# SEVERSTAL-AUTO GROUP

**INTERNATIONAL FINANCIAL REPORTING STANDARDS**

**CONSOLIDATED FINANCIAL STATEMENTS**
**AND AUDITORS' REPORT**

## 31 December 2005

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PRICEWATERHOUSECOOPERS

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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 2005 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 34) 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 2005, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit

Moscow, Russian Federation
21 April 2006

*(in millions of Russian Roubles)*

| | | RUB million | | Supplementary information US$ million (Note 2) | |
|---|---|---|---|---|---|
| | | At 31 December | | At 31 December | |
| | Note | 2005 | 2004 | 2005 | 2004 |
| **ASSETS** | | | | | |
| **Non-current assets:** | | | | | |
| Property, plant and equipment | 5 | 12,227 | 9,854 | 425 | 356 |
| Development costs | 6 | 739 | 543 | 26 | 20 |
| Goodwill | 7 | 1,484 | 1,484 | 52 | 53 |
| Other intangible assets | 8 | 96 | 47 | 3 | 2 |
| Financial assets | 9 | 53 | 84 | 2 | 3 |
| Other non-current assets | 10 | 235 | 184 | 8 | 6 |
| **Total non-current assets** | | **14,834** | **12,196** | **516** | **440** |
| **Current assets:** | | | | | |
| Inventories | 11 | 4,702 | 3,448 | 163 | 124 |
| Accounts receivable and prepayments | 12 | 3,431 | 2,145 | 119 | 77 |
| Other current assets | 13 | 6 | 53 | - | 2 |
| Cash and cash equivalents | 14 | 1,296 | 982 | 45 | 35 |
| **Total current assets** | | **9,435** | **6,628** | **327** | **238** |
| **Total assets** | | **24,269** | **18,824** | **843** | **678** |
| **LIABILITIES AND EQUITY** | | | | | |
| **Equity:** | | | | | |
| **Capital and reserves attributable to equity holders of the Company:** | 15 | | | | |
| Share capital | | 530 | 474 | 18 | 17 |
| Share premium | | 6,019 | 4,259 | 209 | 153 |
| Additional paid-in capital | | 1,438 | 1,438 | 50 | 52 |
| Retained earnings | | 3,422 | 2,210 | 119 | 80 |
| | | **11,409** | **8,381** | **396** | **302** |
| Minority interest | | 3,371 | 3,154 | 117 | 114 |
| **Total equity** | | **14,780** | **11,535** | **513** | **416** |
| **Non-current liabilities:** | | | | | |
| Long-term borrowings | 16 | 1,702 | 1,782 | 59 | 64 |
| Long-term taxes payable | 17 | 157 | 286 | 5 | 10 |
| Post-employment benefit obligation | 18 | 34 | 18 | 1 | 1 |
| Deferred income on government grant | 19 | 306 | 291 | 11 | 10 |
| Deferred income tax liabilities | 29 | 1,268 | 1,162 | 44 | 42 |
| **Total non-current liabilities** | | **3,467** | **3,539** | **120** | **127** |
| **Current liabilities:** | | | | | |
| Accounts payable | | 2,715 | 1,448 | 94 | 52 |
| Advances received and other payables | 20 | 951 | 1,001 | 33 | 36 |
| Taxes payable | 17 | 476 | 372 | 17 | 13 |
| Warranty and other provisions | 21 | 130 | 99 | 5 | 4 |
| Short-term borrowings | 22 | 1,750 | 830 | 61 | 30 |
| **Total current liabilities** | | **6,022** | **3,750** | **210** | **135** |
| **Total liabilities** | | **9,489** | **7,289** | **330** | **262** |
| **Total equity and liabilities** | | **24,269** | **18,824** | **843** | **678** |

General Director
V.A. Shvetsov

21 April 2006

Chief Financial Officer
N.A. Sobolev

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

*(in millions of Russian Roubles)*

| | | RUB million | | Supplementary information US$ million (Note 2) | |
|---|---|---|---|---|---|
| | **Note** | **2005** | **2004** | **2005** | **2004** |
| Sales | 23 | 26,541 | 23,029 | 938 | 799 |
| Cost of sales | 24 | (20,365) | (17,446) | (720) | (605) |
| **Gross profit** | | **6,176** | **5,583** | **218** | **194** |
| Distribution costs | 25 | (913) | (856) | (32) | (30) |
| General and administrative expenses | 26 | (2,266) | (2,011) | (80) | (70) |
| Other operating (expense)/income | 27 | (154) | 50 | (5) | 2 |
| **Operating income** | | **2,843** | **2,766** | **101** | **96** |
| Interest expense | | (351) | (423) | (12) | (15) |
| Foreign exchange, net | | 10 | (40) | - | (1) |
| Gain on forgiveness of tax penalties | 17 | 41 | - | 1 | - |
| **Income before taxation** | | **2,543** | **2,303** | **90** | **80** |
| Income tax expense | 29 | (627) | (631) | (22) | (22) |
| **Net income for the year** | | **1,916** | **1,672** | **68** | **58** |
| **Attributable to:** | | | | | |
| Equity holders of the Company | | 1,527 | 1,342 | 54 | 47 |
| Minority interest | | 389 | 330 | 14 | 11 |
| | | **1,916** | **1,672** | **68** | **58** |
| Weighted average number of shares outstanding during the period (thousands) | 30 | 31,290 | 24,445 | 31,290 | 24,445 |
| Earnings per share (in RUB and US$) – basic and fully diluted | 30 | 48.80 | 54.90 | 1.7 | 1.9 |

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

*(in millions of Russian Roubles)*

| | Note | RUB million Year ended 31 December 2005 | RUB million Year ended 31 December 2004 | Supplementary information US$ million (Note 2) Year ended 31 December 2005 | Supplementary information US$ million (Note 2) Year ended 31 December 2004 |
|---|---|---|---|---|---|
| **Cash flows from operating activities** | | | | | |
| Income before taxation | | **2,543** | **2,303** | **90** | **80** |
| Adjustments for: | | | | | |
| Depreciation and amortisation | 28 | 783 | 596 | 28 | 21 |
| Provision for impairment of receivables | 26 | (30) | 5 | (1) | - |
| Excess of acquired share of net assets over purchase consideration | 7 | (57) | (121) | (2) | (4) |
| Interest expense | | 351 | 423 | 12 | 15 |
| Provisions movements | | (2) | 106 | - | 3 |
| Post-employment benefit obligation | 18 | 17 | 18 | - | 1 |
| Fair value losses on financial assets at fair value through profit or loss | 27 | (3) | 11 | - | - |
| Forgiveness of tax debts | 17 | (41) | - | (1) | - |
| Government grant amortisation | | (10) | - | - | - |
| Development costs write off | 6 | 138 | - | 4 | - |
| (Gain)/loss on sale of property, plant and equipment | 27 | (4) | 44 | - | 1 |
| **Operating cash flows before working capital changes** | | **3,685** | **3,385** | **130** | **117** |
| Increase in accounts receivable and prepayments | | (746) | (470) | (26) | (16) |
| Increase in inventories | | (983) | (348) | (35) | (12) |
| Decrease in other current assets | | 52 | 12 | 2 | - |
| Increase/(decrease) in accounts payable, advances received and other payables | | 1, 035 | (205) | 37 | (7) |
| Decrease in taxes payable, other than income tax | | (51) | (151) | (2) | (5) |
| **Cash provided from operations** | | **2,992** | **2,223** | **106** | **77** |
| Income tax paid | | (576) | (562) | (20) | (20) |
| Interest paid | | (350) | (236) | (12) | (8) |
| **Net cash provided from/(used in) operating activities** | | **2,066** | **1,425** | **74** | **49** |
| **Cash flows from investing activities:** | | | | | |
| Purchase of property, plant and equipment | | (1,340) | (1,374) | (47) | (48) |
| Proceeds from the sale of property, plant and equipment | | 84 | 10 | 3 | - |
| Development costs capitalised | 6 | (350) | (335) | (12) | (12) |
| Increase in stake in subsidiary | 7 | (160) | (214) | (6) | (7) |
| Acquisition of subsidiary, net of cash acquired | 7 | (1,323) | - | (47) | - |
| Purchase of other non-current assets | | (47) | (44) | (2) | (2) |
| Interest received | | 21 | - | 1 | - |
| **Net cash used in investing activities:** | | **(3,115)** | **(1,957)** | **(110)** | **(69)** |
| **Cash flows from financing activities:** | | | | | |
| Proceeds from borrowings | | 12,564 | 9,811 | 444 | 342 |
| Repayment of borrowings and long-term taxes payable | | (12,424) | (10,182) | (440) | (354) |
| Proceeds from parent company share issue | 15 | 1,816 | 1,471 | 64 | 51 |
| Proceeds from government grant | 19 | 15 | 186 | - | 6 |
| Dividends paid | | (549) | (322) | (20) | (12) |
| Dividends paid to minorities | | (59) | (45) | (2) | (1) |
| **Net cash provided from financing activities** | | **1,363** | **919** | **46** | **32** |
| **Net increase in cash and cash equivalents** | | **314** | **387** | **10** | **15** |
| **Cash and cash equivalents at the beginning of the period** | 14 | **982** | **595** | **35** | **20** |
| **Cash and cash equivalents at the end of the period** | 14 | **1,296** | **982** | **45** | **35** |

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

*(in millions of Russian Roubles)*

| | Note | Attributable to equity holders of the Company | | | | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|
| | | Share capital | Share premium | Additional paid-in-capital | Retained earnings | | |
| **Balance at 31 December 2003** | | **377** | **2,885** | **1,438** | **1,541** | **3,159** | **9,400** |
| Net income for the year | | - | - | - | 1,342 | 330 | 1,672 |
| **Total recognised income for 2004** | | **-** | **-** | **-** | **1,342** | **330** | **1,672** |
| Additional share issue | 15 | 97 | 1,374 | - | - | - | 1,471 |
| Dividends for 2003 | 15 | - | - | - | (375) | - | (375) |
| Interim dividends for 2004 | 15 | - | - | - | (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** | **3,154** | **11,535** |
| Net income for the year | | - | - | - | 1,527 | 389 | 1,916 |
| **Total recognised income for 2005** | | **-** | **-** | **-** | **1,527** | **389** | **1,916** |
| Additional share issue | 15 | 56 | 1,760 | - | - | - | 1,816 |
| Dividends for 2004 | 15 | - | - | - | (327) | - | (327) |
| Share of net assets acquired from minority shareholders | 7,33 | - | - | - | 12 | (177) | (165) |
| Business combination | 7 | - | - | - | - | 5 | 5 |
| **Balance at 31 December 2005** | | **530** | **6,019** | **1,438** | **3,422** | **3,371** | **14,780** |

| | Attributable to equity holders of the Company | | | | Minority interest | Total equity |
|---|---|---|---|---|---|---|
| | Share capital | Share premium | Additional paid-in-capital | Retained earnings | | |
| **Supplementary information US$ million** | | | | | | |
| **Balance at 31 December 2004** | **17** | **153** | **52** | **80** | **114** | **416** |
| **Balance at 31 December 2005** | **18** | **209** | **50** | **119** | **117** | **513** |

## 1 The Severstal-auto Group and its operation

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, the Nizhny Novgorod Region and the City of Naberezhnye Chelny 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 63% of the Company's share capital. At the balance sheet date Alexey Mordashov and Vadim Shvetsov controlled, respectively, 85% and 15% of the share capital of Newdeal Investments Limited. See Note 35 for subsequent reduction.

During the 2005 financial year, the Company acquired control of OAO "Small Car Plant" (OAO "ZMA") based in Naberezhnye Chelny, Republic of Tatarstan. OAO "ZMA" produces Class A cars branded as the OKA (Note 7).

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 the General Director and Chief Financial Officer on 21 April 2006.

## 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 ("RUB") and prepare their statutory financial statements in accordance with the Federal Law on Accounting of the Russian Federation. The 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 3.21.

### *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 RUB 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 hyperinflation 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 consolidated financial statements.

## 2 Basis of presentation of the financial statements (continued)

***Functional and presentation currency***

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Russian Roubles, which is the Company's functional and presentation currency.

***Supplementary information***

U.S. Dollar ("US$") amounts shown in the consolidated financial statements are translated from the RUB as a matter of arithmetical computation only, at the official rate of the Central Bank of the Russian Federation at 31 December 2005 of RUB 28.78 = US$1 (at 31 December 2004 of RUB 27.75 = US$1). The statement of income and cash flow statement has been translated at the average exchange rates during the year ended 31 December 2005 and 31 December 2004. The difference was recognised in equity. The US$ amounts are presented solely for the convenience of the reader, and should not be construed as a representation that RUB 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 RUB into other currencies. The RUB is not freely convertible in most countries outside of the Russian Federation.

## 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 with the effective date 1 January 2005. Certain new IFRSs became effective for the Group from 1 January 2006. Listed below are those new of amended standards or interpretations which are or in the future could be relevant to the Group's operations.

IAS 19 (amendment) "Employee Benefits"
IAS 39 (amendment) "Cash Flow Hedge Accounting of Forecast Intragroup Transaction"
IAS 39 (amendment) "The Fair Value Option"
IAS 39 and IFRS 4 (amendment) "Financial Guarantee Contracts"
IFRS 1 (amendment) "First-time Adoption of International Financial Reporting Standards"
IFRS 6 (amendment) "Exploration for and Evaluation of Mineral Resources"
IFRS 7 "Financial Instruments: Disclosures" and a complementary amendment to IAS 1 "Presentation of Financial Statements – Capital Disclosures" (effective from 1 January 2007)
IFRIC 4 "Determining whether an Arrangement contains a Lease"
IFRIC 5 "Rights to Interests arising from Decommissioning, restoration and Environmental Rehabilitation Funds"
IFRIC 6 "Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment" (effective from 1 December 2005)

None of the new standards or interpretations, issued up to the date of signing these financial statements, are expected to have any significant effect upon the Group's financial statements.

### 3.2 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 those 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 those of segments operating in other economic environments.

*(in millions of Russian Roubles)*

## 3 Summary of significant accounting policies (continued)

### 3.3 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.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given up, equity instruments issued or liabilities incurred or assumed at the date of acquisition plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets of the subsidiary acquired is recorded as goodwill (see Note 3.5). If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the statement of income.

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. Transactions with minority interests are accounted for under the parent company model whereby minorities are third parties in the context of the Group's financial statements. Consequently such transactions create assets/liabilities and give rise to gains/losses in the statement of income.

***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.

### 3.4 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 RUB. 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 asset's 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 |

## 3 Summary of significant accounting policies (continued)

### 3.4 Property, plant and equipment (continued)

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 or disposal 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.

### 3.5 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 recognised 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 capitalised are amortised 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.

***Other intangible assets***

Trademarks and licences purchased by the Group are shown at historical cost. Trademarks and licences which were acquired as a result of acquiring subsidiaries are initially recognised at fair value. Trademarks and licences have a definite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost over their estimated useful lives, which are as follows:

| | Number of years |
|---|---|
| Computer software licenses | 3 to 5 |
| Trademarks and licences | 3 to 10 |

### 3.6 Financial assets

***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 Summary of significant accounting policies (continued)

### 3.6 Financial assets (continued)

***Loans and receivables***

Loans and receivables are non-derivative financial assets with fixed ore determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater then 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as 'accounts receivable and prepayments' in the balance sheet (see Note 3.8).

### 3.7 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 overheads (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.

### 3.8 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 include 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.

### 3.9 Value added tax

Value added tax (VAT) related to sales is payable to tax authorities upon collection of receivables from customers. Input VAT is generally 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 tax purposes.

### 3.10 Cash and cash equivalents

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

### 3.11 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 the cost of the asset during the period of time that is required to complete and prepare the asset for its intended use and when it is probable that they will result in future economic benefits to the Group and costs can be measured reliably.

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 Summary of significant accounting policies (continued)

### 3.12 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 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.

### 3.13 Deferred income taxes

Deferred tax assets and liabilities are calculated in respect of temporary differences using the balance sheet liability method. 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.

### 3.14 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.

OAO “ZMZ” and its subsidiaries operate voluntary pension schemes, which are defined benefit plans. 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 average compensation by employee’s grade.

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, 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 service 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 Summary of significant accounting policies (continued)

### 3.15 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 statement of income 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 statement of income on a straight line basis over the expected lives of the related assets.

### 3.16 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.

### 3.17 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.

### 3.18 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.

### 3.19 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.

### 3.20 Foreign currency transactions

Monetary assets and liabilities which are held by Group entities and denominated in foreign currencies are translated into the RUB 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.

### 3.21 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)

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

***Capitalisation of development costs***

The Group capitalises development costs in accordance with the accounting policy stated in Note 3.5. Judgement is required to assess the probability that future economic benefits that are attributable to these assets will flow to the Group.

By 31 December 2005 the Group capitalized development expenditure for the diesel engine of RUB 319 and acquired property, plant and equipment of RUB 149. In accordance with requirements of IAS 38 "Intangible Assets" this amount should be capitalized if the project will generate probable future economic benefits.

As described in Note 19, the Group is required to comply with certain conditions set by the government in relation to finance provided for this project. Management is in process of renegotiation of the conditions attached to the grant with the government. Should management not be able to fulfil conditions attached to this grant, then the Group may incur a fine which could have an adverse impact of the profitability of the project.

If management assumptions at 31 December 2005 in relation to the flow of future economic benefits or its negotiations with the government outlined above are not fulfilled, writing off all development costs which do not meet recognition criteria would reduce the operating income by RUB 739 at 31 December 2005.

***Estimated impairment of goodwill***

The Group tests annually whether the goodwill has suffered any impairment, in accordance with the accounting policy stated in Note 3.5. 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 had been 20% lower, or the estimated pre-tax discount rate applied to the individual segments' cash flows had been 20% higher than management has assumed in its impairment testing, the carrying value of the goodwill relating to either segment would have remained unchanged.

***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 at 31 December 2005 the carrying value of buildings would have been RUB 154 higher or RUB 232 lower accordingly. If the estimated remaining useful life of plant and equipment had been 20% higher or lower than management estimates, then at 31 December 2005 the carrying value of plant and equipment would have been RUB 273 higher or RUB 409 lower accordingly.

***Estimated impairment of property, plant and equipment***

At 31 December 2005 the Group has identified equipment at OAO "ZMA" with net book value RUB 72, for which the plant will have no further use following a planned reorganisation of the production process. The date of this reorganisation has not yet been fixed. The Group has made plans to dispose of this equipment following the reorganization and is confident it will recover the net book value. However, to the extent that these plans are not realised then the Group would have to recognise losses on disposal.

***Income tax***

Judgement is required in determining a 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.

*(in millions of Russian Roubles)*

## 3 Summary of significant accounting policies (continued)

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

***Warranty provision***

Judgement is required in determining a warranty provision. The Group recognises liabilities for warranty based on estimates of 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 the year ended 31 December 2005 had been 50% higher than actual, the Group would need to reduce its income attributable to the equity holders of the Company by RUB 49.

***Provision for impairment of accounts receivable***

Judgement is required in determining a provision for impairment of accounts receivable. The Group recognises a provision for impairment based on estimates of the collectibility of receivables. As at 31 December 2005 the Group had balances outstanding for more than one year of RUB 53. Management is confident that these balances will be recoverable in full. However, to the extent that these estimates are not realised, the Group would have to recognise additional bad debt expense.

## 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, is under common control with, or exercises significant influence over the other party in making financial and 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 2005 and 31 December 2004 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 2005** | | | |
| Accounts receivable and prepayments | - | 25 | 25 |
| Notes receivable | | | |
| Accounts payable and other payables | - | 177 | 177 |
| Borrowings received | - | 3 | 3 |
| **At 31 December 2004** | | | |
| Accounts receivable and prepayments | - | 7 | 7 |
| Accounts payable | - | 55 | 55 |
| Borrowings issued | - | 26 | 26 |

*(in millions of Russian Roubles)*

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

Transactions with related parties of the Group for the year ended 31 December 2005 and 31 December 2004 consist of the following:

| | | | |
|---|---|---|---|
| **Transactions** | | | |
| **Year ended 31 December 2005** | | | |
| Purchases | - | 1,144 | 1,144 |
| Sales revenue | - | 252 | 252 |
| Borrowings issued | - | 52 | 52 |
| Borrowings repaid | - | 78 | 78 |
| Dividends paid | 549 | - | 549 |
| **Year ended 31 December 2004** | | | |
| Purchases | - | 942 | 942 |
| Interest accrued | 39 | - | 39 |
| Borrowings repaid | 1,379 | - | 1,379 |
| Dividends paid | 322 | - | 322 |

The Group purchase metal and other materials mainly from OAO “Severstal” and ZAO “Severstal-Metiz”.

**4.2 Directors’ compensation**

Compensation paid to 9 key management and directors (2004: 9) 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 RUB 63 for the year ended 31 December 2005 (year ended 31 December 2004: RUB 71) representing short-term employee benefits only.

*(in millions of Russian Roubles)*

## 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 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** |
| Acquired through business combination (Note 7) | 719 | 1,004 | 24 | 9 | 1,756 |
| Additions | - | - | - | 1,468 | 1,468 |
| Disposals | (4) | (80) | (15) | (27) | (126) |
| Transfers | 287 | 1,053 | 391 | (1,731) | - |
| **Balance at 31 December 2005** | **5,794** | **7,535** | **1,211** | **615** | **15,155** |
| **Accumulated Depreciation** | | | | | |
| Balance at 31 December 2003 | (564) | (929) | (157) | - | (1,650) |
| Depreciation expense | (175) | (328) | (93) | - | (596) |
| Disposals | 1 | 25 | 17 | - | 43 |
| **Balance at 31 December 2004** | **(738)** | **(1,232)** | **(233)** | **-** | **(2,203)** |
| Depreciation expense | (189) | (426) | (140) | - | (755) |
| Disposals | 1 | 21 | 8 | - | 30 |
| **Balance at 31 December 2005** | **(926)** | **(1,637)** | **(365)** | **-** | **(2,928)** |
| **Net Book Value** | | | | | |
| **Balance at 31 December 2004** | **4,054** | **4,326** | **578** | **896** | **9,854** |
| **Balance at 31 December 2005** | **4,868** | **5,898** | **846** | **615** | **12,227** |

Bank borrowings are secured on properties as at 31 December 2005 to the value of RUB 1,257 (31 December 2004: RUB 1,596); see Note 22.

During 2005 the Group capitalised borrowing costs of RUB 82 (year ended 31 December 2004: RUB 20) in the cost of the qualifying assets. The Group used capitalization rate of 11% at year ended 31 December 2005 (year ended 31 December 2004: 3%).

The Group owns the land on which factories and buildings, comprising the principal manufacturing facilities of the Group, are situated. At 31 December 2005 cost of the land amounts to RUB 931 (31 December 2004: RUB 896).

*(in millions of Russian Roubles)*

## 6 Development costs

| | 2005 | 2004 |
|---|---|---|
| **Cost** | | |
| Balance at the beginning of the year | 543 | 207 |
| Additions | 350 | 336 |
| Disposals | (2) | - |
| Write-off (Note 27) | (138) | - |
| **Balance at the end of the year** | **753** | **543** |
| | | |
| **Accumulated Amortisation** | | |
| Balance at the beginning of the year | - | - |
| Amortisation charge | (14) | - |
| Disposals | - | - |
| **Balance at the end of the year** | **(14)** | **-** |
| | | |
| **Net Book Value** | | |
| **Balance at 31 December** | **739** | **543** |

As of 31 December 2005 the Group wrote off development expenditures of RUB 138 relating to development of certain parts of the gear box for GM-Avtovaz capitalised in the interim financial statements (see Note 27). Management has not received sufficient evidence that the conditions of the contract would be fully implemented.

No amortization was recorded as at 31 December 2004 as all projects were in development phase.

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Expenditures related to establishing production of diesel engine | 165 | 154 |
| Development of diesel engine funded by government grant | 154 | 114 |
| Improvement of diesel engine funded by internal financing | 32 | 32 |
| Development of new off-road vehicle (UAZ Patriot) | 115 | 34 |
| Improvement of four-cylinder petrol engine | 102 | 80 |
| Improvement of vehicles and engines to satisfy Euro-2 requirements | 66 | 52 |
| Improvement of some vehicle component parts | 33 | 39 |
| Development of new light commercial vehicle (UAZ-2360) | 19 | 14 |
| Development of Rexton production process | 14 | - |
| Other | 39 | 24 |
| | **739** | **543** |

## 7 Acquisitions and goodwill

Goodwill arose first on the original purchase of the 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. The positive goodwill is attributable to the profitability of the acquired businesses and the significant synergies expected to arise after the Group’s acquisition of OAO “UAZ” and OAO “ZMZ”.

In addition to acquisitions noted above, on 3 June 2005 the Company completed the acquisition of a new subsidiary OAO “ZMA” based in Naberezhnye Chelny, Republic of Tatarstan. OAO “ZMA” produces Class A cars branded as the OKA. In 2004 its output was 46 thousand vehicles. As a result, the Company acquired 99.66% of OAO “ZMA” shares for RUB 1,403, which also gave rise to negative goodwill of RUB 52. OAO “ZMA” balances and operations for June-December 2005 have been consolidated in these financial statements.

*(in millions of Russian Roubles)*

**7 Acquisitions and goodwill (continued)**

| | OAO "UAZ" | OAO "ZMZ" | OAO "ZMA" | Total |
|---|---|---|---|---|
| <u>**Cost**</u> | | | | |
| **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 (Note 27) | - | 121 | - | 121 |
| **Balance at 31 December 2004** | **1,207** | **277** | **-** | **1,484** |
| Excess of acquired share over purchase consideration | - | (5) | (52) | (57) |
| Write off excess of acquired share over purchase consideration (Note 27) | - | 5 | 52 | 57 |
| **Balance at 31 December 2005** | **1,207** | **277** | **-** | **1,484** |

*Acquisition of OAO "ZMA"*

The acquired business contributed revenues of RUB 1,459 and net loss of RUB 115 to the Group for the period from 3 June to 31 December 2005.

Details of net assets acquired and negative goodwill are as follows:

| | |
|---|---|
| Purchase consideration: | |
| Cash paid | 1,398 |
| Direct costs relating to the acquisition | 5 |
| Total purchase consideration | **1,403** |
| Share of net asset acquired (99.66%) | (1,455) |
| **Excess of acquired share in the net identifiable assets over purchase consideration (negative goodwill)** | **(52)** |

Management estimates the fair value of the net identifiable assets acquired with OAO "ZMA" for the Group is higher than the value for the seller of this entity. The excess of acquired share was recognised in the statement of income on the acquisition realising the income for the Group.

The assets and liabilities arising from the acquisition are as follows:

| | Note | Fair value |
|---|---|---|
| Cash and cash equivalents | | 80 |
| Property, plant and equipment | 5 | 1,756 |
| Trademarks and licences | 8 | 40 |
| Other non-current assets | | 41 |
| Inventories | | 272 |
| Accounts receivable | | 510 |
| Trade and other accounts payable | | (435) |
| Short-term borrowings | | (504) |
| Taxes payable | | (32) |
| Warranty and other provisions | 21 | (33) |
| Long-term borrowings | | (70) |
| Government grant | 19 | (12) |
| Long-term tax liabilities | | (16) |
| Net deferred tax liabilities | 29 | (137) |
| Net identifiable assets | | 1,460 |
| Minority interests (0.34%) | | (5) |
| **Net identifiable assets acquired** | | **1,455** |

Management considers it impractical to disclose the carrying amounts of the net assets of OAO "ZMA" immediately before the combination, nor the acquiree's revenue and net profit for the period as though the acquisition was effected at the beginning of the reporting period due to the fact that the entity did not maintain IFRS compliant financial statements prior to the acquisition by the Company.

*(in millions of Russian Roubles)*

## 7 Acquisitions and goodwill (continued)

### *Increase in holding stake of OAO "ZMZ"*

The holding stake in OAO "ZMZ" was further increased from 66% to 72% in 2004 and further up to 75% of total share capital in 2005.

| | 2005 | 2004 |
|---|---|---|
| Step increase in % of ownership | 2.92% | 6.29% |
| Purchase consideration | 160 | 214 |
| Share of net assets acquired from minority shareholders | (165) | (335) |
| **Excess of acquired share in the net identifiable assets over purchase consideration (negative goodwill)** | **(5)** | **(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 to the Company.

### *Impairment tests for goodwill*

The Group tested its goodwill for impairment at 31 December 2005. 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 and its expectations for 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 estimated growth rates of 7.7% for the vehicle segment and 8.7% for the engine segment (31 December 2004: 7.7% and 8.7% respectively); 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 of 19% for vehicle segment and 18.9% for engine segment (31 December 2004: 19% and 18.9% respectively) are pre-tax and reflect 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.

No indications exist that an impairment provision is necessary at 31 December 2005.

## 8 Other intangible assets

Intangible assets comprise of the following:

| | Trade marks | Licences | Total |
|---|---|---|---|
| <u>**Cost**</u> | | | |
| Balance at 31 December 2003 | - | 46 | 46 |
| Additions | - | 25 | 25 |
| Disposals | - | - | - |
| **Balance at 31 December 2004** | **-** | **71** | **71** |
| | | | |
| Acquired through business combination (Note 7) | 40 | - | 40 |
| Additions | - | 37 | 37 |
| Disposals | - | - | - |
| **Balance at 31 December 2005** | **40** | **108** | **148** |

*(in millions of Russian Roubles)*

## 8 Other intangible assets (continued)

| | Trade marks | Licences | Total |
|---|---|---|---|
| **Accumulated Amortisation** | | | |
| Balance at 31 December 2003 | - | (23) | (23) |
| Amortisation charge | - | (1) | (1) |
| Disposals | - | - | - |
| **Balance at 31 December 2004** | **-** | **(24)** | **(24)** |
| Amortisation charge | (8) | (20) | (28) |
| Disposals | - | - | - |
| **Balance at 31 December 2005** | **(8)** | **(44)** | **(52)** |
| **Net Book Value** | | | |
| **Balance at 31 December 2004** | **-** | **47** | **47** |
| **Balance at 31 December 2005** | **32** | **64** | **96** |

## 9 Financial assets

Non-current financial assets are financial assets at fair value through profit or loss, which 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 to their fair value.

## 10 Other non-current assets

Other non-current assets consist of the following:

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Advances for equipment | 135 | 160 |
| Advances for construction in progress | 41 | - |
| Other | 59 | 24 |
| | **235** | **184** |

## 11 Inventories

Inventories consist of the following:

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Raw materials | 2,972 | 2,402 |
| Less: obsolescence provision | (49) | (162) |
| | 2,923 | 2,240 |
| Work in progress | 640 | 621 |
| Less: NRV provision | - | (20) |
| | 640 | 601 |
| Finished products | 1,139 | 619 |
| Less: NRV provision | - | (12) |
| | 1,139 | 607 |
| | **4,702** | **3,448** |

Inventories of RUB 833 (31 December 2004: RUB 887) have been pledged as security for borrowings, see Note 22. Included in the value of work in progress and finished products at 31 December 2005 is the depreciation charge of RUB 14 (at 31 December 2004: RUB nil).

*(in millions of Russian Roubles)*

## 12 Accounts receivable and prepayments

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Trade receivables | 2,511 | 1,182 |
| Less: provision for impairment | (48) | (27) |
| | 2,463 | 1,155 |
| Other receivables | 335 | 358 |
| Less: provision for impairment | (7) | (19) |
| | 328 | 339 |
| Advances to suppliers | 395 | 264 |
| Less: provision for impairment | (12) | (5) |
| | 383 | 259 |
| VAT recoverable, net | 246 | 384 |
| Prepayments | 11 | 8 |
| | **3,431** | **2,145** |

Included within net VAT recoverable is RUB 515 of deferred VAT payable (31 December 2004: RUB 166).

Foreign currency denominated net trade receivables:

| Currency | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Euro | 39 | 92 |
| US$ | 377 | 76 |
| | **416** | **168** |

The carrying value of accounts receivable and prepayments as at 31 December 2005 and 31 December 2004 is approximately equal to their fair value.

***Non-cash settlements***

In the year ended 31 December 2005 RUB 798 (approximately 3% of total sales) of the Group’s settlements of accounts receivable were settled by means of mutual settlements, and RUB 290 (approximately 1% of total sales) by means of third-party bills of exchange. In the year ended 31 December 2004 RUB 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) were settled by means of third-party bills of exchange.

## 13 Other current assets

Other current assets are represented 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.

## 14 Cash and cash equivalents

Cash and cash equivalents comprise the following:

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Cash on hand and balances with banks | 567 | 298 |
| Letters of credit | 88 | 239 |
| Cash deposits | 570 | 345 |
| Short-term bank promissory notes | 71 | 100 |
| | **1,296** | **982** |

Cash deposits of RUB 570 held by the Group at 31 December 2005 bear interest of 6% per annum (31 December 2004: RUB 345 bear interest of 5.5% per annum). Other cash and cash equivalents apart from cash deposits of RUB 726 (31 December 2004: RUB 637) held by the Group are not interest bearing. Letters of credit were established for suppliers of equipment and components.

*(in millions of Russian Roubles)*

**14 Cash and cash equivalents (continued)**

Foreign currency denominated cash balances consist of the following:

| Currency | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Euro | 29 | 237 |
| US$ | 71 | 5 |
| | **100** | **242** |

The carrying value of cash and cash equivalents as at 31 December 2005 and 31 December 2004 is approximately equal to its fair value.

**15 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, RUB | Share premium, RUB | Additional paid-in capital, RUB | Total share capital, RUB |
|---|---|---|---|---|---|
| At 31 December 2004 | 29,800 | 474 | 4,259 | 1,438 | 6,171 |
| At 31 December 2005 | 34,270 | 530 | 6,019 | 1,438 | 7,987 |

The total authorised number of ordinary shares is 82,074 thousand (31 December 2004: 82,074 thousand). Nominal value of all shares is 12.5 roubles per share. Statutory share capital of the Company totalled RUB 428 (31 December 2004: RUB 374).

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 RUB 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 2005, the net statutory profit for the Company as reported in the published annual statutory reporting forms was RUB 488 and the closing balance of the accumulated profit including the current reporting period net statutory profit totalled to RUB 4,375. Management believes that the accumulated profit including the current year net statutory profit is distributable.

In December 2004, interim dividends for the nine months ended 30 September 2004 were declared in the amount of RUB 298, or 10 roubles per ordinary share. In June 2005, the General Shareholders' Meeting decided to pay dividends of RUB 327 for 2004, or 11 roubles per ordinary share, in addition to the already accrued interim dividends for the nine months ended 30 September 2004.

On 13 January 2005 the Federal Commission of Securities Market registered the issue of 4,470 thousand ordinary shares of the Company at a nominal value of 12.5 roubles per share (which is approximately 15% of the Company's share capital).

In April 2005, the Company started an initial public offering of its shares in the Russian stock market. As part of this offering, Newdeal Investments Ltd. provided 8,940 thousand ordinary registered shares (amounting to approximately 30% of the Company's share capital) for the initial public offering at a price of US$ 15.10 per share. The parent company invested into the Company approximately 50% of the net proceeds from the sale of its shares by purchasing newly-issued shares of the Company. The placement of all the newly-issued shares was completed in July 2005.

On 30 August 2005 the Federal Service for Financial Markets approved the results of the issue of 4,470 thousand ordinary shares. As at 31 December 2005 the Company has received RUB 1,816 from the share issue net of transaction costs of RUB 31. Newdeal Investments' equity stake in the Company's post-offering share capital is equal to 63%.

*(in millions of Russian Roubles)*

## 16 Long-term borrowings

In January 2004 the Company issued rouble-denominated non-convertible bonds for RUB 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 RUB 16 were deducted from proceeds received. The funds received were lent on to subsidiaries at similar terms.

During the year ended 31 December 2004 the Group received a Euro denominated loan from Sberbank amounting to RUB 297 with an effective floating interest rate of Euro LIBOR + 4.35% for purchase of equipment for a painting workshop. As of 31 December 2005 the outstanding long-term part of this loan amounted to RUB 179. The loan is repayable in nine equal semi-annual instalments starting from July 2005.

Long-term debt is repayable as follows:

| | **31 December 2005** | **31 December 2004** |
|---|---|---|
| 1 to 2 years | 89 | 66 |
| 2 to 3 years | 1,545 | 1,584 |
| 3 to 4 years | 60 | 66 |
| 4 to 5 years | 8 | 66 |
| | **1,702** | **1,782** |

As at 31 December 2005 and 31 December 2004 the carrying value of these liabilities approximates their fair value.

## 17 Taxes payable

### Current taxes payable

Current taxes payable comprise the following:

| | **31 December 2005** | **31 December 2004** |
|---|---|---|
| Current portion of taxes restructured to long-term | 178 | 193 |
| Value-added tax | 97 | 64 |
| Payments to the Pension Fund and other social taxes | 54 | 57 |
| Income tax | 52 | 1 |
| Personal income tax | 40 | 24 |
| Property tax | 12 | 3 |
| Tax penalties and interest | 9 | 4 |
| Other taxes | 34 | 26 |
| **Total** | **476** | **372** |

The Group had no tax liabilities past due at 31 December 2005 and 31 December 2004.

### 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 2005** | **31 December 2004** |
|---|---|---|
| Current | 178 | 193 |
| 1 to 2 years | 151 | 133 |
| 2 to 3 years | 4 | 131 |
| 3 to 4 years | 2 | 21 |
| 4 to 5 years | - | 1 |
| **Total restructured** | **335** | **479** |
| Less: current portion of taxes payable | (178) | (193) |
| **Long-term portion of restructured taxes** | **157** | **286** |

*(in millions of Russian Roubles)*

**17 Taxes payable (continued)**

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.

OAO "UAZ", OAO "ZMZ" and OAO "ZMA" are in compliance with the terms of the restructuring of the federal, regional and local tax debts at 31 December 2005. Management is confident that these companies will continue to abide by the terms of the restructuring.

As at 31 December 2005 fair value of these liabilities was estimated to be RUB 172 (31 December 2004: RUB 340) using a current market interest rate of 11.25% (31 December 2004: 11.3%).

During the year OAO "ZMZ" recorded a gain reflecting the forgiveness of penalties previously accrued in excess of the principal tax debt of RUB 41 (2004: RR nil).

**18 Post-employment benefits**

OAO "ZMZ" and its subsidiaries provide post employment 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 2005.

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

| | **31 December 2005** | **31 December 2004** |
|---|---|---|
| Present value of funded defined benefit obligations | 189 | 146 |
| Unrecognized net actuarial loss | (42) | - |
| Unrecognised past service cost | (113) | (128) |
| **Liability in the balance sheet** | **34** | **18** |

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

| | **31 December 2005** | **31 December 2004** |
|---|---|---|
| Recognised actuarial gain | - | 9 |
| Current service cost | 12 | 6 |
| Amortisation of past service cost | 8 | 12 |
| Interest cost | 13 | 10 |
| **Total included in labour expenses (Note 28)** | **33** | **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 2005** | **31 December 2004** |
|---|---|---|
| At the beginning of the period | **18** | - |
| Total expense as above | 33 | 37 |
| Benefits paid | (17) | (19) |
| **Net liability at the end of the period** | **34** | **18** |

The principal actuarial assumptions used were as follows:

| | **31 December 2005** | **31 December 2004** |
|---|---|---|
| Withdrawal rate | 3% | 3% |
| Interest rate | 9% | 9% |
| Salary growth | 8% | 6% |

*(in millions of Russian Roubles)*

## 19 Deferred income on government grant

In May 2003 the Group won a government grant for a total of RUB 500 for the development of a new diesel engine during the years 2003 - 2007. As at 31 December 2005 the Group had received RUB 306 of this grant. RUB 149 was used for the purchase of new equipment required for research and development works and RUB 154 was spent on the development of the diesel engine and capitalised as development costs in the balance sheet as at 31 December 2005. 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 RUB 4,000. If the sales target is not met, the Group will have to pay a fine to the government equal to 20% of the difference between the volume designated and sales made. During the reporting year the Group commenced depreciation of the non-current assets acquired and amortization of deferred income.

Management is in process of renegotiating the conditions attached to the grant with the government. Revised terms would require the Group to sell new diesel engines in the amount of RUB 2,000 over the period 2006 – 2009. The overall financing of the project would be reduced to RUB 391. Management believes they will be successful in renegotiating these terms, and that the Group will be able to comply with the new terms of the grant and will not need to pay a fine.

The Group acquired through business combination a government grant from Research and Development Fund of Tatarstan Republic of RUB 11. The grant was obtained to finance construction of new painting line at OAO “ZMA”, and is amortised to the statement of income on a straight line basis over the useful life of the underlying asset.

## 20 Advances received and other payables

| | **31 December 2005** | **31 December 2004** |
|---|---|---|
| Advances from customers | 229 | 225 |
| Salaries payable | 231 | 180 |
| Vacation accrual | 152 | 107 |
| Bonus accrual | 105 | 92 |
| Dividends payable | 29 | 309 |
| Payable for bills | 74 | 66 |
| Other | 131 | 22 |
| **Total** | **951** | **1,001** |

***Non-cash settlements***

In the year ended 31 December 2005 RUB 329 (approximately 2% 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 RUB 799 (approximately 4.3% of total purchases) by means of mutual settlements with suppliers. In the year ended 31 December 2004 RUB 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 RUB 479 (approximately 4% of total purchases) by means of mutual settlements.

## 21 Warranty and other provisions

During 2005 and 2004 the following movements of the warranty provision took place:

| | **Warranty** | **Tax claims** | **Total** |
|---|---|---|---|
| Balance at 31 December 2003 | 83 | 6 | 89 |
| Additional provision | 109 | 1 | 110 |
| Utilised in the year 2004 | (100) | - | (100) |
| **Balance at 31 December 2004** | **92** | **7** | **99** |
| | | | |
| Acquired through business combination (Note 7) | 22 | 11 | 33 |
| Additional provision | 125 | - | 125 |
| Utilised in the year of 2005 | (114) | (2) | (116) |
| Reversal of provision | - | (11) | (11) |
| **Balance at 31 December 2005** | **125** | **5** | **130** |

The Group gives one-year warranty on ZMZ and UAZ product as well as two-years warranty on ZMA vehicles, and undertakes to repair or replace items that fail to perform satisfactorily. A provision of RUB 125 (31 December 2004: RUB 92) was recognised at 31 December 2005 for expected warranty claims based on past experience of the level of repairs and replacements.

*(in millions of Russian Roubles)*

## 22 Short-term borrowings

As at 31 December 2005 and 31 December 2004 short-term borrowings consist of bank loans amounting to RUB 1,750 and RUB 830 respectively. That amount included short-term part of long-term loans of RUB 174 (31 December 2004: RUB 199); and interest accrued on loans amounting to RUB 19 (31 December 2004: RUB 78).

As at 31 December 2005 short-term debt comprises a total of rouble-denominated loans at effective fixed interest rates of 3-5% of RUB 53, 11% of RUB 179 and 6-9% of RUB 1,518. 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 ended 31 December 2004.

As at 31 December 2005 and 31 December 2004 loans for RUB 1,897 and RUB 1,016 respectively, inclusive of long-term borrowings, are guaranteed by collateral of inventories and equipment; see Notes 5 and 11.

## 23 Sales

Sales were as follows:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Vehicles | 13,397 | 10,310 |
| Engines | 7,879 | 7,870 |
| Automotive components | 3,944 | 3,493 |
| Assembly kits | 125 | 506 |
| Other sales | 1,196 | 850 |
| | **26,541** | **23,029** |

## 24 Cost of sales

The components of cost of sales were as follows:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Materials and components used | 16,073 | 12,618 |
| Labour costs | 3,122 | 3,416 |
| Other production costs | 1,068 | 1,236 |
| Depreciation | 673 | 504 |
| Change in finished goods and work in progress | (571) | (328) |
| | **20,365** | **17,446** |

## 25 Distribution costs

Distribution costs comprise:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Transportation | 506 | 441 |
| Materials | 148 | 114 |
| Advertising | 162 | 93 |
| Labour costs | 51 | 80 |
| Check and inspection performed by dealers | 21 | 75 |
| Other | 25 | 53 |
| | **913** | **856** |

*(in millions of Russian Roubles)*

## 26 General and administrative expenses

General and administrative expenses comprise:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Labour costs | 1,288 | 1,200 |
| Services provided by third parties | 330 | 225 |
| Taxes other than income | 171 | 133 |
| Depreciation | 110 | 92 |
| Materials | 59 | 82 |
| Transportation | 51 | 24 |
| Repairs and maintenance | 35 | 22 |
| Insurance | 34 | 93 |
| Fire brigade and security costs | 32 | 36 |
| Training costs | 25 | 32 |
| Reversal of provision for impairment of receivables | (30) | 5 |
| Other | 161 | 67 |
| | **2,266** | **2,011** |

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

The components of other operating income and expenses were as follows:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Research and development expenses | 168 | 8 |
| Social expenses | 80 | 78 |
| Charity | 54 | 36 |
| Fair value (gain)/loss on financial assets at fair value through profit or loss | (3) | 11 |
| (Gain)/loss on disposals of property, plant and equipment | (4) | 44 |
| Write-off of accounts payable | (7) | (10) |
| Amortisation of deferred income | (10) | - |
| Provisions and settlements of claims and similar charges | (13) | 1 |
| Gain on disposal of materials | (22) | (55) |
| Excess of acquired share over purchase consideration | (57) | (121) |
| Other | (32) | (42) |
| | **154** | **(50)** |

*(in millions of Russian Roubles)*

## 28 Expenses by nature

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

| | **Year ended 31 December 2005** | **Year ended 31 December 2004** |
|---|---|---|
| Cost of sales | 3,122 | 3,416 |
| Administrative expenses | 1,288 | 1,200 |
| Distribution costs | 51 | 80 |
| | **4,461** | **4,696** |

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

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

| | **Year ended 31 December 2005** | **Year ended 31 December 2004** |
|---|---|---|
| Cost of sales | 673 | 504 |
| Administrative expenses | 110 | 92 |
| | **783** | **596** |

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

| | **Year ended 31 December 2005** | **Year ended 31 December 2004** |
|---|---|---|
| Cost of sales | 16,073 | 12,618 |
| Distribution costs | 148 | 114 |
| Administrative expenses | 59 | 82 |
| | **16,280** | **12,814** |

## 29 Income tax expense

| | **Year ended 31 December 2005** | **Year ended 31 December 2004** |
|---|---|---|
| Income tax expense – current | 658 | 590 |
| Deferred tax (credit)/expense – origination and reversal of temporary differences | (31) | 41 |
| **Income tax expense** | **627** | **631** |

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:

| | **Year ended 31 December 2005** | **Year ended 31 December 2004** |
|---|---|---|
| **Income before taxation** | **2,543** | **2,303** |
| Theoretical tax charge at the statutory rate of 24% | 610 | 553 |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| Forgiveness of tax penalties | (10) | - |
| Charity | 15 | 9 |
| Tax penalties and interest | 18 | 27 |
| Excess of acquired share over purchase consideration | (14) | (29) |
| Other | 8 | 71 |
| **Income tax expense** | **627** | **631** |

The weighted average applicable tax rate was 25% (2004: 27%). The reduction is caused by a change in the profitability due to acquisition of new subsidiary during the year.

*(in millions of Russian Roubles)*

## 29 Income tax expense (continued)

In general, during the year ended 31 December 2005 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 2005 and 31 December 2004.

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| **Deferred tax assets** | | |
| Deferred tax asset to be recovered after more than 12 month | 47 | 4 |
| Deferred tax asset to be recovered within 12 month | 118 | 93 |
| | **165** | **97** |
| **Deferred tax liabilities** | | |
| Deferred tax liabilities to be recovered after more than 12 month | (1,424) | (1,244) |
| Deferred tax liabilities to be recovered within 12 month | (9) | (15) |
| | **(1,433)** | **(1,259)** |
| **Net deferred tax liabilities** | **(1,268)** | **(1,162)** |

| | 31 December 2003 | Movement in the year | 31 December 2004 | Acquired through business combination | Movement in the year | 31 December 2005 |
|---|---|---|---|---|---|---|
| **Tax effects of deductible temporary differences:** | | | | | | |
| Accounts receivable | 30 | (5) | 25 | 12 | (16) | 21 |
| Inventories | 36 | (36) | - | - | - | - |
| Financial assets | - | 1 | 1 | 45 | (46) | - |
| Pension fund liabilities | - | 4 | 4 | - | 4 | 8 |
| Accounts payable and provisions | 63 | 4 | 67 | 5 | 25 | 97 |
| Other non-current assets | 9 | (9) | - | (8) | 47 | 39 |
| | **138** | **(41)** | **97** | **54** | **14** | **165** |
| **Tax effects of taxable temporary differences:** | | | | | | |
| Property, plant and equipment | (1,259) | 15 | (1,244) | (193) | 13 | (1,424) |
| Inventories | - | (15) | (15) | 2 | 4 | (9) |
| | **(1,259)** | **-** | **(1,259)** | **(191)** | **17** | **(1,433)** |
| **Total net deferred tax liabilities** | **(1,121)** | **(41)** | **(1,162)** | **(137)** | **31** | **(1,268)** |

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 RUB 494 (31 December 2004: RUB 249) 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 RUB 5,495 at 31 December 2005 (31 December 2004: RUB 4,144).

*(in millions of Russian Roubles)*

## 30 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 period.

| | **Year ended 31 December 2005** | **Year ended 31 December 2004** |
|---|---|---|
| Weighted average number of ordinary shares in issue (thousands) | 31,290 | 24,445 |
| Income attributable to equity holders of the Company | 1,527 | 1,342 |
| Basic/diluted earnings per share (in roubles per share) | 48.80 | 54.90 |

## 31 Segment information

### Primary reporting format – business segments

At 31 December 2005 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 31 December 2005 and balances at 31 December 2005 are as follows:

| | **Vehicles segment** | **Engines segment** | **Unallocated** | **Group** |
|---|---|---|---|---|
| Sales | 15,812 | 11,327 | - | 27,139 |
| Inter-segmental sales | (24) | (574) | - | (598) |
| **Net sales** | **15,788** | **10,753** | **-** | **26,541** |
| Operating income | 856 | 1,987 | - | 2,843 |
| Interest expense | (323) | (18) | (10) | (351) |
| Net foreign exchange gain | - | - | 10 | 10 |
| Gain on forgiveness of tax penalties | - | 41 | - | 41 |
| Segment results | 533 | 2,010 | - | 2,543 |
| Income tax expense | | | | (627) |
| **Income for the year** | | | | **1,916** |
| Segment assets | 13,848 | 8,364 | 2,057 | 24,269 |
| Segment liabilities | 5,891 | 2,019 | 1,579 | 9,489 |
| Capital expenditures | 889 | 848 | - | 1,737 |
| Depreciation | 550 | 233 | - | 783 |
| Non-cash gains/(losses) other than depreciation | 126 | (143) | - | (17) |

*(in millions of Russian Roubles)*

## 31 Segment information (continued)

The segment results for the year ended 31 December 2004 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** |
| Operating income | 807 | 1,959 | - | 2,766 |
| Interest expense | (284) | (95) | (44) | (423) |
| Net foreign exchange loss | - | - | (40) | (40) |
| Segment results | 523 | 1,864 | (84) | 2,303 |
| Income tax expense | | | | (631) |
| **Income for the period** | | | | **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 |

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** | **Year ended 31 December 2005** | **Year ended 31 December 2004** |
|---|---|---|
| Domestic | 23,108 | 19,435 |
| Export to CIS | 2,934 | 2,473 |
| Export to other countries | 499 | 1,121 |
| **Total** | **26,541** | **23,029** |

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

## 32 Contingencies, commitments and operating risks

### 32.1 Contractual commitments

As at 31 December 2005 the Group had contractual commitments of RUB 265 for the purchase of property, plant and equipment from third parties (31 December 2004: RUB 34).

As at 31 December 2005 one subsidiary of the Group, OAO "UAZ", had contractual commitment of RUB 4,747 to deliver assembly kits to Ukraine, Nigeria and spare parts to Switzerland (31 December 2004: RUB 2,775).

### 32.2 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 periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review. Under certain circumstances reviews may cover longer periods.

Before the acquisition by the Group OAO "ZMA" was the subject of a tax audit. As a result of this audit tax authorities raised a claim against this entity for additional taxes, penalties and late payment interest totalling RUB 22. This assessment relates primarily to income tax. Management is defending its position through the courts. At the date of issuing these financial statements this court case has not been resolved. Management believes that the Group's position can be sustained in the future. Therefore, no provision for this litigation or tax assessment has been recorded in these consolidated financial statements.

As at 31 December 2005 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.

### 32.3 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 57% (2004: 61%) 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.

### 32.4 Insurance policies

The Group holds insurance policies in relation to its operating assets and vehicles and all events subject to mandatory insurance. The Group does not have business interruption insurance. The Group is subject to political, legislative, tax and regulatory developments and risks, which are not covered by insurance.

### 32.5 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.

### 32.6 Legal proceedings

During the year ended 31 December 2005 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.

*(in millions of Russian Roubles)*

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

### 32.7 Operating environment of the Group

Whilst there have been improvements in the economic trends in the country, 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.

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.

## 33 Principal subsidiaries

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

| Entity | Country of incorporation | Activity | 31 December 2005 % of total share capital | 31 December 2005 % of ordinary shares | 31 December 2004 % of total share capital | 31 December 2004 % 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 | 75 | 88 | 72 | 88 |
| OAO "Small Car Plant" | Russia | Manufacture and sale of passenger automobiles | 100 | 100 | - | - |
| OOO "UAZ-Metallurgia" | Russia | Manufacture and sale of metals products | 66 | - | - | - |
| OOO "UAZ-Autotrans" | Russia | Transport services | 66 | - | 66 | - |
| OOO "UAZ-Tekhinstrument" | Russia | Manufacture and sale of tooling equipment | 66 | - | - | - |
| OOO "ZMZ-Podshipniky Skolzheniya" | Russia | Manufacture and sale of bearings | 100 | - | 76 | - |
| OOO "RosALit" | Russia | Manufacture and sale of metals products | 75 | - | - | - |
| OOO "Zavod "Metalloform" | Russia | Manufacture and sale of metals products | 75 | - | 72 | - |
| OOO "Specinstrument" | Russia | Manufacture and sale of tooling equipment | 75 | - | 72 | - |
| OOO "ZMZ-Transservice" | Russia | Transport services | 75 | - | 72 | - |

OOO "ZMZ - Transservice", OOO "RosALit", OOO "Zavod "Metalloform", OOO "Specinstrument" are 100% owned by the Company's subsidiary OAO "ZMZ". OOO "UAZ – Autotrans", OOO "UAZ-Tekhinstrument" and OOO "UAZ-Metallurgia" are 100% owned by the Company's subsidiary OAO "UAZ". Share in OOO "ZMZ – Podshipniky Skolzheniya", OOO "ZMZ - Transservice", OOO "UAZ-Metallurgia", OOO "UAZ-Autotrans", OOO "UAZ-Tekhinstrument", OOO "RosALit", OOO "Zavod "Metalloform" OOO "Specinstrument" represent stockholders' stakes, not number of shares held.

During the year 2005 OAO "ZMZ" sold its share of 85% in OOO "Podshipniky Skolzheniya" to the Company. Respective portion of minority interest share of RUB 12 was transferred to retained earnings attributable to the Group.

## 34 Financial risks

### 34.1 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 other 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.

### 34.2 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 11% (for year ended 31 December 2004: 16%) of total revenue, most of these sales are denominated in hard currency. Net foreign currency receivables amount to RUB 416 (31 December 2004: RUB 168). Hence, the Group is exposed to the related foreign exchange risk primarily with respect to the U.S. Dollar. However, management believe that foreign exchange risk is not significant.

### 34.3 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 6% (see Note 14). The Group has mostly fixed rate interest bearing borrowings, however the Group has a long term loan with floating interest rate of Euro LIBOR (see Notes 16 and 22).

### 34.4 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 2005 and 31 December 2004 the carrying value of financial liabilities approximates their fair value, unless otherwise indicated in the respective notes to these consolidated financial statements.

At 31 December 2005 and 31 December 2004 the carrying value of financial assets and cash deposits approximates their fair value.

## 35 Post balance sheet events

On 15 February 2006 OAO "UAZ" announced a plan for staff reduction. The Group estimates termination costs of RUB 49 to be recorded following the announcement of the plan.

In February 2006 a further 5% of the Company's shares held by Newdeal Investments Limited was sold on the open market.