

**ОАО БАЛТИКА BREWERY
AND SUBSIDIARIES**

Consolidated Financial Statements

December 31, 2003 and 2002

**OAO BALTIKA BREWERY
AND SUBSIDIARIES**

Consolidated Financial Statements and Independent Auditors' Report
December 31, 2003 and 2002

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Independent Auditors' Report

The Board of Directors of OAO Baltika Brewery Group:

We have audited the accompanying consolidated balance sheets of OAO Baltika Brewery and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for the years then ended. These consolidated financial statements, as set out on pages 2 to 26, 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 opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO Baltika Brewery and subsidiaries as of December 31, 2003 and 2002, the results of their operations, shareholders' equity and comprehensive income and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

ZAO KPMG
St. Petersburg, Russian Federation
March 4, 2004

**OAO BALTIKA BREWERY
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Consolidated Balance Sheets

December 31, 2003 and December 31, 2002

(in thousands U.S. dollars)

Assets	2003	2002
Current assets:		
Cash and cash equivalents	\$ 27,429	12,844
Trade accounts receivable, net (note 2)	26,031	7,024
Loans receivable, net (note 3)	-	110
Inventories (note 4)	68,583	58,583
Net investments in direct financing and sales-type leases (note 5)	2,426	-
Prepayments and other receivables (note 6)	62,778	72,251
Total current assets	<u>187,247</u>	<u>150,812</u>
Investment securities (note 7)	291	310
Investments in affiliated companies (note 8)	10,765	8,042
Loans receivable, net (note 3)	150	10,408
Net investments in direct financing and sales-type leases (note 5)	2,390	-
Property, plant and equipment net (note 9)	657,839	525,688
Intangible assets	957	668
Total assets	<u>\$ 859,639</u>	<u>695,928</u>
Liabilities and Shareholders' Equity		
Current Liabilities:		
Trade accounts payable	\$ 30,270	33,136
Short-term debt including current installments of long-term debt (note 11)	76,465	69,766
Current installments of obligations under capital leases (note 12)	3,659	-
Accrued salaries, wages and benefits	11,944	15,914
Accrued taxes	22,912	10,768
Other liabilities	3,273	4,073
Due to related parties (note 18)	3,189	902
Total current liabilities	<u>151,712</u>	<u>134,559</u>
Long-term debt, excluding current installments (note 10)	8,326	10,000
Obligations under capital leases, excluding current installments (note 12)	6,082	-
Deferred income taxes	32,867	2,934
Total liabilities	<u>198,987</u>	<u>147,493</u>
Shareholders' equity (note 15):		
Preference shares	2,965	2,965
Ordinary shares	23,872	23,872
Additional paid-in capital	40,068	40,068
Retained earnings	564,263	481,151
Treasury shares	(1,349)	(759)
Other comprehensive income	30,833	1,138
Total shareholders' equity	<u>660,652</u>	<u>548,435</u>
Commitments and contingencies (note 17)		
Total liabilities and shareholders' equity	<u>\$ 859,639</u>	<u>695,928</u>

See accompanying notes to consolidated financial statements.

Ekaterina Azimina

Director on finance and economy

Sergei Alexeev

Chief accountant

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Consolidated Statements of Income For the
Years Ended December 31, 2003 and 2002
(in thousands U.S. dollars, except per share data)

	<u>2003</u>	<u>2002</u>
Sales	\$ 805,244	736,806
Excise taxes	<u>(67,999)</u>	<u>(54,146)</u>
Net sales	737,245	682,660
Cost of goods sold	<u>397,298</u>	<u>341,711</u>
Gross profit	339,947	340,949
Selling, general and administrative expenses	<u>171,414</u>	<u>150,374</u>
Operating income	168,533	190,575
Other income (expense)		
Equity in income of affiliates	1,377	2,400
Interest income	993	4,795
Interest expense (note 13)	(2,240)	(1,172)
Other expense, net	(3,163)	(2,210)
Foreign currency income/(loss)	<u>5,047</u>	<u>(3,691)</u>
Income before income taxes and minority interest	170,547	190,697
Income taxes (note 14)	<u>47,407</u>	<u>37,952</u>
Income before minority interest	<u>123,140</u>	<u>152,745</u>
Minority interest	<u>-</u>	<u>12,954</u>
Net income before cumulative effect of a change in accounting principle	<u>123,140</u>	<u>139,791</u>
Cumulative effect on prior years of retroactive application of depreciation for kegs	-	(2,737)
Net income	<u>\$ 123,140</u>	<u>137,054</u>
Basic earnings per share before cumulative effect of accounting change	1.01	1.20
Accounting change	<u>-</u>	<u>(0.02)</u>
Basic earnings per share (note 19)	<u>1.01</u>	<u>1.18</u>
Diluted earnings per share before cumulative effect of accounting change	1.01	1.20
Accounting change	<u>-</u>	<u>(0.02)</u>
Diluted earnings per share (note 19)	<u>1.01</u>	<u>1.18</u>

See accompanying notes to consolidated financial statements.

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Consolidated Statement of Shareholders' Equity and Comprehensive Income For the
Years Ended December 31, 2003 and 2002
(in thousand U.S. dollars)

	Preference shares	Ordinary shares	Additional paid-in capital	Retained earnings	Treasury shares	Other comprehensive income (loss)	Total shareholders equity
Balances at January 1, 2002	\$ 2,963	23,530	-	370,097	(463)	-	396,127
Net income				137,054			137,054
Net treasury stock acquired					(296)		(296)
Shares issued	2	342	40,068				40,412
Translation adjustments - other						1,138	1,138
Dividends declared							
Preference shares				(3,639)			(3,639)
Ordinary shares				(22,361)			(22,361)
Balances at December 31, 2002	\$ 2,965	23,872	40,068	481,151	(759)	1,138	548,435
Net income				123,140			123,140
Net treasury stock acquired					(590)		(590)
Translation adjustment related to change in functional currency (note 14)						(16,080)	(16,080)
Translation adjustments - other						45,775	45,775
Dividends declared							
Preference shares				(5,231)			(5,231)
Ordinary shares				(34,797)			(34,797)
Balances at December 31, 2003	\$ 2,965	23,872	40,068	564,263	(1,349)	30,833	660,652

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows For the
Years Ended December 31, 2003 and 2002
(in thousand U.S. dollars)

	<u>2003</u>	<u>2002</u>
Net cash provided by operating activities (note 16)	191,588	160,830
Cash flows from investing activities:		
Capital expenditures	(150,810)	(188,263)
Acquisition of subsidiary net of cash acquired	(499)	-
Proceeds on disposal of fixed assets	1,044	141
Purchase of investment securities	41	98
Dividends received	372	-
Financing provided under sales and lease back transactions	(6,032)	-
Principle payments received under leases	1,215	-
Purchase of bank promissory notes	(2,142)	(1,338)
Net change in loans made to third parties	10,748	34
Net cash used in investing activities	<u>(146,063)</u>	<u>(189,328)</u>
Cash flows from financing activities:		
Bank indebtedness	1,436	58,486
Dividends paid	(40,304)	(25,915)
Dividends paid to minority	-	(3,347)
Proceeds from operations with treasury shares	(509)	(296)
Proceeds from leased-back transactions	12,404	-
Principal payments under capital lease obligations	(2,498)	-
Proceeds from long-term borrowings	2,326	14,000
Repayments of long-term borrowings	(4,000)	(18,000)
Net cash (used in)/provided by financing activities	<u>(31,145)</u>	<u>24,928</u>
Translation difference	205	-
Increase/(decrease) in cash and cash equivalents	14,585	(3,570)
Cash and cash equivalents, beginning of year	12,844	16,414
Cash and cash equivalents, end of year	<u>\$ 27,429</u>	<u>12,844</u>

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

December 31, 2003 and 2002

(1) Summary of Significant Accounting Policies and Practices

(a) Description of Business

OAO Baltika Brewery (the "Company") is an open joint-stock company incorporated under Russian legislation and was registered on 21 July 1992, and through a controlling interest in four companies and four branches (referred to collectively as the "Group"), produces and distributes beer and mineral water.

The Company's ordinary shares are 81% owned and controlled by Baltic Beverages Holding AB. The remainder of the ordinary shares are widely held.

The Company's preference shares are 16% owned and controlled by Baltic Beverages Holding AB. The remainder of the preference shares are widely held.

As at reporting period end the Group consists of five production plants: Baltika-Saint-Petersburg, Baltika-Tula, Baltika-Rostov, Baltika-Samara and Baltika-Khabarovsk and four subsidiaries: OOO Baltika-Moscow, OOO Leasing-Optimum, OOO Universaloptorg and Baltika Deutschland GmbH.

Most of the Group's customers are located in Russia. The Group's raw materials are readily available, and the Group is not dependent on a single supplier or only a few suppliers.

(b) Effects of the Russian business environment on activities in Russia

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 Baltika Brewery and subsidiaries.

(c) Convertibility of the Rouble

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

(d) Functional and reporting currency

Prior to 2003 Russian economy was considered to be hyperinflationary under Statement of Financial Accounting Standard No. 52 (SFAS 52) "Foreign Currency Translation", the Group elected to use the US Dollar as the functional and reporting currency for financial statement purposes.

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Monetary assets and liabilities denominated in roubles at the balance sheet date were translated to US dollars at the exchange rate ruling at that date. Foreign exchange differences arising on translation were recognised in the income statement. Non-monetary assets and liabilities denominated in roubles, which are stated at historical cost, were translated to US dollars at the foreign exchange rate ruling at the date of the transaction. Income statement transactions in foreign currencies were translated to US dollars with application of period weighted average rate approximating the foreign exchange rate ruling at the date of the transaction.

Starting January 1, 2003 the Russian economy was no longer considered to be hyperinflationary under Statement of Financial Accounting Standard No. 52 "Foreign Currency Translation". Accordingly the Group has conducted an assessment of its operations and determined the Russian Rouble to be its functional currency. Management of the Group have elected to use US Dollar as the reporting currency for these financial statements.

As a result of the change in the functional currency to the rouble, the carrying values of all non-monetary assets and equity items were translated and fixed in Russian Rouble at the rates effective at the date of transition to the Russian Rouble as the functional currency, January, 1, 2003, and all subsequent additions to non-monetary assets and equity, accounted for using Russian Rouble as the functional currency.

Further translation from functional currency to reporting currency for the 2003 financial statements was conducted as follows:

All assets and liabilities are translated from functional currency to reporting currency at the exchange rate effective at the reporting date.

Equity items are translated from functional currency to reporting currency at the historical exchange rate. Translation adjustments arising from translation of equity are included in Accumulated Other Comprehensive Income in accordance with SFAS 52.

Income statement transactions are translated from functional to reporting currency with application of period weighted average rate approximating the rate, ruling at the dates of the transactions. Translation adjustments arising from translation of equity are included in Accumulated Other Comprehensive Income in accordance with SFAS 52.

The closing rate of exchange effective at December 31, 2003 and 2002 was 1 USD to 29.45 Roubles and 1 USD to 31.78 Roubles, respectively.

(e) Principles of Consolidation

Subsidiary companies are those companies in which the Company directly or indirectly holds more than 50% of the voting rights and is able to exercise control. Subsidiary companies have been fully consolidated from the date the Company acquired control. Minority interests in the income and assets and liabilities of the subsidiaries are disclosed separately.

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As at December 31, 2003, the subsidiary companies which are included in the consolidation, consist of the following:

Name	Nature of Business	Country of Incorporation	Ownership
ООО Baltika-Moscow	Distribution of Baltika beer	Russia	100.00%
ООО Leasing-Optimum	Leasing	Russia	100.00%
ООО Universalopttorg	Warehouse	Russia	100.00%
Baltika Deutschland GmbH	Distribution of Baltika beer	Germany	100.00%

ООО Universalopttorg (Voronezh) is an entity that owns a warehouse and office building in Voronezh and derives its revenues from letting these premises to the Company. ООО Universalopttorg was acquired by the Group in June, 2003 for approximately \$499 th.

Associated companies are those companies over which the Group can exercise significant influence, but which it cannot control. Associated companies are accounted for by the equity method. As at December 31, 2003, the only associated company is a company founded in conjunction with the Soufflet group - ZAO Malterie Soufflet Saint-Petersburg (Soufflet). This company produces malt.

(f) Cash Equivalents

Cash equivalents of \$27,429 th. and \$12,844 th. at December 31, 2003 and December 31, 2002, respectively, consist of bank balances and short-term certificates of deposit held in local banks. For purposes of the consolidated statements of cash flows, the Group considers all short-term deposits to be cash equivalents.

(g) Loans Receivable

Loans receivable are recorded at cost, less the related allowance for impaired loans receivable. Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Group will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate. Impairment losses are included in the allowance for doubtful accounts through a charge to bad debt expense.

(h) Inventories

Inventories are stated at the lower of cost or market value. Cost is determined using the weighted average method for all inventories.

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(i) Investment Securities

Investment securities at December 31, 2003 consist of equity securities. The Group classifies its equity securities as available-for-sale.

Available-for-sale securities are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis.

A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related available-for-sale security as an adjustment to yield using the effective interest method.

(j) Investments in Affiliated Companies

Investments in the common stock of affiliated companies are accounted for by the equity method.

(k) Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation on plant and equipment is calculated on the straight-line method over the estimated useful lives of the assets as follows.

Asset	Estimated useful lives
Buildings	40 years
Construction	25-50 years
Machinery and equipment	6-10 years
Trucks	6 years
Other	5-10 years

(l) Leased assets

Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as capital leases. Plant and equipment acquired by the way of capital lease is stated at an amount equal to the lower of its fair value or the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses (refer to note (1)(q)).

Payments for operating leases, under which the Group does not assume substantially all the risks and rewards of ownership, are expensed in the period they are incurred.

(m) Investments in direct financing and sales-type leases

Leases where the Group transfers substantially all the risks and rewards incident to ownership of an asset to the lessee are classified either as direct financing or sales-type leases. A net investment in

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direct financing and sales-type leases at an amount equal to the present value of the lease payments, including any guaranteed residual value, is recognised.

The difference between the gross receivable and the present value of the receivable is unearned finance income and is recognised over the term of the lease using the effective interest rate method.

(n) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(o) Pension and Other Postretirement Plans

The Company and its subsidiaries make contributions to the Pension Fund of the Russian Federation as required by Russian law. The contributions amount to 21% of gross salaries and are expensed as incurred.

(p) Use of Estimates

Management of the Group has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

(q) Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

Long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognised by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Goodwill and intangible assets not subject to amortization are tested annually for impairment. An impairment loss is recognised to the extent that the carrying amount exceeds the asset's fair value.

(r) Revenue Recognition

The Group recognizes revenue on sales when products are shipped and the customer takes ownership and assumes risk of loss. Revenues are stated net of value-added taxes charged to customers.

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During 2003 the Company has changed terms of dealing with customers in relation to returnable packaging (bottles). As a result of these changes the Company does not have an obligation to take back the dispatched bottles.

Following the change in underlying circumstances of dealing with bottles the Company included the sold bottles into revenue and costs of goods sold. In 2003 the amounts included in revenue and costs of goods sold comprised USD 27,038 th. and USD 26,429 th. respectively.

(s) *Commitments and Contingencies*

A considerable degree of uncertainty currently exists in the Russian Federation with regard to the direction of domestic economic policy, regulatory policy and political developments. Group management is unable to predict what changes in conditions may occur and what effect such changes may have on the financial statements.

As Russian commercial legislation, and tax legislation in particular, contains provisions which can be interpreted in more than one way, and due to the tax authorities' practice, as developed in a generally unstable environment, of arbitrarily judging business activities and arbitrarily classifying enterprises' activities where the regulatory basis for such a decision is insufficient, management's judgment of the Group's business activities may not coincide with the tax authorities' interpretation of these same activities.

Management is not currently aware that any situations exist which may be challenged by the tax authorities which have not already been reflected in the financial statements. However, if a particular treatment was to be challenged by the tax authorities, significant penalties may be imposed on the Group. Although the actual amount of tax due on a transaction may be minimal, penalties can be charged at 20% of the value of the outstanding tax amount and also include interest accrued thereon at 1/300 of Central Bank of Russia interest rate per day.

The Group is affected by political, legislative, fiscal and regulatory developments in Russia and also to physical risks of various kinds. The nature and frequency of the developments and risks, which are not covered by insurance, as well as their effect on the future operation and earnings are not predictable. The occurrence of significant losses and impairments associated with facilities could have a material effect on the Group's operations and no provisions for self-insurance to cover such items are incorporated into these financial statements.

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(2) Trade Receivables

Trade receivables at December 31, 2003 and December 31, 2002 consist of the following:

	2003	2002
Trade receivables	\$ 27,392	7,368
Less: allowance for doubtful debts	(1,361)	(344)
	\$ 26,031	7,024

(3) Loans Receivable

Loans receivable at December 31, 2003 and December 31, 2002 consist of the following:

	2003	2002
Current:		
Other loans receivable	-	110
	\$ -	110
Long-term:		
Loan receivable from OAO Krinita	\$ 150	10,408
	\$ 150	10,408

(4) Inventories

Inventories are stated at the lower of cost or market value and are calculated using the weighted-average method. Inventory consists of the following:

	2003	2002
Raw materials and supplies	\$ 47,738	40,634
Work in progress	7,376	6,894
Finished goods	13,469	11,055
	\$ 68,583	58,583

(5) Net Investment in Direct Financing and Sales-Type Leases

The Group's leasing operations consist of leasing of certain machinery and equipment to several companies. The Group's leases are classified as direct financing leases. During 2003 the Group leased out to Vena, a company, with which the Company have a Parent in common, machinery and equipment with a carrying value of \$5,064 th. The contract expires within the next two years.

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The following lists the components of the net investment in direct financing and sales-type leases as of December 31, 2003:

Year ending December 31	2003
Total minimum lease payments to be received	\$ 5,134
Less: Allowance for uncollectibles	-
Net minimum lease payments receivable	5,134
Less: Unearned income (at rates approximating LIBOR+ 5%)	(318)
Net investment in direct financing and lease-type leases	4,816
Less current installments of lease payments	(2,426)
Net investments in direct financing and lease-type leases, excluding current installments	\$ 2,390

(6) Prepayments and other receivables

Prepayments and other receivables at December 31, 2003 and December 31, 2002 consist of the following:

	2003	2002
VAT receivable	\$ 40,978	39,948
Profit tax receivable	1,036	14,044
Advances to suppliers	9,596	8,728
Bank promissory notes	6,795	4,228
Other	4,373	5,303
	\$ 62,778	72,251

(7) Investment Securities

Investment securities at December 31, 2003 consist of equity securities in Bin Bank and as at December 31, 2002 in Bin Bank and Menatep Bank. Shares of Menatep Bank were sold by the Company in September 2003. All investment securities are classified as available-for-sale.

(8) Investments in Affiliated Companies

Investments in affiliated companies consist of 30% of the common stock of Soufflet, malt producing company. This investment has been accounted for under the equity method.

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(9) Property, plant and equipment

Property and equipment at December 31, 2003 and December 31, 2002 consists of the following:

	<u>2003</u>	<u>2002</u>
Buildings	\$ 172,346	107,300
Machinery and equipment	592,158	368,020
Kegs	18,558	12,336
Construction in progress	67,941	165,084
Less: accumulated depreciation	(193,164)	(127,052)
	<u>\$ 657,839</u>	<u>525,688</u>

Property and equipment includes production equipment amounting to \$42,716 th. and \$46,908 th. (by net book value) at December 31, 2003 and December 31, 2002 respectively that has been pledged under a long term loan agreement with the EBRD.

(10) Long-Term Debt

Long-term debt at December 31, 2003 and December 31, 2002 consists of the following:

	<u>2003</u>	<u>2002</u>
Borrowings under financing agreement with EBRD, payable each six months, principal due May 2006	\$ 10,034	14,012
Borrowings under financing agreement with Credit Lyonnais S.A.	\$ 2,335	-
Total long-term debt	<u>12,369</u>	<u>14,012</u>
Less current installments	<u>(4,043)</u>	<u>(4,012)</u>
Long-term debt, excluding current installments	<u>\$ 8,326</u>	<u>10,000</u>

EBRD loan represents revolving credit facility with the loan amount not exceeding \$14,000 th. Under the terms of the EBRD borrowing agreement the Group is required to follow the specified levels of cash flow in relation to the amounts borrowed in order to be able to declare or pay dividends, distribute any of its share capital, purchase, redeem or acquire any of its shares, or make any payment of principal on any subordinated debt.

In July 2003 the Group signed a financing agreement with Credit Lyonnais S.A. Under which the Group was granted a credit line to partially finance the eligible commercial contracts. The terms of the credit facility are determined for each individual withdrawal. The credit line should not exceed \$30,000 th.

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As of December, 31 2003 the liability represents a loan received to finance the purchase of the equipment for the malt production in the amount not exceeding Euro 7,179 th. to be repaid in US dollars. The loan is to be repaid in 10 semi-annual instalments commencing in six months after the date of provisional acceptance of malt production equipment and at the latest on June 30, 2004.

The weighted average interest rate for long-term debt as at December 31, 2003 comprises LIBOR interest plus 2.15% per annum.

(11) Short-term debt including current instalments of long-term debt

Short-term debt at December 31, 2003 and December 31, 2002 consists of the following:

	<u>2003</u>	<u>2002</u>
Current portion of long-term debt	\$ 4,043	4,012
Short term loans payable	<u>72,422</u>	<u>65,754</u>
Short-term debt, including current instalments of long-term debt	<u>\$ 76,465</u>	<u>69,766</u>

As at December 31, 2003 an amount of \$72,422 th. has been drawn at interest rates equal LIBOR plus margin varying from 2.1% to 2.5% on US dollar denominated loans and 11% on rouble denominated loans.

(12) Obligations under capital leases

The Group is obligated under capital lease covering certain machinery and equipment that expire within the next three years. At December 31, 2003 and December 31, 2002 the gross amount of plant and equipment and related accumulated amortisation recorded under capital leases were as follows:

	<u>2003</u>	<u>2002</u>
Machinery and equipment	\$ 10,709	-
Less accumulated amortization	<u>(452)</u>	<u>-</u>
	<u>\$ 10,257</u>	<u>-</u>

Amortization of assets held under capital leases is included with cost of goods sold.

Future minimum capital lease payments as of December 31, 2003 are:

<u>Year ending December 31</u>	<u>2003</u>
2004	\$ 4,193
2005	3,964

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2006		2,496
Later years		-
Total minimum lease payments		10,653
Less: amount representing interest (at rates approximating LIBOR+ 5%)		(912)
Present value of net minimum capital lease payments		9,741
Less current installments of obligations under capital leases		(3,659)
Obligations under capital leases, excluding current installments	\$	6,082

(13) Interest expense

The Group capitalizes interest cost as a component of the cost of construction in progress. The following is a summary of interest cost incurred during years 2003 and 2002:

		2003	2002
Interest cost capitalized	\$	1,310	440
Interest cost charged to income		2,240	1,172
Total interest cost incurred	\$	3,550	1,612

(14) Income Taxes

Income tax expense attributable to income from continuing operations consists of:

		Current	Deferred	Total
Year ended December 31, 2003	\$	35	11,850	47,407
Year ended December 31, 2002	\$	33	4,787	37,952

The Group's applicable tax rate for the year 2003 and 2002 is the corporate income tax rate of 24.00%.

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Due to the fact that starting January 1, 2003, the economy of the Russian Federation ceased to be considered highly inflationary (see note (1) (d)) the differences between the new rouble functional currency basis and the tax basis represent temporary differences, for which additional deferred taxes liability of \$16,080 th. as of January 1, 2003 is recognized. The effects of recognizing such deferred taxes were included as an adjustment to accumulated other comprehensive income, a component of stockholders' equity.

Reconciliation of effective tax rate:

	<u>2003</u>	<u>2002</u>
Computed "expected" tax expense	\$ 40,932	45,767
Increase (reduction) in income taxes resulting from:		
Adjustment to deferred tax assets and liabilities for enacted changes in tax laws and rates	(803)	(364)
Tax concessions granted in respect of local portion of tax	(1,051)	(1,961)
Tax concessions granted in respect of local portion of tax for excise payers	-	(6,820)
Tax effect of non-deductible expenditures	3,822	4,377
Other, net	4,507	(3,047)
	<u>\$ 47,407</u>	<u>37,952</u>

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2003 and December 31, 2002 are presented below.

	2003	2002
Deferred tax assets/(liabilities):		
Accounts receivable, principally due to allowance for doubtful accounts	\$ (135)	61
Inventories, principally due to obsolete inventory written off	108	69
Inventories, principally due to the differences in principles of overhead allocation	(142)	(92)
Prepayments and other receivables, principally due to allowance for doubtful accounts	126	129
Investments in affiliated companies under equity method	(444)	(297)
Fixed assets, principally due to different tax depreciation rates and different accounting basis	(33,282)	(3,859)
Effect of recoverable within 5 years transformation base	1,752	1,585
WIP and FG, principally due to different capitalisation rules for tax and accounting purposes	(764)	(530)
Other	(86)	-
Total gross deferred tax assets/(liabilities)	(32,867)	(2,934)
Less valuation allowance	-	-
Net deferred tax assets/(liabilities)	\$ (32,867)	(2,934)

(15) Share capital and dividends

During 2001 and 2002 the Company was in process of reorganisation of its legal structure that was finalised on June 28, 2002 and resulted in exchange of shares held by minority shareholders in Baltika-Don and Tula Brewery into newly issued shares of the Company.

As of December 31, 2003 the Company had authorized and issued share capital of 117,158,530 ordinary shares and 13,545,150 preference shares with a par value of 1 rouble each.

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Preference shares earn dividends not less than an amount calculated as follows: the nominal value multiplied by the interest rate of the Savings Bank of the Russian Federation, plus 10% and are cumulative. In accordance with the Company Charter, preference shares grant shareholders the following additional rights: if the Company is liquidated, the nominal value of preference shares will be returned to shareholders and, if dividends on preference shares are in arrears, the preference shareholders obtain the right to vote. Shareholders are entitled to sell their shares to the Company at their nominal value adjusted for inflation before any return is made to holders of ordinary shares.

Distributable reserves are restricted to the rouble denominated retained earnings of the Company as determined by Russian legislation.

At December 31, 2003 the dollar equivalent of the amount available for distribution for Parent company and its subsidiaries, calculated based on statutory retained earnings of consolidated financial statements of the Company in roubles with application of period end rate is \$449,363 th. (2002: \$312,464 th.).

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The following table demonstrates declared dividends for the periods ended December 31, 2003 and December 31, 2002:

	<u>RUR per share</u>	<u>USD per share equivalent</u>	<u>Thousands USD</u>
December 31, 2002			
Preference shares			
Final portion of dividends for 2001 (first instalment)	4.70	0.15	2,036
Final portion of dividends for 2001 (second instalment)	3.70	0.12	1,603
Total dividends declared preference shares in 2002			<u>3,639</u>
Ordinary shares			
Final portion of dividends for 2001 (first instalment)	3.65	0.12	12,556
Final portion of dividends for 2001 (second instalment)	2.85	0.09	9,805
Total dividends declared ordinary shares in 2002			<u>22,361</u>
December 31, 2003			
Preference shares			
Dividends for 2002 (first instalment)	4.91	0.16	2,119
Dividends for 2002 (second instalment)	7.21	0.23	3,112
Total dividends declared preference shares in 2003			<u>5,231</u>
Ordinary shares			
Dividends for 2002 (first instalment)	3.77	0.12	14,076
Dividends for 2002 (second instalment)	5.55	0.18	20,721
Total dividends declared ordinary shares in 2003			<u>34,797</u>

The Shareholder's meeting held on March 31, 2003 approved dividends in equivalent of \$40,028 th.

During 2003 the Group performed operations on repurchase and selling of ordinary and preference shares, 153,020 ordinary shares and 47,331 preference shares were purchased and 101,873 ordinary shares and 46,923 preference shares were sold. As at December 31, 2003 the balance of treasury shares amounted to 101,012 ordinary and 408 preference shares.

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(16) Reconciliation of Net Income to Cash Provided by Operating activities

The reconciliation of net income to net cash provided by operating activities for years ended December 31, 2003 and 2002 follows:

	<u>2003</u>	<u>2002</u>
Cash flows from operating activities:		
Net income	\$ 123,140	137,054
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	58,285	43,488
Cumulative effect of prior years of retroactive application of depreciation for packaging material	-	2,737
(Gain)/loss on disposal of property and equipment	2,977	2,339
Undistributed income of affiliates	(1,377)	(2,400)
Minority interest	-	12,954
Other non-cash items	451	-
Changes in operating assets and liabilities:		
(Increase)/decrease in trade receivables	(17,706)	(855)
(Increase)/decrease in prepayments	16,718	(38,435)
(Increase)/decrease in inventory	(5,149)	(12,977)
Increase/(decrease) in accounts payable, accrued liabilities, taxes payable and other current liabilities	12,224	17,285
Increase/(decrease) in amount due to related parties	2,025	(360)
Net cash provided by operating activities	<u>\$ 191,588</u>	<u>160,830</u>

The Group paid \$3,297 th. and \$1,635 th. for interest and \$23,277 th. and \$39,999 th. for income taxes in 2003 and 2002, respectively.

(17) Commitments and Contingents

As at December 31, 2003, the Group had the following major capital commitments for projects to be completed in 2004:

Project	<u>Amount in million USD</u>
St. Petersburg plant	3.5
Baltika-Rostov plant	0.7
Baltika-Tula plant	3.8
Baltika-Samara plant	0.4
Total	<u>8.4</u>

Baltika-Samara started production of beer in January 2003. Its' capacity is 1.5 million Hl. Baltika-Khabarovsk started production of beer in April 2003. Its' capacity is 1 million Hl.

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Use of tax exemption

In 2002 the Company used a tax exemption with regard to the profits tax paid to St.Petersburg budget. The exemption was granted to companies located in St.Petersburg that produce excisable goods and have implemented capital investment program at a level prescribed by local legislation. The exemption was provided in the form of a 50% reduction to the tax rate for profits tax payable to the St.Petersburg budget. By applying this exemption, the Group reduced current tax expense in 2002 by approximately \$7.7 mln.

The application of this tax exemption was challenged by the tax authorities in 2002 and it has been claimed that the total amount of exempted tax is due to the budget.

A series of Arbitration Court hearings have taken place but the disagreement on this issue had not been resolved as at the date of preparing these financial statements due to the fact that the announcement of the ruling of the Arbitration Court was deferred until a decision is taken by the Charter Court of St. Petersburg. The Company expects that if the opinion of the Charter Court coincides with that of the Company, this should considerably strengthen its position in the Arbitration Court proceedings.

Therefore, as at 31 December 2003, this amount of profits tax (\$ 7.7 mln) represents a contingent tax liability which may arise should the Arbitration Court's ruling not be in favour of the Company.

In addition, an unfavourable decision of the Arbitration Court may result in a penalty (approximately \$1.5 mln) and interest for the delay in payment of this amount of profits tax for 2002 being accrued. Interest is calculated as 0.05% of the underpaid amount for each day of delay. As at 31 December 2003, the estimated maximum amount of the interest fine which may be imposed by the tax authorities may equal \$1.4 mln. However, this amount may be reduced taking into account interest on the balance of settlements with the budget (i.e. the interest fine may not be imposed by the tax authorities for periods when the Group had profits tax overpayments).

The Company has not claimed the tax exemption during of 2003.

Financial Guarantees

As of December 31, 2003, the Group has issued guarantees aggregating \$2.5 million on borrowings by its affiliate Soufflet. It is expected that the Group will not be required to make payments under its guarantees. The Group monitors the financial performance of its associate. No amount has been accrued for the Group's obligation under its guarantee arrangements.

(18) Related Party Transactions

In 2003 Group purchased raw materials (i.e. malt) from Soufflet, an associate to the Group amounting to a total of \$28,052 th., (w/out VAT) or 23% of total malt purchases, and 75,229 tons, or 25% in total malt purchases by volume. In 2002 Group's purchases from Soufflet amounted to a total of \$26,043 (w/out VAT) or 28% of total malt purchases, and 78,683 tons, or 29% in total malt purchases by volume.

Liability to Soufflet for malt amounted to \$3,084 th. and \$902 th. as at December 31, 2003 and December 31, 2002 respectively.

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In 2003 the Group leased out to Vena, certain machinery and equipment in amount of \$5,064 th. see note (5) Net Investment in Direct Financing and Sales-Type Leases.

Under arrangements with Carlsberg the Group received \$4,891 th. and \$344 th. as reimbursement of expenses incurred in relation to advertising of Carlsberg brands and paid \$293 th. and \$10 th. royalty to Carlsberg in 2003 and 2002 respectively.

Liability to Carlsberg for royalty amounted to \$105 th. and nil as at December 31, 2003 and December 31, 2002 respectively.

(19) Earnings per share

Basic earnings per share of common stock is calculated by dividing the income attributable to common stock by the average number of shares of common stock outstanding during the applicable period.

The calculation of diluted earnings per share of common stock takes into account the effect of obligations, such as convertible preferred stock, considering to be potentially dilutive.

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Earnings per share of common stock is as follows (in thousands U.S. dollars, except per share data):

	<u>2003</u>		<u>2002</u>	
	Income	Shares	Income	Shares
Net income before cumulative effect of a change in accounting principle	123,140		137,892	
Preferred stock dividend requirements	(5,231)		(3,639)	
Basic income and shares	<u>117,909</u>	<u>117,158,530</u>	<u>134,253</u>	<u>112,716,108</u>
Basic earnings per share before cumulative effect of accounting change	<u>1.01</u>		<u>1.20</u>	
Accounting change	-		(0.02)	
Basic earnings per share	<u><u>1.01</u></u>		<u><u>1.18</u></u>	
Basic income and shares				
Convertible preferred shares	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Diluted earnings per share before cumulative effect of accounting change	<u>1.01</u>		<u>1.20</u>	
Accounting change	-		(0.02)	
Diluted earnings per share	<u><u>1.01</u></u>		<u><u>1.18</u></u>	

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(20) Fair Value of Financial Instruments

The following table presents the carrying amounts and estimated fair values of the Group's financial instruments at December 31, 2003 and December 31, 2002. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

	2003		2002	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets:				
Cash and cash equivalents	\$ 27,429	27,429	12,844	12,844
Trade accounts receivables	26,031	26,031	7,024	7,024
Loans receivable	150	150	10,518	9,169
Net investments in direct financing and sales-type leases, short-term	2,426	2,426	-	-
Net investments in direct financing and sales-type leases, long-term	2,390	2,390	-	-
Investment securities	291	291	310	310
Prepayments and other receivables	62,778	62,778	72,251	72,251
Financial liabilities:				
Trade accounts payables	\$ 30,270	30,270	33,136	33,136
Due to related company	3,189	3,189	902	902
Accrued salaries, wages and benefits	11,944	11,944	15,914	15,914
Other liabilities	3,273	3,273	4,073	4,073
Long-term debt, excluding current installments	8,326	8,326	10,000	10,000
Obligations under capital leases, excluding current installments	6,082	6,082	-	-
Short-term debt including current installments of long-term debt	76,465	76,465	69,766	69,766
Current installments of obligations under capital leases	3,659	3,659	-	-

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The carrying amounts shown in the table are included in the consolidated balance sheets under the indicated captions.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, trade accounts receivable, prepayments and other receivables, trade accounts payable, due to related company, accrued salaries wages and benefits, other liabilities and short-term debt: The carrying amounts approximate fair value because of the short maturity of these instruments.

Loans receivable: The fair value of the loan is determined as the present value of expected future cash flows discounted at the originally contracted effective interest rate.

Investment securities: The fair values of equity investments are based on quoted market prices at the reporting date for those or similar investments.

Net investments in direct and sales-type leases, long-term debt and obligations under capital leases: The carrying amounts of these items approximate their fair value as they are provided or received by the Group at terms currently offered in the market for similar loans and leases of comparable maturities to like borrowers.