuses | 66 | 68 | 66 | 68 |
| OAO "Zavolzhskiy Motor Works" | Russia | Manufacture and sale of engines for passenger automobiles, trucks and buses | 72 | 88 | 66 | 88 |
| OOO "ZMZ-Podshipniky Skolzheniya" | Russia | Manufacture and sale of bearings | 76 | - | 71 | - |
| OOO "ZMZ-Transservice" | Russia | Transport services | 72 | - | 66 | - |
| OOO "UAZ-Autotrans" | Russia | Transport services | 66 | - | - | - |

OAO "Severstal-auto" owns 15% directly and 61% indirectly via its subsidiary OAO "ZMZ" in OOO "ZMZ – Podshipniky Skolzheniya". OOO "ZMZ - Transservice" is 100% owned by the Company's subsidiary OAO "ZMZ". OOO "UAZ – Autotrans" is 100% owned by the Company's subsidiary OAO "UAZ". Share in OOO "ZMZ – Podshipniky Skolzheniya", OOO "ZMZ - Transservice" and OOO "UAZ-Autotrans" represents stockholders' stakes, not number of shares held.

## 33 Financial risks

### 33.1 Credit risk

Financial assets, which potentially subject Group entities to credit risk, consist principally of trade receivables. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. The Group has no significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision already recorded.

Cash is placed in financial institutions, which are considered at the time of deposit to have minimal risk of default.

### 33.2 Foreign exchange risk

The Group's manufacturing operation is in the Russian Federation with limited imports of raw materials and components. Revenue from export of the Group's automotive production is 16% (2003: 12%) of total revenue, most of these sales are denominated in hard currency. Net foreign currency receivables amount to RR 168 (31 December 2003: RR 191). Hence, the Group is exposed to the related foreign exchange risk primarily with respect to US dollar. However, management believe that foreign exchange risk is not significant.

### 33.3 Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest bearing borrowings. The Group has cash deposits bearing the interest rate of 5.5% (see Note 13). The Group has mostly fixed rate interest bearing borrowings (see Note 15, 21).

### 33.4 Fair values

In assessing the fair value of non-traded financial instruments the Group uses a variety of methods including estimated discounted value of future cash flows, and makes assumptions that are based on market conditions existing at each balance sheet date.

At 31 December 2004 and 31 December 2003, the fair value of financial liabilities, which is estimated by discounting the future contractual cash flows at the current market interest rate for similar financial instruments with the same remaining maturity and were disclosed in relevant notes to these consolidated financial statements.

At 31 December 2004 and 31 December 2003, the carrying value of financial assets and cash deposits approximates their fair value.

## 34 Post balance sheet events

On 1 March 2005 the Company purchased a further 2.92% of preferred shares of OAO "ZMZ" and increased its stake in ZMZ share capital to 75%. Purchase consideration paid equal to RR 158. The Company acquired RR 163 of net identifiable assets and liabilities using the carrying value at 31 December 2004. Consequently, approximate value of the excess of acquired share over purchase consideration is RR 5 which would be taken to the statement of income in 2005 in accordance with the accounting policy stated in Note 3.6.

On 13 January 2005 the Federal Commission of Securities Market registered the prospectus of 4,470 thousand ordinary shares of the Company at a nominal value of 12.5 roubles per share.

On 27 January 2005 OAO "ZMZ" signed a contract for engine sales in 2005 with its major customer OAO "GAZ" with reasonable price increase.