OAO Concern "Kalina" and subsidiaries

Independent Auditors' Report

Consolidated Financial Statements
Six Months Ended June 30, 2004 and 2003

OAO CONCERN "KALINA" AND SUBSIDIARIES

TABLE OF CONTENTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of OAO Concern "Kalina":

We have audited the accompanying consolidated balance sheets of OAO Concern "Kalina" and subsidiaries (the "Group") as of June 30, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the six months then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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 audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of June 30, 2004 and 2003, and the results of its operations and cash flows for the six months then ended, in conformity with accounting principles generally accepted in the United States of America.

September 23, 2004

OAO CONCERN "KALINA" AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
JUNE 30, 2004 AND 2003
(in US dollars and in thousands)

	Notes	2004	2003
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	3	$ 29,496	$ 3,082
Accounts receivable, net	4	9,815	11,415
Advances to suppliers and prepaid expenses	5	10,652	13,969
Inventories, net	6	33,518	36,670
Taxes recoverable	7	10,112	10,624
Investments	8	2,736	1,782
Assets associated with discontinued operations	14	7,745	9,402
Deferred tax asset	13	2,645	1,830
Total current assets		106,719	88,774
PROPERTY, PLANT AND EQUIPMENT, net	9	32,506	26,649
INTANGIBLE ASSETS, net		482	119
TOTAL ASSETS		$ 139,707	$ 115,542
COMMITMENTS AND CONTINGENCIES	18	-	-
LIABILITIES AND STOCKHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Accounts payable	10	$ 12,959	$ 16,514
Short-term debt	11	1,772	18,926
Accrued liabilities		58	215
Taxes payable	7	2,859	3,748
Liabilities associated with discontinued operations	14	9,976	8,926
Total current liabilities		27,624	48,329
LONG-TERM DEBT	12	4,752	166
NON-CURRENT TAXES PAYABLE	7	3,935	3,766
NON-CURRENT DEFERRED TAX LIABILITY	13	2,016	1,873
Total liabilities		38,327	54,134
STOCKHOLDERS' EQUITY:			
Capital stock	15	23,596	20,243
Additional paid in capital		24,203	1,233
Retained earnings		53,581	39,932
Total stockholders' equity		101,380	61,408
TOTAL LIABILITIES AND STOCKOLDERS' EQUITY		$ 139,707	$ 115,542

See notes to the consolidated financial statements on pages 6-17

OAO CONCERN "KALINA" AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003
(in US dollars and in thousands)

	Notes	2004	2003
NET SALES		$ 91,245	76,781
COST OF SALES		46,005	42,740
GROSS PROFIT		45,240	34,041
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES		29,232	20,819
OPERATING INCOME		16,008	13,222
OTHER INCOME/(EXPENSES):			
Interest expense, net		(493)	(1,780)
Foreign currency exchange (losses)/gains, net		(834)	239
Tax fines and penalties gains	7	-	726
Other expenses, net		(1,819)	(1,047)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE		12,862	11,360
INCOME TAX EXPENSE	13	3,874	3,874
NET INCOME FROM CONTINUING OPERATIONS		8,988	7,486
DISCONTINUED OPERATIONS			
Loss from operations of subsidiary JSC Alye Parusa	14	-	238
Loss from operations of subsidiary JSC Pallada Vostok	14	385	800
NET INCOME		$ 8,603	6,448

See notes to the consolidated financial statements on pages 6-17.

OAO CONCERN "KALINA" AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003
(in US dollars and in thousands)

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 8,603	$ 6,448
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,016	888
Gain on disposal of property, plant and equipment	(11)	(258)
Deferred tax benefit	(146)	(463)
Interest expense, net	493	1,780
Changes in operating assets and liabilities:		
Accounts receivable, net	3,215	6,261
Accounts payable and accruals	(2,493)	(3,760)
Inventories, net	2,453	1,021
Advances to suppliers and prepaid expenses	2,342	(2,390)
Taxes receivable	1,617	(647)
Taxes payable	(1,223)	(2,712)
Discontinued operations	381	1,363
Interest paid	(439)	(1,916)
Net cash provided by operating activities	15,808	5,615
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant, equipment and intangible assets	(4,926)	(979)
Proceeds from sale of property, plant and equipment	41	692
Proceeds from sale of securities	956	-
Net cash used in investing activities	(3,929)	(287)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from short-term debt	17,325	3,611
Repayment of short-term debt	(37,932)	(6,598)
Proceeds from bond issue	6,000	-
Cash payments for outstanding financial lease liability	(118)	(23)
Proceeds from stock issue	26,323	-
Dividends declared and paid	(1,585)	-
Foreign exchange on opening cash balance	(113)	34
Net cash provided by/(used in) financing activities	9,900	(2,976)
NET INCREASE IN CASH AND CASH EQUIVALENTS	21,779	2,352
CASH AND CASH EQUIVALENTS, beginning of period	7,717	730
CASH AND CASH EQUIVALENTS, end of period	$ 29,496	$ 3,082
CASH PAID DURING THE PERIOD FOR:		
Income tax	3,516	6,791

See notes to the consolidated financial statements on pages 6-17.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003

(in US dollars and in thousands)

	Capital Stock	Additional Paid in Capital	Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
Balance January 1, 2003	$ 20,243	$ 1,233	$ -	33,351	54,827
Translation adjustment	-	-	2,397	-	2,397
Income tax effect of changes in functional currency	-	-	(2,264)	-	(2,264)
Net income	-	-	-	6,448	6,448
Balance June 30, 2003	$ 20,243	$ 1,233	$ 133	39,799	61,408
Translation adjustment	-	-	1,905	-	1,905
Income tax effect of changes in functional currency	-	-	103	-	103
Net income	-	-	-	4,342	4,342
Dividends	-	-	-	(568)	(568)
Balance January 1, 2004	$ 20,243	1,233	2,141	43,573	67,190
Translation adjustment	-	-	849	-	849
Net income	-	-	-	8,603	8,603
Dividends	-	-	-	(1,585)	(1,585)
New stock issue	3,353	22,970	-	-	26,323
Balance June 30, 2004	$ 23,596	24,203	2,990	50,591	101,380

See notes to the consolidated financial statements on pages 6-17.

1. DESCRIPTION OF BUSINESS

OAO Concern "Kalina" (hereinafter the "Company"), a Russian Open Joint Stock Company, was incorporated on December 12, 1992 as OAO "Uralskiye Samotsveti" under the laws of the Russian Federation ("RF") and renamed OAO Concern "Kalina" on November 30, 1999. The consolidated financial statements presented herein include the financial statements of the Company and its subsidiaries (hereinafter referred to jointly as "Operating Subsidiaries" or separately as "Operating Subsidiary")

Operating subsidiary	Share of ownership	Place of incorporation	Principal activity
JSC Pallada Vostok	100%	Uzbekistan	Manufacturing
JSC Lola Atir Upa	56%	Uzbekistan	Manufacturing
JSC Pallada Ukraina	100%	Ukraine	Trading
LLC Zavod Novoplast	100%	Russia	Manufacturing
Kalina Overseas Holding B.V.	100%	Netherlands	Trading
Kosmetik und Rasierwaren Solingen GmbH	100%	Germany	Trading

The Company and its Operating Subsidiaries (collectively referred to as the "Group") manufacture and sell a wide range of perfume, cosmetics and household products in CIS countries.

In June and December 2003 the Group management made a decision to dispose of its 65% share in JSC Alye Parusa (Ukrain) and its wholly owned subsidiary JSC Pallada Vostok (Uzbekistan) respectively, therefore their assets, liabilities as well as cash flows and financial results for the reporting periods ended June 30, 2004 and 2003 are presented as assets, liabilities, cash flows and financial results associated with discontinued operations (Notes 14 and 19).

During 6 months ended June 30, 2004 the Group exchanged its 100% share in JSC Torzhok (Ukraine) for a 12.17% stake in the construction contract development company, LLC KIT-Capital, incorporated in Russa (Note 8).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation – The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("US GAAP").

The accounts of the Company are prepared in accordance with Russian Federation accounting laws and accounting regulations in Russian roubles ("RUR") and then converted to accounting principles that are generally accepted in the United States of America ("US GAAP"). The accounts of the Operating Subsidiaries are prepared in accordance with local laws and accounting regulations and then converted to accounting principles that are generally accepted in the United States of America ("US GAAP").

Principles of Consolidation – The consolidated financial statements include the accounts of the Company and its operating subsidiaries after the elimination of significant intercompany transactions and balances.

Business Combinations – For business combinations that have been accounted for under the purchase method of accounting, the financial statements of the Company include the results of operations of the acquired businesses from the date of acquisition. The excess of the fair value of identifiable tangible and intangible net assets acquired over the purchase price (negative goodwill) is used to reduce the fair value of long-term non-monetary assets acquired.

Use of Estimates – The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses of the reporting period. Actual results could differ from those estimates.

Concentration of Credit Risk – Financial instruments that potentially expose the Group to concentration of credit risk consist primarily of cash, cash equivalents and accounts receivable. The carrying amount of financial instruments, including cash and cash equivalents and short-term obligations, approximates fair value due to the short-term maturity of the instruments.

Foreign Currency Translation – The Group follows a translation policy in accordance with SFAS No. 52, "Foreign Currency Translation". Starting from January 1, 2003, the Russian economy ceased to be considered highly inflationary for accounting purposes. Management has determined that for the fiscal year beginning January 1, 2003, the functional currency of the Group is the Russian rouble. Accordingly, US dollar amounts were translated into Russian roubles at the exchange rate current at January 1, 2003. These amounts became the new accounting basis for non-monetary assets and liabilities.

The Group retained the US dollar as its reporting currency and translated its functional currency financial statements into US dollars. Assets and liabilities are translated at period-end exchange rates, while income and expense items are translated at average rates of exchange prevailing during the period. The resulting cumulative translation adjustment is recorded as a separate component of other comprehensive income (loss).

The Russian rouble (RUR), Uzbek soum (UZS) and Ukrainian hrivna (UAH) are not fully convertible currencies outside the territory of the RF, Uzbekistan and Ukraine, respectively. The translation of rouble, soum and hrivna denominated assets and liabilities into US dollars for the purpose of these financial statements does not indicate that the Company and its Operating Subsidiaries could realize or settle in US dollars the reported values of the assets and liabilities. Likewise, it does not indicate that the Group could return or distribute the reported US dollar values of capital and retained earnings to its shareholders.

The official rates of exchange were as follows:

Exchange rate	**As of June 30, 2004**	**Average for six months ended June 30, 2004**	**As of June 30, 2003**	**Average for six months ended June 30, 2003**
Russian rouble / US dollar	29.03	28.76	30.34	31.26
Uzbek soum / US dollar	1,020.00	1,000.20	975.30	972.44
Ukrainian hrivna / US dollar	5.32	5.33	5.33	5.33

Cash and Cash Equivalents – Includes cash on hand and bank deposits. Cash equivalents include financial instruments with a maturity of less than ninety days when purchased.

Accounts Receivable – Accounts receivable are stated at their net realizable value after deducting a provision for doubtful accounts. Such provision reflects either specific cases or estimates based on evidence of recoverability.

Investments – Investments in marketable securities consist primarily of "not trading" securities and, accordingly, are carried on the balance sheet at cost.

Inventories – Inventories are stated at the lower of cost, determined by the first-in first-out method for raw materials and weighted average for finished goods, or market value.

Property, Plant and Equipment – Property, plant and equipment is carried at cost less accumulated depreciation. Depreciation is charged using the straight-line method over the asset's estimated useful lives. When assets are retired or otherwise disposed of, the cost and the accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the statement of operations. The cost of maintenance and repairs is charged to the statement of operations as incurred. Significant renewals and betterment, that extend an asset's estimated useful life, are capitalized.

The overall useful economic lives of the assets for depreciation purposes are as follows:

Description	**Useful Life (years)**
Buildings	50
Machinery and equipment	10-15
Vehicles	5
Office equipment and other assets	5

Property, plant and equipment held and used by the Group are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may have been impaired. Management considers that no impairment has occurred relating to the Group's investments in property, plant and equipment as of June 30, 2004.

Sales Recognition – Sales are recognized when products are shipped to the customer, net of discounts.

Income Taxes – Income taxes payable have been computed in accordance with the laws of the Russian Federation, Ukraine and Uzbekistan. The Group accounts for deferred taxes on income using the asset and liability method wherein material deferred tax assets and liabilities are recognized based on the future consequences of temporary differences between the financial reporting carrying amounts and tax bases of assets and liabilities using the current enacted income tax rates.

Borrowing Costs – The Group expenses interest on borrowings as incurred. Debt issue costs are amortized to expense over the term to maturity.

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consisted of the following at June 30, 2004 and 2003 (in thousands):

	2004	**2003**
Cash on hand – RUR	$ 23	$ -
Cash in bank – RUR accounts	2,078	696
Cash in bank – US dollar accounts	26,659	26
Bank deposits – RUR accounts	476	2,158
Other - US dollar, UAH accounts	260	202
Total	$ **29,496**	$ **3,082**

4. ACCOUNTS RECEIVABLE, NET

Accounts receivable consisted of the following at June 30, 2004 and 2003 (in thousands):

	2004	2003
Accounts receivable – trade	$ 10,223	$ 10,002
Other accounts receivable	311	2,130
Bad debt allowance	(719)	(717)
Total	$ 9,815	$ 11,415

5. ADVANCES TO SUPPLIERS AND PREPAID EXPENSES

Advances to suppliers and prepaid expenses consisted of the following at June 30, 2004 and 2003 (in thousands):

	2004	2003
Advances to suppliers	$ 10,078	$ 13,778
Prepaid expenses	574	191
Total	$ **10,652**	$ **13,969**

6. INVENTORIES, NET

Inventories consisted of the following at June 30, 2004 and 2003 (in thousands):

	2004	2003
Raw materials	$ 23,030	$ 24,913
Work in process	534	668
Finished goods	12,204	13,625
Allowance for obsolescence	(2,250)	(2,536)
Total	$ 33,518	$ 36,670

7. TAXES RECOVERABLE AND PAYABLE

Current taxes recoverable consisted of the following at June 30, 2004 and 2003 (in thousands):

	2004	2003
VAT	$ 9,459	$ 10,462
Other	653	162
Total	$ 10,112	$ 10,624

Current taxes payable consisted of the following at June 30, 2004 and 2003 (in thousands):

	2004	2003
Income tax	$ 521	$ 885
Advertising tax	264	-
Other taxes	2,074	2,863
Total	$ **2,859**	$ **3,748**

Non-current taxes payable consist of fines and interest that have been contested with the tax authorities since 1998. The Company made accruals in respect of this liability that were based on information available to management as of the respective reporting date. The amounts accrued were 137 mln RUR (4,310 thousand US dollars), 115.6 mln RUR (3,677 thousand US dollars) and 69.9 mln RUR (2,319 thousand US dollars) as of December 31, 2002, June 30, 2002 and December 31, 2001 respectively.

In 2003, a restructuring agreement was signed with the tax authorities, which resolves the uncertainty as to the amount of the liability and established terms for its repayment. As a result the accrued liability has decreased in 2003 to 114.3 mln RUR (3,935 thousand US dollars) and remains at this level as of June 30, 2004. This liability is to be paid as follows (in thousands):

Due in 2006	$ 170
Due in 2007	983
Due in 2008	983
Due in 2009	983
Due in 2010	816
Total	$ **3,935**

8. INVESTMENTS

Investments consisted of the following at June 30, 2004 and 2003 (in thousands):

	2004	2003
Equity investments in JSC "Zhirovoi Kombinat" (Ekaterinburg) (EZhK) – 19.19%	$ -	$ 1,610
Equity investments in LLC KIT-Capital – 12.17%	2,736	-
Other short-term investments	-	172
Total	$ **2,736**	$ **1,782**

During 2001, the Company acquired 27.24% of JSC "Zhirovoi Kombinat" (Ekaterinburg) ("EZhK"). EZhK is a Ekaterinburg-based fat and fat-based food producer. The purchase was made through acquisition of small blocks of shares from different third party investors. The intent of the purchase was to consolidate a greater block of shares from small blocks and to sell it at a substantial profit to a strategic investor in the near future. 8.05% of these shares were sold to the related party OOO "Souzspezstroy" realizing a profit of 61 thousand US dollars. As a result, at June 30, 2003 the Company owned 19.19% of the equity of EZhK. The Company accounted for this investment at cost.

As of June 30, 2003, the entire portfolio of investments in EZhK held by the Company is classified as available for sale. The Company does not have or affect any significant influence over business activities of EZhK. The investment in EZhK was sold on July 25, 2003 to a third party for 3,972 thousand US dollars.

On April 26, 2004 Kalina increased the share capital of JSC Torzhok (a 100% subsidiary) by 75,183 thousand RUR (2,597 thousand USD) to 97,725 thousand RUR (3,305 thousand USD).

On June 30, 2004 the Group exchanged its share in JSC Torzhok for a 12.17% share in the construction project development company, LLC KIT-Capital (Note 1). The main activities of JSC Torzhok were construction works. During 2003 and 2004 the Subsidiary developed one construction site of trade-mall center in Nikolaev (Ukraine).

KIT-Capital is a construction site development company. The exchange of 100% stock in JSC Torzhok for 12.17% of KIT-Capital represents an exchange transaction of assets and in accordance with APB 29 "Accounting for Nonmonetary Transactions", Par. 22 is classified as an exchange of similar assets. The exchange transaction did not result in the recognition of any financial gain or loss in the financial statements of the Group.

The value of the new investment in LLC KIT-Capital is represented by the value of the monetary consideration transferred to JSC Torzhok as share capital contributions less any accumulated losses generated by the Subsidiary up to the date of the exchange transaction. The value thus formed is the cost of the new investment and is shown as such on the face of the consolidated balance sheet.

9. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consisted of the following at June 30, 2004 and 2003 (in thousands):

		2004		2003
Land	$	449	$	429
Buildings		26,437		23,233
Machinery and equipment		52,161		51,143
Vehicles		2,853		2,862
Office equipment and other assets		1,784		1,869
Construction in progress		9,968		6,095
Less: accumulated depreciation		(61,146)		(58,982)
Total	$	32,506	$	26,649

In the second half of 2002, the Company entered into a financial lease agreement of production equipment. The net book value of the leased assets as of June 30, 2004 was 545 thousand US dollars (see Note 12).

10. ACCOUNTS PAYABLE

Accounts payable consisted of the following at June 30, 2004 and 2003 (in thousands):

		2004		2003
Accounts payable – trade	$	11,484	$	15,204
Accrued interest		-		388
Other payables		1,475		922
Total	$	12,959	$	16,514

11. SHORT-TERM DEBT

Outstanding short-term credit facilities of the Group as of June 30, 2004 and 2003 consisted of the following (in thousands):

	Effective interest rate	2004	2003
EBRD loan (USD)	6%	$ 1,332	$ -
Citibank loan (RUR)	23%	-	527
Bonds – first issue (RUR)	14%	-	157
Bonds – second issue (RUR)	14%	-	18,123
Financial lease			
Current portions of liability on financial lease (RUR)	13%	440	119
Total		$ **1,772**	$ **18,926**

In 2001 and 2002 the Group made two bond issues. The face value of the first and the second issues was 100 RUR (3.33 US dollars) and 1,000 RUR (31.44 US dollars) respectively. The number of bonds issued was 51,340 and 550,000 respectively. The bonds were issued at face value. Coupon income on the bonds is accrued at the rate of 80% of the official Central Bank of the Russian Federation refinancing rate effective during the period and is paid quarterly. Bonds of the first and the second issue were repaid on March 5, 2004 and February 2, 2004 respectively.

The effective Central Bank of Russian Federation refinancing rate was as follows:

Date of coupon accrual	CB refinancing rate
August 7, 2002- February 16, 2003	21%
February 17, 2003 – June 20, 2003	18%
June 21, 2003 – January 14, 2004	16%
January 15, 2004 – March 5, 2004	14%

Coupon income on the bonds of the second issue was accrued at the weighted average rate of return of the Bonds of the Ministry of Finance of Russian Federation (OFZ). The effective weighted average rate of return on OFZ was as follows:

Date of coupon accrual	Weighted average rate of return
November 13, 2002 – February 11, 2003	22%
February 12, 2003 – May 13, 2003	20%
May 14, 2003 – July 18, 2003	15%
July 19, 2003 – February 2, 2004	14%

As of June 30, 2003 the maturity period of the bonds was shorter than one year, and they are shown as short-term on the face of the Group's balance sheet.

12. LONG-TERM DEBT

Long-term debt consisted of the following as of June 30, 2004 and 2003 (in thousands):

	2004	2003
Loans		
EBRD (USD)	$ 4,668	$ -
Financial lease		
Long-term portion (RUR)	84	166
Total long-term debt	$ **4,752**	$ **166**

In the second half of 2002 the Company entered into a financial lease agreement of production equipment with an implicit interest rate of 13% (see Note 9).

Future minimum lease payments due under non-cancelable leases at June 30, 2004 were (in thousands):

Financial lease commitments as lessee:	
Due within 12 months	$ 440
Due during the second year	80
Due during the third year	4
Total minimum lease payments:	524
Less amount, representing interest	(27)
Present value of minimum lease payments	$ 497

In 2003, the Group entered into a long-term credit line agreement with a related party (Note 16) – the European Bank for Reconstruction and Development (EBRD). The total amount of credit line facilities to be provided under the contract is 20 mln. US dollars with an annual interest rate of LIBOR plus 4.5%. As of June 30, 2004 the Group had received 6,000 thousand USD of which 1,332 thousand USD is payable within 12 months commencing June 30, 2004 (Note 11).

13. TAXES

Total tax expense consisted of the following at June 30, 2004 and 2003 (in thousands):

	2004	2003
Current tax expense	$ 4,020	$ 4,374
Deferred tax benefit	(146)	(463)
Total	3,874	3,911
Current income tax expense of JSC "Pallada Vostok" shown as discontinued operations for 6 months ended June 30, 2003	-	(37)
Total	$ 3,874	$ 3,874

The Group provides for current taxes based on statutory financial statements maintained and prepared in local currencies and in accordance with local statutory regulations which differ significantly from US GAAP. The Group was subject to a tax rate of 24% in Russia, 30% in Ukraine, and 26% in Uzbekistan in 2003 and 2002.

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rates to income before income taxes. Below is a reconciliation of theoretical income tax to the actual amount of tax expense recorded in the Group's statement of operations:

		2004		2003
Income tax expense at statutory rates	$	2,994	$	2,477
Adjustments due to:				
Discontinued operations		10		9
Permanent differences		870		1,388
Income tax expense	$	**3,874**	$	**3,874**

The tax effects of temporary differences that give rise to deferred tax assets and liabilities at June 30, 2004 and 2003 are as follows (in thousands):

		2004		2003
Current deferred tax assets:				
Accrued expenses	$	2,769	$	1,745
Valuation of investments		-		(17)
Valuation of closing stock of work in progress and finished goods		(124)		102
	$	2,645	$	1,830
Non-current deferred tax assets/(liabilities):				
Valuation of non-current assets		12		239
Depreciation expense		(2,028)		(2,112)
	$	(2,016)	$	(1,873)

As more fully described in Note 2, starting from January 1, 2003, the Russian economy ceased to be considered highly inflationary for accounting purposes. The amount of the adjustment to the deferred tax asset opening balance, resulting from the change in accounting policies was 2,161 thousand US dollars as of June 30, 2004.

14. DISCONTINUED OPERATIONS

Pallada Vostok (Uzbekistan)

In December 2003 Group management made a decision to dispose of its wholly owned subsidiary JSC Pallada Vostok based in Uzbekistan. The subsidiary was engaged in the production of a wide range of cosmetic brands sold on the Uzbekistan market.

Major assets and liabilities of the subsidiary as of June 30, 2004 and 2003 were as follows (in thousands)

		2004		2003
Assets associated with discontinued operations:				
CURRENT ASSETS:				
Cash and cash equivalents	$	85	$	556
Accounts receivable, net		1,162		413
Advances to suppliers and prepaid expenses		823		-
Inventories		2,811		2,694
Taxes recoverable		36		14
Investments		15		-
Total current assets		**4,932**		**3,677**
PROPERTY, PLANT AND EQUIPMENT, net		2,813		3,033
Total assets associated with discontinued operations	$	**7,745**	$	**6,710**

Liabilities associated with discontinued operations:

CURRENT LIABILITIES:		
Accounts payable	$ 8,418	$ 6,615
Short-term debt	361	158
Accrued liabilities	125	3
Taxes payable	208	154
Total current liabilities	9,112	6,930
LONG-TERM DEBT	729	624
MINORITY INTEREST	135	145
Total liabilities associated with discontinued operations:	$ 9,976	$ 7,699

At June 30, 2004 JSC Pallada Vostok was indebted to the rest of the Group in the amount of 5,934 thousand US dollars, represented by 2,042 thousand US dollars in trade payables and 3,524 US dollars received as advances from the rest of the Group.

Revenues (and net profits) of Pallada Vostok for the six months ended June 30, 2004 and 2003 were 2,252 (and 385) thousand dollars and 3,736 (and 800) thousand US dollars respectively (Note 19).

Alye Parusa (Ukraine)

In June 2003 the Group management decided to sell its 65% stake in a Ukrainian based subsidiary - JSC Alye Parusa. JSC Alye Parusa was engaged in the production of a wide range of cosmetics brands that are sold on the Ukrainian market.

Major assets and liabilities of the subsidiary as of June 30, 2003 were as follows (in thousands):

	2003
Assets associated with discontinued operations:	
CURRENT ASSETS:	
Cash and cash equivalents	$ 16
Accounts receivable, net	973
Advances to suppliers and prepaid expenses	178
Inventories	910
Taxes recoverable	72
Investments	3
Total current assets	2,152
PROPERTY, PLANT AND EQUIPMENT, net	529
INTANGIBLE ASSETS, net	11
Total assets associated with discontinued operations	$ **2,692**

Liabilities associated with discontinued operations:	
CURRENT LIABILITIES:	
Accounts payable	$ 549
Short-term debt	104
Accrued liabilities	39
Taxes payable	89
Total current liabilities	781
LONG-TERM DEBT	446
Total liabilities associated with discontinued operations:	$ **1,227**

Revenues (and net profit) of the subsidiary for the six months ended June 30, 2003 were 2,223 (and 238) thousand US dollars respectively.

As of June 30, 2003 the amount of accounts payable due from JSC Alye Parusa to the rest of the Group was 3,045 thousand US dollars and accounts receivable of JSC Alye Parusa from the rest of the Group were 33 thousand US dollars.

The investment was sold to the subsidiary's chief operating officer on August 5, 2003 realizing a loss of 1,682 US dollars.

15. CAPITAL STOCK

As of June 30, 2004 and 2003 the Group had 8,364,908 and 9,752,311 authorised and issued ordinary shares at RUR 70 per share.

In April 2004 the Group issued 1,387,403 new common shares at a par value of 70 RUR per share. Shares were placed at 525 RUR against shareholders pre-emptive rights and 550.62 RUR per share through a public offering.

As of June 30, 2004 dividends for the second half of 2003 in the amount of 46,007 thousand RUR (1,585 thousand US dollars) were declared and paid in full.

The Company is owned 50.18% by an individual, 10.67% by EBRD and 7.52% by Renaissance Securities (Cyprus) and 31.63% by other shareholders as of 30 June 2004.

16. RELATED PARTY TRANSACTIONS

The Group has a party related by means of common control – OOO "Soyuzspezstroy".

Receivables from related parties as of June 30, 2004 and 2003 were as follows (in thousands):

	2004	2003
OOO "Soyuzspezstroy"	$ -	$ 1,183
Total	$ **-**	$ **1,183**

Payables to related parties as of June 30, 2004 and 2003 were as follows (in thousands):

	2004	2003
OOO "Soyuzspezstroy"	$ 484	$ 1,653
Total	$ **484**	$ **1,653**

Sales to related parties for the six months ended June 30, 2004 and 2003 were as follows (in thousands):

	2004	2003
OOO "Soyuzspezstroy"		
Sales of third party shares	$ -	$ 2
Total	$ **-**	$ **2**

Purchases from related parties for the six months ended June 30, 2003 and 2002 were as follows (in thousands):

	2004	2003
OOO "Soyuzspezstroy"		
Purchase of services	$ 92	$ 1,525
Total	$ **92**	$ **1,525**

17. POST RETIREMENT BENEFITS

Employees of the Group are beneficiaries of state-administered defined contribution pension programs. The Group remits a required percentage of the aggregate employees' salaries to the statutory Pension Funds. As at June 30, 2004 and 2003 the Group was not liable for any supplementary pensions, post retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

18. COMMITMENTS AND CONTINGENCIES

Operating Environment – The Group's principal business activities are within the Russian Federation and CIS countries. Laws and regulations affecting businesses operating in the Russian Federation and CIS countries are subject to rapid changes and the Group's assets and operations could be at risk due to negative changes in the political and business environment.

Tax Environment – Due to the presence in Russian, Ukrainian and Uzbek commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgment on business activities, if a particular treatment based on Management's judgment of the Group's business activities was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest. Tax years remain open to review by the tax authorities for three years.

19. SUBSEQUENT EVENTS

In June 2004 the Group ratified an agreement on sales of its shares in Pallada Vostok. The ownership rights are transferred upon final payment. Payments start in August 2004 (Note 14).

In August 2004 the Group declared interim dividends relating to 2004 of 3.75 RUR per common share.