



**Joint Stock Company
Novolipetsk Iron and Steel Corporation**

Consolidated Financial Statements
as at and for the years ended
31 December 1999 and 1998

Contents

| | |
|---|---|
| Independent Auditor's report | 3 |
| Consolidated balance sheets | 4 |
| Consolidated statements of income | 5 |
| Consolidated cash flow statements | 6 |
| Consolidated statements of stockholders' equity and comprehensive income | 7 |
| Notes to the consolidated financial statements | 8 |



Independent Auditor's Report

Board of Directors
JSC Novolipetsk Iron and Steel Corporation

We have audited the accompanying consolidated balance sheets of JSC Novolipetsk Iron and Steel Corporation and its subsidiary ZAO Refrigerator Plant Stinol (jointly referred to as "the Company") as of 31 December 1999 and 1998 and the related consolidated statements of income, cash flows and stockholders' equity and other comprehensive income for the years then ended. The consolidated financial statements, as set out on pages 4 to 21, are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 audits provide a reasonable basis for our opinion.

In our report dated 5 November 1999, we expressed an opinion on the Company's 1998 consolidated financial statements and qualified for the Company's method of accounting for property, plant and equipment using Russian accounting principles and translated at rates other than historical exchange rates applicable on the date the transactions occurred. As described in note 1 (s), the Company has changed its method of accounting for these items and has restated its 1998 consolidated financial statements to conform with accounting principles generally accepted in the United States of America. Accordingly, our present opinion on the 1998 consolidated financial statements, as presented herein, is different from that expressed in our previous report.

As disclosed in note 1 (e) the consolidated financial statements include the JSC Novolipetsk Iron and Steel Corporation and its wholly owned subsidiary ZAO Refrigerator Plant Stinol. All other investments in subsidiaries and associates have been valued at cost less provisions for permanent diminution in value. Except in certain circumstances, accounting principles generally accepted in the United States of America require the Company to consolidate all subsidiaries, and investments in associates be accounted for under the equity method. Had all subsidiaries been consolidated and all investments in associates been accounted for under the equity method, in our opinion, net assets, retained earnings and net income would have been increased by less than 10% as of and for the years ended 31 December 1999 and 1998.

In our opinion, except for the effects of accounting for investments as discussed in the preceding paragraph, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of JSC Novolipetsk Iron and Steel Corporation and its subsidiary ZAO Refrigerator Plant Stinol as of 31 December 1999 and 1998 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

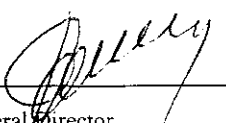
KPMG Limited


KPMG Limited
Moscow, Russian Federation
5 April 2001



Novolipetsk Iron and Steel Corporation
Consolidated balance sheets as at 31 December 1999 and 1998
(Thousands of US dollars)

| | Notes | 1999 | 1998 |
|--|-------|------------------|------------------|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | 2 | 11,824 | 16,214 |
| Trade accounts receivable (less provisions of 17,770 in 1999 and 30,246 in 1998) | 3 | 157,459 | 105,907 |
| Taxes and other receivables | | 28,285 | 21,559 |
| Inventories | 4 | 118,432 | 141,962 |
| Other current assets | | 14,919 | 22,474 |
| Total current assets | | 330,919 | 308,116 |
| Non current assets: | | | |
| Long term investments | | 20,807 | 19,074 |
| Property, plant and equipment (net of accumulated depreciation of 3,437,649 in 1999 and 3,305,561 in 1998) | 5 | 1,215,629 | 1,307,546 |
| Assets held for sale | 7 | 125,964 | 125,964 |
| Total non current assets | | 1,362,400 | 1,452,584 |
| Total assets | | 1,693,319 | 1,760,700 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable | | 38,706 | 52,612 |
| Accrued expenses | | 16,492 | 3,279 |
| Advance payments from customers | | 14,102 | 5,540 |
| Taxes and other payables | | 26,177 | 23,560 |
| Short term debt | 9 | 36,272 | 126,388 |
| Deferred tax liability | 8 | 46,848 | 31,842 |
| Total current liabilities | | 178,597 | 243,221 |
| Non-current liabilities: | | | |
| Long-term debt | 10 | 104,887 | 140,511 |
| Total liabilities | | 283,484 | 383,732 |
| Stockholders' equity: | | | |
| Cumulative preferred stock (one ruble par value; 1,999 shares authorized, issued and outstanding in 1999 and 1998) | | 5 | 5 |
| Common Stock (one ruble par value; 5,985,241 shares authorized and issued in 1999 and 1998; 5,979,447 and 5,985,241 outstanding in 1999 and 1998, respectively) | 11 | 14,435 | 14,435 |
| Additional paid-in capital | | 679 | - |
| Accumulated other comprehensive income | | 768 | - |
| Retained earnings | | 1,394,036 | 1,362,528 |
| Treasury stock (5,794 common shares at historical cost) | | (88) | - |
| Total stockholders' equity | | 1,409,835 | 1,376,968 |
| Total liabilities and stockholders' equity | | 1,693,319 | 1,760,700 |


 General Director
 Frantsevich I.V.


 Chief Accountant
 Sokolov A.A.

Novolipetsk Iron and Steel Corporation

*Consolidated statements of income for the years ended 31 December 1999 and 1998
(Thousands of US dollars)*

| | Notes | 1999 | 1998 |
|---|-------|------------------|--------------------|
| Net sales | | 965,929 | 1,344,309 |
| Costs and expenses: | | | |
| Cost of sales | | (549,543) | (883,680) |
| Depreciation | | (132,089) | (131,508) |
| Selling, general and administrative expense | | (22,993) | (81,839) |
| Taxes other than income taxes | | (27,200) | (97,714) |
| Total costs and expenses | | (731,825) | (1,194,741) |
| Income from operations | | 234,104 | 149,568 |
| Interest and other finance costs | | (19,779) | (37,312) |
| Interest and investment income (loss) | | (737) | 5,738 |
| Foreign exchange gain (loss), net | | (78,607) | (98,191) |
| Other income (expense), net | | 585 | (28,362) |
| Impairment of fixed assets | | (8,525) | (52,504) |
| Income (loss) from continuing operations before income taxes | | 127,041 | (61,063) |
| Income tax expense | 8 | (95,533) | 53,960 |
| Income (loss) from continuing operations | | 31,508 | (7,103) |
| Discontinued operations: | | | |
| Loss from operations of discontinued subsidiary, Stinol, (less applicable income taxes of \$721) | 7 | - | (2,574) |
| Loss on disposal of Stinol | 7 | - | (168,679) |
| Net income (loss) | | 31,508 | (178,356) |
| Income (loss) per share of common stock (basic and diluted): | | | |
| from continuing operations | | 0.005 | (0.001) |
| from discontinued operations | | - | (0.029) |
| net income | | 0.005 | (0.030) |

Novolipetsk Iron and Steel Corporation

Consolidated statements of cash flows for the years ended 31 December 1999 and 1998
(Thousands of US dollars)

| | 1999 | 1998 |
|--|------------------|------------------|
| Cash flows from operating activities | | |
| Net income (loss) | 31,508 | (178,356) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation | 132,089 | 131,508 |
| Gain on fixed assets disposal | (1,998) | - |
| Other provisions and write-offs | 1,047 | - |
| Impairment of fixed assets | 8,525 | 52,504 |
| Loss from discontinued operations | - | 171,253 |
| Changes in assets and liabilities | | |
| Decrease (increase) in trade accounts receivable | (51,552) | 179,765 |
| Decrease (increase) in taxes and other receivables | (6,726) | 64,230 |
| Decrease in inventory | 23,530 | 110,102 |
| Decrease in other current assets | 7,555 | 16,321 |
| Decrease in accounts payable | (13,906) | (139,563) |
| Increase (decrease) in accrued expenses | 13,213 | (3,780) |
| Increase (decrease) in taxes and other payables | 2,617 | (61,702) |
| Increase (decrease) in deferred tax liability | 15,006 | (124,733) |
| Increase (decrease) in advance payments from customers | 8,562 | (20,931) |
| Total adjustments | 137,962 | 374,974 |
| Net cash provided by operating activities | 169,470 | 196,618 |
| Cash flows from investing activities | | |
| Purchase of investments | (2,011) | 3,272 |
| Plant, property and equipment purchases | (52,835) | (71,511) |
| Proceeds from disposals of plant and equipment | 6,135 | 1,425 |
| Net cash used in investing activities | (48,711) | (66,814) |
| Cash flows from financing activities | | |
| Payments to acquire treasury stock | (88) | - |
| Recapture of unpaid dividends | 679 | - |
| Net movements in borrowings | (125,740) | (137,702) |
| Net cash used in financing activities | (125,149) | (137,702) |
| Net decrease in cash and cash equivalents | (4,390) | (7,898) |
| Cash and cash equivalents at beginning of year | 16,214 | 24,112 |
| Cash and cash equivalents at end of year | 11,824 | 16,214 |
| Disclosure of cash flow information | | |
| Cash paid during the year for: | | |
| interest paid (without interest capitalized) | 10,399 | 39,070 |
| income tax paid | 50,699 | 21,563 |

Novolipetsk Iron and Steel Corporation

Consolidated statements of stockholders' equity and comprehensive income for 1999 and 1998
(Thousands of US dollars)

| | Cumulative Preferred Stock | Common Stock | Additional Capital | Accumulated Deficit | Other Compre- hensive Income | Treasury Stock | Total Stockholders' Equity |
|---|----------------------------------|-----------------|-----------------------|------------------------|---------------------------------------|-------------------|----------------------------------|
| Balances at 31 December 1997 | - | 14,440 | - | 1,540,884 | - | - | 1,555,324 |
| Net loss | - | - | - | (178,356) | - | - | (178,356) |
| Shares issued in connection with Conversion of 295,176 Preferred B shares (note 11) | 5 | (5) | - | - | - | - | - |
| Sale of treasury stock | - | - | - | - | - | - | - |
| Balances at 31 December 1998 | <u>5</u> | <u>14,435</u> | <u>-</u> | <u>1,362,528</u> | <u>-</u> | <u>-</u> | <u>1,376,968</u> |
| Net income | - | - | - | 31,508 | - | - | 31,508 |
| Net unrealised change in investment securities | - | - | - | - | 768 | - | 768 |
| Comprehensive income | | | | | | | <u>32,276</u> |
| Recapture of unpaid dividends | - | - | 679 | - | - | - | 679 |
| Acquisition of 5,794 common shares | - | - | - | - | - | (88) | (88) |
| Balances at 31 December 1999 | <u>5</u> | <u>14,435</u> | <u>679</u> | <u>1,394,036</u> | <u>768</u> | <u>(88)</u> | <u>1,409,835</u> |

(1) Summary of significant accounting policies and practices

(a) Operations

OA O Novolipetsk Metallurgical Kombinat ("the Company") is a Russian open joint stock (public) company as defined by the Law on Joint Stock Companies of the Russian Federation. The Company was originally established as a state owned enterprise in 1934 and was reorganized into an open-type joint stock company on 28 January 1993 as a result of the privatization program enacted during that period. On 12 August 1998 the Company's name was reregistered as a public joint stock company in accordance with the Law on Joint Stock Companies of the Russian Federation.

The main activity of the Company is the production and sale of ferrous metals, primarily consisting of pig iron, steel slabs, hot rolled steel, cold rolled steel, cold rolled sheet with polymeric coatings. The Company's products are sold in both domestic and international markets.

The Company's main operations are in the Lipetsk region of the Russian Federation and subject to the legislative requirements of the Russian Federation and the Lipetsk regional authorities.

The Company has a wholly owned subsidiary, ZAO Refrigerator Plant Stinol ("Stinol" or "the Subsidiary"), which is a Russian closed joint stock company. Stinol commenced operations in 1993 as a division of the Company and was subsequently established as a subsidiary in November 1994. Stinol designs and manufactures refrigerators and freezers at a plant located in the city of Lipetsk. The refrigerators are sold primarily in the Russian Federation. During June 2000, the Company announced the sale of Stinol. As a result, the consolidated financial statements have been reclassified to segregate the net assets and operating results of the subsidiary. See additional information at note 7 in respect of discontinued operations.

The Company has other investments which are described at note 6.

(b) Russian business environment

The Russian Federation has been experiencing political and economic change which has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks, which do not typically exist in other markets.

The accompanying financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Company. The future business environment may differ from management's assessment.

(c) Basis of preparation

The accompanying financial statements of the Company have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. The Company's ability to realize its assets and settle its liabilities may have been adversely affected by the current economic environment. The accompanying financial statements do not include any adjustments should the Company ultimately be unable to continue as a going concern.

(d) Presentation of the financial statements

The Company maintains its books and records in accordance with accounting principles and practices mandated by Russian legislation ("RAP"), which differs significantly from generally accepted accounting principles in the United States of America ("US GAAP").

The financial statements presented have been transformed for US GAAP presentation from the Company's RAP basis financial statements as at and for the years ended 31 December 1999 and 1998 and adjusted to comply with US GAAP. However, investments are accounted for using the cost method only (see note 1(e)).

(e) Consolidation principles

These financial statements include the financial statements of JSC Novolipetsk Iron and Steel Corporation and the net assets of its wholly owned subsidiary Stinol, plus provisions for losses on the sale of Stinol. See additional information regarding the accounting for Stinol at note 7. All significant interdivisional and intercompany balances and transactions have been eliminated.

The Company does not consolidate its other subsidiaries, and investments in other subsidiaries and all affiliates have been valued at cost less provisions for permanent diminution in value, rather than under the equity method, since the cumulative impact of these subsidiaries and affiliates on the financial statements is considered to be relatively small (less than 10%).

(f) Foreign currency

The ruble is not a convertible currency outside the Russian Federation and accordingly any conversion of ruble amounts to US dollars should not be construed as a representation that ruble amounts have been, could, or will be converted or convertible into US dollars at the exchange rates used or at any other exchange rates.

These financial statements are presented in accordance with Statement of Financial Accounting Standards No. 52 "Foreign Currency Translation". For the purposes of these financial statements, the Company has used the US dollar as its functional currency. All monetary assets and liabilities have been converted into US dollars using the closing exchange rate as at the respective balance sheet dates of 31 December 1999 and 1998. Historical exchange rates have been used to translate all non-monetary assets and liabilities and income statement items to US dollars.

The Central Bank official exchange rate was 27 rubles to the US dollar at 31 December 1999 and 20.65 rubles to the US dollar at 31 December 1998. The annual weighted average exchange rate was 24.6 and 9.7 rubles to the US dollar for the years ended 31 December 1999 and 1998, respectively.

(g) Cash and cash equivalents

Cash and cash equivalents of \$11,824 and \$16,214 at 31 December 1999 and 1998 include highly liquid, short-term investments with original maturities of three months or less. For the purposes of cash flows, the Company considers all highly liquid debt instruments with maturities of three months or less to be cash equivalents.

(h) Trade accounts receivable

Receivables are stated net of a provision for doubtful accounts. Management quantifies this provision based on current information and events regarding the customers ability to repay their obligation. Payments of amounts previously written off are recognized as income thereafter.

(i) Inventories

Inventories are stated at the lower of cost (determined using a monthly weighted average) or market (net realizable value).

(j) Other current assets

Other current assets primarily consist of advances paid to suppliers, prepayments and other non trade receivables.

Advances paid to suppliers and prepayments are normally used to secure orders for raw materials and components used in production. The carrying value of advances and prepayments are stated net of any provision for amounts believed to be unrealizable.

(k) Property, plant and equipment

Property, plant and equipment ("PP&E") is carried at cost less adjustment for impairment and is depreciated using a straight line method based on the remaining economic useful life of the asset as required by US GAAP. The Company uses the following ranges for useful lives of property, plant and equipment:

| <u>Asset Class</u> | <u>Useful Life</u> |
|-------------------------|--------------------|
| Buildings | 20 – 45 years |
| Machinery and equipment | 2 – 40 years |
| Vehicles | 5 – 25 years |
| Software | 6 – 12 years |

Assets under construction include various construction projects and purchased machinery and equipment that is delivered but not yet installed. These assets are depreciated from the date they are placed in service.

(l) Net sales

Net sales are recognized when products are shipped to customers and the risks of ownership have passed.

(m) Income taxes

The Company does not file income tax returns on a consolidated basis. The statutory income taxation rate applicable to the Company was 30% beginning in April 1999. This rate was 35% in 1998 and in the first three months of 1999. Under Russian legislation, an operating loss may be used fully or partially in the five subsequent tax years to offset up to 50% of taxable profit in that year including tax concessions.

Income tax for the year comprises current and deferred tax. Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset should be recognised for all temporary differences to the extent that it is more likely than not that taxable profit will be available against which the deductible temporary differences can be utilized. When uncertainties exist regarding the realization of deferred tax assets, a valuation allowance is established to reduce the assets to their net realizable value.

(n) Barter transactions

The environment in Russia gives rise to numerous barter transaction agreements with customers and suppliers, in which a common element is identified and goods are shipped between the parties at an agreed market value, without physical movement of cash. The related sales and purchases are recorded in the same manner as cash transactions. Management estimates that approximately \$104,000 and \$300,000 of all the Company's 1999 and 1998 revenues, respectively, were received in the form of barter and they receive raw materials and other related production materials as settlement for finished goods shipments. Prices for goods sold and purchased through barter are fixed in the respective contracts and generally reflect current market prices.

(o) Pension and post retirement benefits other than pensions

The Company follows the Pension and Social Insurance legislation of the Russian Federation, which requires current contributions by the employer calculated as a percentage of current gross salary payments. Such contributions are charged to expense as incurred.

The Company also sponsors certain other pensions and post retirement benefits. All of these benefits are part of an annually negotiated Trade Union agreement. These benefits do not vest and may be canceled when the Trade Union agreement is negotiated annually. As such, all benefit payments are charged to expense as incurred and have not been accrued.

(p) Land ownership

The Company holds a perpetuity right to use land and pays annual land taxes. The Company also pays the municipal government rent payments on properties occupied by certain smaller divisions of the Company. Currently, there are no limitations on the period or usage of the land by the Company.

(q) Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make certain estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(r) Reclassifications

Certain prior year amounts have been reclassified to conform with current year presentation.

(s) Restatement of prior year financial statements

This is the first year that the Company has properly accounted under US GAAP for all information concerning the carrying value of property, plant and equipment and discontinued operations. As such the financial statements of prior years have been restated to apply this new information retroactively. These restatements have also had an impact on the prior year's financial statements for income tax purposes.

| | |
|--|------------------|
| Statement of income | 1998 |
| Income (loss) for 1998 before extraordinary item as reported in prior year | (439,392) |
| Adjustment to value of property, plant and equipment | 304,981 |
| Change in deferred tax | 124,734 |
| Discontinued operations | (168,679) |
| Net income (loss) as adjusted | (178,356) |
| Statement of retained earnings | 1998 |
| Balance as at 31 December 1997, as reported in prior year | 2,437,480 |
| Add adjustment for the cumulative effect on prior year of applying retroactively the new value of property, plant and equipment | (896,596) |
| Balance as at 31 December 1997, as adjusted | 1,540,884 |
| Net income for 1998 | (178,356) |
| Balance as at 31 December 1998 | 1,362,528 |

The Company had previously valued property, plant and equipment based on ruble value of fixed assets as at 31 December 1996 and translated using the exchange rate applicable on that date. Additions and disposals subsequent to this date have been recorded using exchange rates corresponding to the dates of transactions. The Company has now restated property, plant and equipment in accordance with US GAAP and these changes were applied retroactively.

The Company has recognized the disposal of its subsidiary Stinol as a discontinued operation based on a review of the Company's formal plan (Refer Note 7).

(2) Cash and cash equivalents

Cash and cash equivalents consist of the following:

| | 1999 | 1998 |
|-------------------------|---------------|---------------|
| Cash - rubles | 5,552 | 4,975 |
| Cash - foreign currency | 907 | 6,144 |
| Restricted cash | - | 4,816 |
| Other cash equivalents | 5,365 | 279 |
| Total | 11,824 | 16,214 |

Restricted cash recorded in 1998 comprised of deposits frozen in domestic banks. In the current year, many of these frozen deposits were offset against taxes payable, converted into government bonds and used for settlement on claims, which were specifically provided for as 50%.

(3) Trade accounts receivable

Trade accounts receivable consist of the following:

| | 1999 | 1998 |
|------------------------------|----------------|----------------|
| Trade accounts receivable | 175,229 | 136,153 |
| Provision for doubtful debts | (17,770) | (30,246) |
| Total | 157,459 | 105,907 |

(4) Inventories

Inventories consist of the following:

| | 1999 | 1998 |
|-----------------|----------------|----------------|
| Raw materials | 68,443 | 46,858 |
| Work in process | 23,281 | 14,149 |
| Finished goods | 12,747 | 18,023 |
| Supplies | 13,961 | 62,932 |
| Total | 118,432 | 141,962 |

(5) Property, plant and equipment

Property, plant and equipment consists of the following:

| | 1999 | 1998 |
|-------------------------------|------------------|------------------|
| Buildings | 486,607 | 474,589 |
| Machinery and equipment | 3,449,807 | 3,428,902 |
| Transport equipment | 87,952 | 87,165 |
| Construction in progress | 26,451 | 23,512 |
| Land | 198,340 | 198,402 |
| Other | 404,121 | 400,537 |
| Subtotal | 4,653,278 | 4,613,107 |
| Less accumulated depreciation | (3,437,649) | (3,305,561) |
| Total | 1,215,629 | 1,307,546 |

(6) Long term investments

The Company owns controlling and equity interests in various Russian and foreign entities. All investments in equity securities, with the exception of Stinol, have been accounted for at cost less any provisions for permanent diminution in value.

As none of the companies listed below are traded on Russian or international stock exchanges, it is not possible to obtain a reliable current market price for non-publicly traded investments. However, management believe the historical cost, net of any provisions for permanent diminution in value, approximates the fair value of the investment.

The Company's significant investments in equity securities and investments are summarized below as at 31 December 1999 and 1998 respectively:

| Name | Nature of Business | Type of Control | 1999 % Shareholding | 1998 % Shareholding |
|---|--------------------|-----------------|---------------------------|---------------------------|
| Open Stock Companies | | | | |
| AO "Stinol A.G." (Switzerland) | Metal sales | Subsidiary | 60% | 60% |
| AO "Novolipetsk Metallurg" Resort (Ukraine) | Resort | Subsidiary | 100% | 100% |
| OAO "Dolomite" (Russia) | Mining | Subsidiary | 59.1% | 59.1% |
| OAO "Studyonovskaya mining company " (Russia) | Mining | - | 15.68% | 15.68% |
| OAO "Lipetskoblغاز" (Russia) | Housing | - | 5.43% | 0% |
| OAO "Filit" (Russia) | Pipe production | - | 12% | 0% |
| OAO "KMA Ruda" (Russia) | Mining | - | 1.4% | 0% |

Novolipetsk Iron and Steel Corporation

Notes to the consolidated financial statements as at and for the years ended 31 December 1999 and 1998
(Thousands of US dollars)

| Name | Nature of Business | Type of Control | % Shareholding | % Shareholding |
|---|--------------------|-----------------|----------------|----------------|
| <i>Closed Stock Companies</i> | | | | |
| ZAO "Stalkonverst" (Russia) | Fishing | Affiliated | 37% | 37% |
| ZAO "Stinol Invest" (Russia) | Investing activity | Subsidiary | 99.5% | 99.5% |
| <i>Limited Liability Companies</i> | | | | |
| OOO LSO "Shans"(Russia) | Insurance | Subsidiary | 100% | 100% |
| OOO "Stal" (Russia) | Metal sales | Subsidiary | 100% | 100% |
| <i>Joint Activity</i> | | | | |
| Joint activity with municipal government | Housing | Joint Activity | 38% | 38% |
| OAO "Trest Lipetskstroy" (Russia) | Construction | Joint Activity | 14% | 14% |

(7) Discontinued operations

In June 2000, the Company signed a conditional agreement to sell its fully owned subsidiary Stinol which produces refrigeration units for the Russian market. Stinol was reported as a discontinued operation as at 31 December 1998, at which date the management were authorized and had developed a plan to formally dispose of the subsidiary within a period of one year.

Within the consolidated financial statements the subsidiary's net assets and operating results have been segregated. As at 31 December 1999 and 31 December 1998 the financial position of the discontinued operation was reported as assets held for sale. These assets were valued at \$125,964 which consisted of the agreed selling price of \$119,300 and intercompany balances payable to the parent company of \$6,664 as at 31 December 1999.

Summary results of the discontinued operations are as follows:

| | 1999 | 1998 |
|----------------------------|-----------|-----------|
| Revenues | 109,809 | 158,469 |
| Costs and expenses | (131,118) | (153,180) |
| Income (loss) before taxes | (21,309) | 5,289 |
| Income tax expense | (721) | (7,863) |
| Net loss | (22,030) | (2,574) |

The Company estimates that it will incur a profits tax charge of \$22,696 arising from the sale transaction, as the sale price is greatly in excess of the tax base of the investment.

(8) Income taxes

The following sets forth the tax effects of the temporary differences that gave rise to deferred tax assets and deferred tax liabilities:

| | 1999 | 1998 |
|---|-----------------|-----------------|
| Deferred tax assets | | |
| Accrued expenses | 805 | - |
| Accounts payable | 180 | - |
| Taxes and other payables | 85 | 111 |
| Inventory | 2,114 | 17,928 |
| Long-term investments | 709 | 1,357 |
| Trade and other receivables | - | 5,498 |
| Cash and cash equivalents | - | 97 |
| Tax losses carried forward | 14,485 | 26,553 |
| Total deferred tax assets | 18,378 | 51,544 |
| Deferred tax liabilities | | |
| Property, plant and equipment | (38,437) | (42,685) |
| Trade and other receivables | (4,093) | (16,192) |
| Accrued expenses | - | (517) |
| Interest payable | - | (1,296) |
| Total deferred tax liability | (42,530) | (60,690) |
| Net deferred tax liability | (24,152) | (9,146) |
| Deferred income tax due to disposal of Stinol | (22,696) | (22,696) |
| Deferred tax liability, total | (46,848) | (31,842) |

The following is a break down of the income tax expense:

| | 1999 | 1998 |
|---|---------------|-----------------|
| <i>Current tax expense</i> | | |
| | 76,700 | - |
| <i>Deferred tax expense</i> | | |
| Net movements in temporary differences | 19,930 | (76,656) |
| Reduction in tax rate | (1,097) | - |
| Deferred income tax due to disposal of Stinol | - | 22,696 |
| Total income tax expense | 95,533 | (53,960) |

Below is a reconciliation of the effective tax rate:

| | 1999 | 1998 |
|---|---------------|-----------------|
| Income (loss) before income tax | 127,041 | (7,103) |
| Expected tax at statutory rate of 30% in 1999 and 35% in 1998 | 38,112 | (2,486) |
| Increase (reduction) in income tax due to: | | |
| Non-deductible items | 62,345 | (3,396) |
| Foreign currency exchange and translation differences | (3,827) | (70,774) |
| Effect of tax rate changes on temporary differences carried forward | (1,097) | - |
| Deferred income taxes due to disposal of Stinol | - | 22,696 |
| Income tax expense (benefit) | 95,533 | (53,960) |

(9) Short term debt

| | 1999 | 1998 |
|-----------------------------------|---------------|----------------|
| Principal balance | 28,748 | 78,547 |
| Interest payable | 387 | 3,704 |
| Current portion of long term debt | 7,137 | 44,137 |
| Total | 36,272 | 126,388 |

As at 31 December 1999, short term debt consisted of one credit line which is used to finance the Company's current operating activities. The credit limit is \$150,000 and the average interest rate was 15% during 1999. The credit line is denominated in US dollars and the Company is required to apply US currency proceeds received from specific export sale contracts against the balance to ensure the debt is serviced. The credit agreement stipulates that the Company must pledge portions of its inventories which amounted to approximately \$42,000. In March 2000, the balance was paid off.

(10) Long term debt

The debt has the following general characteristics:

| | 1999 | 1998 |
|----------------------------------|----------------|----------------|
| Principal balance | 103,137 | 184,648 |
| Amounts maturing within one year | (7,137) | (44,137) |
| Interest accrued | 8,887 | - |
| Long term portion | 104,887 | 140,511 |

The Company borrowed funds from a Russian lender to finance the construction of the Stinol production plant. Subsequent to a dispute, the original Russian lender took legal action against the Company to recover the principal and outstanding interest. The interest accrued for 1998 was included into the principle balance as of 31 December 1998. The amount of interest accrued will be paid after the principal repayment. During 1999, the loan was transferred to a foreign company (a related party, one of the Company's shareholders), and the interest rate was reduced from 10.8% to 8%. The loan is to be paid off in equal installments from March 1999 to December 2002.

As part of the agreement, the Company was required to pledge as security the share capital of Stinol. As at the date of these financial statements, Stinol's share capital had not been formally pledged. The loan is unsecured as no other means of security has been established.

(11) Share capital

(a) Shares

The Company has 5,987,240 shares issued at year end with a par value of 1 ruble. Of these shares, 1,999 are preferred B shares. The holder of the preferred B shares is the Russian Fund of Federal Property which during the course of 1998 disposed of 295,176 preferred B shares to various parties. When the fund disposes of the preferred shares, the shares automatically convert to common shares.

(b) Voting rights, privileges and liquidation

All common shares have voting rights. The preferred shares do not have voting rights, except in situations concerned with the re-organization and liquidation of the Company, changes and amendments to the Charter Documents that restrict their rights and in other cases stipulated by the effective Russian legislation.

Upon liquidation of the Company all creditors requests are to be satisfied, property is to be sold through auction and any remaining proceeds should be distributed proportionally between preferred and common stockholders.

(c) Dividends

Dividends may be paid on common shares at the recommendation of the Board of Directors and approval at the annual shareholders meeting, subject to certain limitations as determined by Russian legislation. From 1993 to 1997 the preferred stock class B shareholders were paid dividends (20% of the nominal value). Based on decisions of the shareholders meetings, no dividends have been paid since 1993.

(d) Treasury stock

During 1999, the Company repurchased 5,794 shares of its common stock for a total consideration of \$88. These shares were purchased from individual shareholders including some employees. In year 2000 these shares were sold.

(e) Retained earnings

The Company was privatized from a state owned entity during 1993. Retained earnings consist of the cumulative earnings and losses since its inception as a private entity.

(12) Concentration of significant risks

The Company exports approximately 66% (1998: 73%) of its metal production to overseas markets. The Company's major export markets are North America - 16% (1998: 47%), Asia - 33% (1998: 22%) and the European Union - 19% (1998: 15%). The Company relies on export sales to generate foreign currency earnings which are used to service foreign currency denominated debt. As the Company exports the majority of its production, it is exposed to global economic and political events.

During the past several years, the Company has been involved in several anti-dumping investigations. The most significant of which were in the US and Canada (see note 14(a)).

The Company has two international customers that account for the majority of its export sales. Paragale Trading Limited and Mildmay S.A. each accounted for in excess of 10% of the Company's 1999 and 1998 export sales. ZAO Vimet accounted for in excess of 10% of the Company's 1999 and 1998 domestic sales. No other individual customer accounted for in excess of 10% of the Company's export or domestic sales during 1999 or 1998.

The majority of the Company's workers (approximately 96%) are covered by a Trade Union agreement which is negotiated annually. Significant disagreements with the Trade Union and industrial action have been historically rare and management do not consider disruption caused by labor disputes to be a significant risk to the Company.

(13) Financial instruments

The carrying amount of cash and cash equivalents approximates fair value because of the short term nature of these instruments.

The carrying amounts for trade accounts receivable, taxes receivable, advances, accounts payable and taxes payable are reasonable estimates of fair value due to the short term nature of the associated transactions.

(14) Related party transactions

The Company had the following related parties transactions in 1999 and 1998:

| | 1999 | 1998 |
|---------------------------|----------------|---------------|
| Sales of goods | 5,068 | 4,512 |
| Purchases | | |
| Purchase of raw materials | 118,082 | 34,175 |
| Purchase of services | 1,724 | 3,510 |
| Total purchases | 119,806 | 37,685 |

As at 31 December 1999 and 1998, the Company had the following balances with the related parties:

| | 1999 | 1998 |
|---|--------------|--------------|
| Accounts receivable and advances paid | | |
| Trade receivables | 537 | 47 |
| Advances paid | 725 | 1,710 |
| Total accounts receivable and advances paid | 1,262 | 1,757 |
| Accounts payable and advances received | | |
| Trade payables | 6,460 | 3,668 |
| Advances received | 59 | - |
| Other | 5 | - |
| Total accounts payable and advances received | 6,524 | 3,668 |

(15) Commitments and contingencies

(a) Anti-dumping actions against the Company

The Company's exports of rolled steel are being considered within several anti-dumping investigation frameworks.

The Company has taken steps to prevent and settle anti-dumping investigations and participates in the settlement of trade disputes as coordinated through the Russian authorities.

No adjustment or provision arising from any negotiations or agreements have been made in the accompanying financial statements.

(b) Litigation

The Company, in the common course of business, is the subject of, or party to, various pending or threatened legal actions. The management of the Company believes that any ultimate liability resulting from legal action will not have a material effect on its financial position or results of operations.

(c) Environmental matters

Management is of the opinion that the Company has met the government's federal and regional requirements concerning environmental matters, and therefore believes that the Company does not have any current material environmental liabilities.

Currently, there is no material legislation in Russia regarding environmental damages or restrictions on the Company's activities as a result of environmental concerns.

(d) Insurance matters

The Russian insurance industry is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available in the Russian Federation. The Company has purchased coverage for plant and equipment. This insurance does not include coverage for auxiliary production, administrative and production buildings or coverage for business interruption.

The Company has also purchased limited coverage for environmental and third party liability and health insurance for its employees. Until the Company obtains adequate insurance coverage, there is a risk that uninsured losses could have a certain adverse effect on the Company's operations. Management strives to insure the Company's assets and operations with financially reliable and reputable insurance companies within the industry.

(e) Taxation contingencies

The taxation system in the Russian Federation is relatively new and is characterised by numerous taxes and frequently changing legislation. Often, differing interpretations exist among numerous taxation authorities and jurisdictions. Taxes are subject to review and investigation by a number of authorities, who are enabled by law to impose severe fines, penalties and interest charges.

These facts may create tax risks in Russia substantially more significant than in other countries. Management believes that it has adequately provided for tax liabilities based on its interpretation of tax legislation.

(f) Capital, sales and purchase commitments

In the normal course of business the Company enters into long-term purchase contracts for raw materials, and long-term sales contracts. These contracts allow for variations in the quantities and types of goods, as well as for periodic adjustments in prices dependent on prevailing market conditions.

The Company has developed a Technical Reequipment Program. According to this Program, the projected investments from 2000 till 2005 in assets for the main production and environmental assets amount to USD 1,105 mln.

(g) Social commitments

The Company makes contributions to mandatory and voluntary social programs. The Company's social assets, as well as local social programs, benefit the community at large and are not normally restricted to the Company's employees. The Company has transferred certain social operations and assets to local authorities; however, management expects that the Company will continue to fund these social programs through the foreseeable future. These costs are recorded in the year they are incurred.