# EUROCHEM GROUP

## INTERNATIONAL FINANCIAL REPORTING STANDARDS

## CONSOLIDATED FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

## 31 DECEMBER 2010

## Contents

# *Independent Auditor's Report*

To the Shareholders and Board of Directors of EuroChem Group:

We have audited the accompanying consolidated financial statements of open joint stock company Mineral Chemical Company "EuroChem" (the "Company") and its subsidiaries (the "Group") which comprise the consolidated statement of financial position as of 31 December 2010 and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

**Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit

28 February 2011
Moscow, Russian Federation

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*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

| | Note | 31 December 2010 | 31 December 2009 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets:** | | | |
| Property, plant and equipment | 7 | 73,121,566 | 56,382,417 |
| Mineral rights | 11 | 7,318,107 | 7,271,496 |
| Goodwill | 8 | 204,866 | 204,866 |
| Intangible assets | 9 | 814,523 | 427,457 |
| Restricted cash | 14 | 143,898 | 179,115 |
| Available-for-sale investments | 10 | 36,954,062 | 33,619,657 |
| Available-for-sale investments pledged as collateral | 10 | 909,269 | - |
| Deferred income tax assets | 28 | 969,064 | 1,328,848 |
| Other non-current assets | | - | 247,893 |
| **Total non-current assets** | | **120,435,355** | **99,661,749** |
| **Current assets:** | | | |
| Inventories | 12 | 9,827,892 | 8,105,067 |
| Trade receivables | 13 | 2,710,818 | 2,151,240 |
| Prepayments, other receivables and other current assets | 13 | 7,523,132 | 7,630,102 |
| Derivative financial assets | 18 | 36,751 | - |
| Restricted cash | 14 | 37,461 | 551,086 |
| Cash and cash equivalents | 14 | 8,896,623 | 10,676,772 |
| **Total current assets** | | **29,032,677** | **29,114,267** |
| **TOTAL ASSETS** | | **149,468,032** | **128,776,016** |
| **LIABILITIES AND EQUITY** | | | |
| **Equity:** | | | |
| **Capital and reserves attributable to owners of the parent:** | | | |
| Share capital | 15 | 6,800,000 | 6,800,000 |
| Treasury shares | 15 | (7,760) | (7,760) |
| Retained earnings and other reserves | | 87,388,382 | 65,644,137 |
| | | **94,180,622** | **72,436,377** |
| Non-controlling interests | | 323,896 | 758,683 |
| **Total equity** | | **94,504,518** | **73,195,060** |
| **Non-current liabilities:** | | | |
| Bank borrowings | 16 | 11,464,834 | 26,556,324 |
| Bonds issued | 17 | 18,772,380 | 8,724,895 |
| Deferred income tax liabilities | 28 | 1,908,932 | 1,972,782 |
| Other non-current liabilities and deferred credits | | 795,321 | 430,393 |
| **Total non-current liabilities** | | **32,941,467** | **37,684,394** |
| **Current liabilities:** | | | |
| Bank borrowings | 16 | 12,589,767 | 12,491,434 |
| Derivative financial liabilities | 18 | 127,981 | - |
| Trade payables | 20 | 2,182,951 | 1,373,488 |
| Other accounts payable and accrued expenses | 20 | 5,860,875 | 3,574,522 |
| Income tax payable | | 682,050 | 108,465 |
| Other taxes payable | | 578,423 | 348,653 |
| **Total current liabilities** | | **22,022,047** | **17,896,562** |
| **Total liabilities** | | **54,963,514** | **55,580,956** |
| **TOTAL LIABILITIES AND EQUITY** | | **149,468,032** | **128,776,016** |

Approved on behalf of the Board of Directors
28 February 2011

D.S. Strezhnev
Chief Executive Officer

A.A. Ilyin
Chief Financial Officer

The accompanying notes on pages 5 to 37 are an integral part of these consolidated financial statements.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

| | Note | 2010 | 2009 |
|---|---|---|---|
| Sales | 21 | 97,787,533 | 73,577,249 |
| Cost of sales | 22 | (50,205,529) | (42,884,070) |
| **Gross profit** | | **47,582,004** | **30,693,179** |
| Distribution costs | 23 | (17,784,897) | (16,944,421) |
| General and administrative expenses | 24 | (3,754,449) | (3,261,398) |
| Other operating income/(expenses) | 25 | (16,695) | 225,029 |
| **Operating profit** | | **26,025,963** | **10,712,389** |
| Dividend income | 10 | 147,946 | 2,168,715 |
| Gain/(loss) on disposal of non-current assets held for sale | 26 | (429,598) | 358,878 |
| Fair value gain on trading investments | | - | 139,584 |
| Gain on disposal of available-for-sale investments | 10 | 1,407,261 | 966,640 |
| Financial foreign exchange gain/(loss) – net | | (389,660) | 748,903 |
| Interest income | | 180,444 | 399,724 |
| Interest expense | | (2,066,011) | (1,983,587) |
| Other financial income | 27 | 134,831 | 193,458 |
| **Profit before taxation** | | **25,011,176** | **13,704,704** |
| Income tax expense | 28 | (4,958,699) | (2,629,256) |
| **Net profit for the period** | | **20,052,477** | **11,075,448** |
| **Other comprehensive income/(loss)** | | | |
| Currency translation differences, net of tax | | (695,283) | 364,188 |
| Revaluation of available-for-sale investments | 10 | 9,642,508 | 1,689,667 |
| Disposal of available-for-sale investments – reclassification of revaluation to profit and loss | 10 | (1,407,261) | (966,640) |
| **Total other comprehensive income for the period** | | **7,539,964** | **1,087,215** |
| **Total comprehensive income for the period** | | **27,592,441** | **12,162,663** |
| **Net profit for the period attributable to:** | | | |
| Owners of the parent | | 19,997,844 | 11,111,048 |
| Non-controlling interests | | 54,633 | (35,600) |
| | | **20,052,477** | **11,075,448** |
| **Total comprehensive income/(loss) attributable to:** | | | |
| Owners of the parent | | 27,588,209 | 12,189,656 |
| Non-controlling interests | | 4,232 | (26,993) |
| | | **27,592,441** | **12,162,663** |
| Earnings per share – basic and diluted (in RR) | 29 | 294.38 | 163.56 |

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

| | Note | 2010 | 2009 |
|---|---|---|---|
| **Operating profit** | | **26,025,963** | **10,712,389** |
| Income tax paid | | (3,736,157) | (1,767,696) |
| **Operating profit less income tax paid** | | **22,289,806** | **8,944,693** |
| Depreciation and amortisation | 24 | 3,465,963 | 2,976,353 |
| Net loss on disposals and write-off of property, plant and equipment and other intangible assets | | 370,788 | 262,098 |
| Impairment of receivables and provision for obsolete and damaged inventories | | (32,578) | 192,265 |
| Other non-cash (income)/expenses | | (1,147,301) | 540,363 |
| **Gross cash flow** | **5** | **24,946,678** | **12,915,772** |
| Changes in operating assets and liabilities: | | | |
| Trade receivables | | (111,650) | 896,167 |
| Advances to suppliers | | (424,551) | 20,612 |
| Other receivables | | (5,443) | 2,023,335 |
| Inventories | | (1,534,620) | 2,969,179 |
| Trade payables | | 244,784 | (251,884) |
| Advances from customers | | 761,765 | 735,336 |
| Other payables | | 1,768,154 | (1,280,751) |
| Other assets and liabilities | | 548,842 | (489,073) |
| **Net cash – operating activities** | | **26,193,959** | **17,538,693** |
| **Cash flows from investing activities** | | | |
| Capital expenditure on property, plant and equipment and other intangible assets | | (20,417,298) | (18,593,560) |
| Investment grants received | 7 | 146,764 | - |
| Purchase of mineral rights | 11 | (46,611) | (108,220) |
| Acquisition of subsidiary, net of cash acquired | | - | (149,913) |
| Acquisition of available-for-sale investments | | - | (25,405,127) |
| Proceeds from sale of property, plant and equipment | | 48,306 | 78,937 |
| Proceeds from disposal of non-current assets held for sale | | - | 68,069 |
| Proceeds from disposal of trading investments | | - | 311,855 |
| Proceeds from sale of available-for-sale investments | 10 | 5,398,834 | 7,374,575 |
| Proceeds from sale of derivatives | | 226,061 | 193,458 |
| Dividends received, net of tax | | 140,549 | 2,060,279 |
| Repayment of originated loans | | - | 6,568,110 |
| Interest received | | 172,059 | 560,572 |
| **Net cash – investing activities** | | **(14,331,336)** | **(27,040,965)** |
| **Free cash inflow/(outflow)** | **5** | **11,862,623** | **(9,502,272)** |
| **Cash flows from financing activities** | | | |
| Proceeds from bank borrowings | 16 | 10,424,846 | 9,843,054 |
| Repayment of bank borrowings | 16 | (25,751,901) | (15,800,009) |
| Proceeds from bonds, net of transaction costs | | 9,955,112 | - |
| Prepaid and additional transaction costs | | (15,239) | (140,343) |
| Interest paid | | (1,672,262) | (1,778,824) |
| Acquisition of interest in subsidiaries | 31 | (448,983) | (4,255) |
| Dividends paid | 15 | (5,834,000) | - |
| **Net cash – financing activities** | | **(13,342,427)** | **(7,880,377)** |
| Effect of exchange rate changes on cash and cash equivalents | | (300,345) | 1,834,071 |
| **Net decrease in cash and cash equivalents** | | **(1,780,149)** | **(15,548,578)** |
| **Cash and cash equivalents at the beginning of the period** | **14** | **10,676,772** | **26,225,350** |
| **Cash and cash equivalents at the end of the period** | **14** | **8,896,623** | **10,676,772** |

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

| | | Attributable to owners of the parent | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Note | Share capital | Treasury shares | Cumulative currency translation differences | Revaluation of investments available-for-sale | Retained earnings | Total | Non-controlling interests | Total equity |
| **Balance at 1 January 2009** | | **6,800,000** | **(7,760)** | **1,529,180** | **4,371,990** | **47,533,368** | **60,226,778** | **809,874** | **61,036,652** |
| **Comprehensive income** | | | | | | | | | |
| Profit/(loss) for the period | | - | - | - | - | 11,111,048 | 11,111,048 | (35,600) | 11,075,448 |
| *Other comprehensive income* | | | | | | | | | |
| Currency translation differences | | - | - | 355,581 | - | - | 355,581 | 8,607 | 364,188 |
| Revaluation of investments available-for-sale | | - | - | - | 1,689,667 | - | 1,689,667 | - | 1,689,667 |
| Disposal of investments available-for-sale | | - | - | - | (966,640) | - | (966,640) | - | (966,640) |
| *Total other comprehensive income* | | - | - | 355,581 | 723,027 | - | 1,078,608 | 8,607 | 1,087,215 |
| **Total comprehensive income** | | **-** | **-** | **355,581** | **723,027** | **11,111,048** | **12,189,656** | **(26,993)** | **12,162,663** |
| **Transactions with owners** | | | | | | | | | |
| Acquisitions of additional interest in subsidiaries | | - | - | - | - | 19,943 | 19,943 | (24,198) | (4,255) |
| **Total transactions with owners** | | - | - | - | - | **19,943** | **19,943** | **(24,198)** | **(4,255)** |
| **Balance at 31 December 2009** | | **6,800,000** | **(7,760)** | **1,884,761** | **5,095,017** | **58,664,359** | **72,436,377** | **758,683** | **73,195,060** |
| | | | | | | | | | |
| **Balance at 1 January 2010** | | **6,800,000** | **(7,760)** | **1,884,761** | **5,095,017** | **58,664,359** | **72,436,377** | **758,683** | **73,195,060** |
| **Comprehensive income** | | | | | | | | | |
| Profit for the period | | - | - | - | - | 19,997,844 | 19,997,844 | 54,633 | 20,052,477 |
| *Other comprehensive income* | | | | | | | | | |
| Currency translation differences | | - | - | (644,882) | - | - | (644,882) | (50,401) | (695,283) |
| Revaluation of investments available-for-sale | | - | - | - | 9,642,508 | - | 9,642,508 | - | 9,642,508 |
| Disposal of investments available-for-sale | | - | - | - | (1,407,261) | - | (1,407,261) | - | (1,407,261) |
| *Total other comprehensive income* | | - | - | (644,882) | 8,235,247 | - | 7,590,365 | (50,401) | 7,539,964 |
| **Total comprehensive income** | | **-** | **-** | **(644,882)** | **8,235,247** | **19,997,844** | **27,588,209** | **4,232** | **27,592,441** |
| **Transactions with owners** | | | | | | | | | |
| Dividends | 15 | - | - | - | | (5,834,000) | (5,834,000) | - | (5,834,000) |
| Acquisitions of additional interest in subsidiaries | 31 | - | - | - | - | (9,964) | (9,964) | (439,019) | (448,983) |
| **Total transactions with owners** | | **-** | **-** | **-** | **-** | **(5,843,964)** | **(5,843,964)** | **(439,019)** | **(6,282,983)** |
| **Balance at 31 December 2010** | | **6,800,000** | **(7,760)** | **1,239,879** | **13,330,264** | **72,818,239** | **94,180,622** | **323,896** | **94,504,518** |

## 1 The EuroChem Group and its operations

EuroChem Group comprises the parent entity, Open Joint Stock Company Mineral Chemical Company "EuroChem" (the "Company"), and its subsidiaries (collectively the "Group" or "EuroChem Group").

The Group's principal activities include extracting minerals (iron-ore, apatite and baddeleyite), producing fertilisers and their distribution in domestic and foreign markets. The Group manufactures a large number of products, the most significant of which is a wide range of mineral fertilizers (nitrogen and phosphate group).

A company that holds the business interests beneficially of Mr. Andrey Melnichenko owns 100% of Linea Limited registered in Bermuda, which in turn owns 95% of EuroChem Group S.E. (formerly MCC Holding Public Company Limited (Cyprus)). The remaining 5% is held by Mr. Dmitry Strezhnev, CEO of the Group. EuroChem Group S.E. owns 99.9% of EuroChem. In September 2010, MCC Holding Public Company Limited (Cyprus) changed its legal form to S.E. (Societas Europea) and its name to "EuroChem Group S.E.". As of the date of these consolidated financial statements, the company continued to be registered in Cyprus.

The Group's manufacturing facilities are primarily based in the Russian Federation with the exception of one entity, Lifosa AB, located in Lithuania.

The Company was incorporated and domiciled in the Russian Federation on 27 August 2001 as a closed joint stock company. On 3 April 2006 the Company changed its legal form to an open joint stock company. The Company has its registered office at:

Dubininskaya St. 53, bld. 6
Moscow, Russian Federation

## 2 Basis of presentation and significant accounting policies

***Basis of presentation.*** These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by available-for-sale investments, which are accounted for at fair value. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all periods presented, unless otherwise stated (Note 4).

***Reclassifications.*** Certain reclassifications have been made to prior year amounts in the consolidated statement of comprehensive income and related notes to conform to the current period presentation. The reclassifications relate to the expenses of RR 1,444,271 thousand were reclassified to the line "Cost of sales – Materials and components used or resold" from line "Distribution costs – Transportation".

***Functional currency.*** The functional currency for the Group's subsidiaries located in Russia is the national currency of the Russian Federation, the Russian Rouble ("RR"). The Group has a subsidiary located in Lithuania, where the functional currency is the Lithuanian Lita, which is the currency of measurement in Lifosa AB's financial statements. These have been translated into Russian Roubles, the presentation currency, at the applicable exchange rates as required by IAS 21 "The Effects of Changes in Foreign Exchange Rates" ("IAS 21") for inclusion in these consolidated financial statements.

***Translation from functional to presentation currency.*** These consolidated financial statements have been presented in Russian Roubles ("RR"), which management believes is the most useful currency to adopt for users of these consolidated financial statements. The results and financial position of each group entity are translated into the presentation currency using the official exchange rate of the Central Bank of the Russian Federation (hereinafter "CBRF") as follows:

(i) assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;

(ii) income and expenses for the statement of comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as currency translation differences in other comprehensive income.

***Foreign currency translation.*** The functional currency of each of the Group's consolidated entities is the currency of the primary economic environment in which the entity operates. Monetary assets and liabilities are translated into each entity's functional currency at the official exchange rate of the CBRF at the respective balance sheet dates. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into each entity's functional currency at year-end official exchange rates of the CBRF are recognised in profit and loss. Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit and loss are recognised in profit and loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available-for-sale are recognised in other comprehensive income.

## 2 Basis of presentation and significant accounting policies (continued)

Foreign exchange gains and losses that relate to borrowings and deposits are presented in the consolidated statement of comprehensive income in a separate line “Financial foreign exchange gain/(loss) – net”. All other foreign exchange gains and losses are presented in the profit and loss within “Other operating income/(expenses)”.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. When a subsidiary is disposed of through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity, the exchange differences recognised in other comprehensive income and accumulated in the separate component of equity are reclassified to profit and loss.

In addition to RR, the Group enters into transactions in other currencies, such as the United States Dollar (“US$”) and the Euro.

***Consolidated financial statements.*** Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has the power to govern the financial and operating policies so as to obtain economic benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are de-consolidated from the date that control ceases.

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest’s proportionate share of the acquiree’s net assets.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group’s share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit and loss.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all of its subsidiaries use uniform accounting policies consistent with the Group’s policies.

***Transactions and non-controlling interest.*** The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

***Property, plant and equipment.*** Property, plant and equipment are stated at cost, restated to the equivalent purchasing power of the Russian Rouble at 31 December 2002 for assets acquired prior to 1 January 2003, less accumulated depreciation and a provision for impairment, where required.

At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset’s fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the profit and loss. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset’s value in use or fair value less costs to sell. Minor repair and maintenance costs are expensed when incurred. The cost of replacing major parts or components of property, plant and equipment items is capitalised and the replaced part is retired.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in the profit and loss.

***Depreciation.*** Depreciation of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

| | Useful lives in years |
|---|---|
| Buildings and land improvements | 15 to 80 |
| Transfer devices | 25 to 30 |
| Machinery and equipment | 2 to 30 |
| Transport | 5 to 25 |
| Other items | 1 to 8 |

## 2 Basis of presentation and significant accounting policies (continued)

The residual value of an asset is the estimated amount that the Group would currently obtain from disposing of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

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

***Operating leases.*** Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit and loss on a straight-line basis over the period of the lease.

When assets are leased out under an operating lease, the lease payments receivable are recognised as rental income on a straight-line basis over the lease term.

***Goodwill.*** Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is presented separately in the consolidated statement of financial position. Goodwill is carried at cost less accumulated impairment losses, if any. The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is allocated to the acquirer's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination.

Such units or group of units represent the lowest level at which the Group monitors goodwill and are not larger than an operating segment. Gains or losses on disposal of an operation within a cash generating unit to which goodwill has been allocated include the carrying amount of goodwill associated with the operation disposed of, generally measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit which is retained. Goodwill on acquisitions of associates is included in the investment in associates.

***Other intangible assets.*** The Group's other intangible assets have definite and indefinite useful lives and primarily include acquired land lease agreements and capitalized computer software costs.

Acquired computer software licenses, beneficial land and equipment lease agreements are capitalised on the basis of the costs incurred to acquire and bring them to use.

Intangible assets with definite useful lives are amortised using the straight-line method over their useful lives:

| | Useful lives in years |
|---|---|
| Land lease agreements | 45 |
| Equipment lease agreements | 5 |
| Software licences | 5 |

Intangible assets with an indefinite useful life are not amortised. The Group tests such intangible assets for impairment at least annually and whenever there are indications that intangible assets may be impaired.

If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less cost to sell.

***Exploration assets.*** Expenditures incurred in exploration activities (acquisition of rights to explore; topographical, geological, geochemical and geophysical studies; exploratory drilling; trenching; sampling; and activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource) are expensed unless they meet the definition of an asset. The Group recognises an asset when it is probable that economic benefits will flow to the Group as a result of the expenditure. In accordance with IFRS 6, *Exploration for and Evaluation of Mineral Resources,* exploration assets are measured applying the cost model described in IAS 16, *Property, plant and equipment* after initial recognition. Depreciation and amortisation are not calculated for exploration assets because the economic benefits that the assets represent are not consumed until the production phase. Exploration assets are tested for impairment when there are facts and circumstances that suggest that the carrying value of the asset may not be recoverable.

***Development expenditure.*** Development expenditure incurred by the Group is accumulated separately for each area of interest in which economically recoverable resources have been identified. Such expenditure comprises cost directly attributable to the construction of a mine and the related infrastructure. Once a development decision has been taken, the expenditure in respect of the area of interest is classified in the assets under construction category.

## 2 Basis of presentation and significant accounting policies (continued)

***Classification of financial assets.*** The Group classifies its financial assets into the following measurement categories: a) loans and receivables; b) available-for-sale financial assets; c) financial assets held to maturity and d) financial assets at fair value through profit and loss. Financial assets at fair value through profit and loss have two subcategories: (i) assets designated as such upon initial recognition, and (ii) those classified as held for trading.

Financial assets held for trading are classified in this category if acquired principally for the purpose of selling in the short term. Trading investments are not reclassified out of this category even when the Group's intentions subsequently change.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in the current assets, except for those with maturities greater than 12 months after the reporting date, which are classified as non-current assets.

The "Held-to-maturity" classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at each balance sheet date. At 31 December 2010 and 2009 the Group did not have "held to maturity" investments.

All other financial assets are included in the available-for-sale category.

***Initial recognition of financial instruments.*** Trading investments and derivatives are initially recorded at their fair value. All other financial assets and liabilities are initially recorded at their fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and the transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at their trade date, which is the date that the Group commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

***De-recognition of financial assets.*** The Group de-recognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

***Available-for-sale investments.*** Available-for-sale investments are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit and loss. Dividends on available-for-sale equity instruments are recognised in profit and loss when the Group's right to receive payment is established. All other elements of changes in the fair value are recognised in other comprehensive income and accumulated in equity until the investment is derecognised or impaired at which time the cumulative gain or loss is reclassified from equity to profit and loss.

Impairment losses are recognised in profit and loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of available-for-sale investments. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any revaluation loss on that asset previously recognised in other comprehensive income – is reclassed from equity and recognised in profit and loss. Impairment losses on equity instruments are not reversed through profit and loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit and loss, the impairment loss is reversed through the current period's profit and loss.

***Derivative financial instruments.*** As part of trading activities the Group is also party to derivative financial instruments including forward, options and swap contracts in foreign exchange and securities. The Group's policy is to measure these instruments at fair value, with resultant gains or losses being reported within the profit and loss. The fair value of derivatives financial instruments is determined using actual market data information and valuation techniques based on prevailing market interest rate for similar instruments as appropriate. The Group has no derivatives accounted for as hedges.

## 2 Basis of presentation and significant accounting policies (continued)

***Income taxes.*** Income taxes have been provided for in the consolidated financial statements in accordance with tax legislation enacted or substantively enacted by the reporting date for each country where the Group subsidiaries are registered. The income tax charge comprises current tax and deferred tax and is recognised in the profit and loss unless it relates to transactions that are recognised, in the same or a different period, in other comprehensive income or directly in equity. The most significant Group subsidiaries are registered in Russia, where the corporate income tax rate can range from 15.5% to 20%, depending on applicable rates set by regional authorities (2009: from 15.5% to 20%).

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxes, other than on income, are recorded within operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

Deferred income tax is provided on post acquisition retained earnings of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not be reversed through dividends or otherwise in the foreseeable future.

***Inventories.*** Inventories are recorded at the lower of cost and net realisable value. The cost of inventory is determined on the weighted average basis. The cost of finished goods and work in progress comprises raw material, direct labour, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

***Trade and other receivables.*** Trade and other receivables are carried at amortised cost using the effective interest method. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy and default or delinquency in payments are considered indicators that the trade and other receivables are impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the profit and loss. When a receivable is uncollectable, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited in the profit and loss.

***Cash and cash equivalents.*** Cash and cash equivalents include cash in hand, term deposits held with banks, and other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. Term deposits for longer than three months that can be redeemed, subject to the interest income being forfeited, may be classified as cash equivalents if the deposit is held to meet short term cash needs and there is no significant risk of a change in value as a result of an early withdrawal. The longer the deposit's term, the less likely it becomes that the instrument is being held to meet short term cash needs and is subject to insignificant changes in value. Cash and cash equivalents are carried at amortised cost using the effective interest method. Restricted balances are excluded from cash and cash equivalents for the purposes of the consolidated statement of cash flows. Balances restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date are included in non-current assets.

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

***Treasury shares.*** Where any Group company purchases the Company's equity share capital, the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

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

## 2 Basis of presentation and significant accounting policies (continued)

***Value added tax.*** Output value added tax ("VAT") related to sales is payable to tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the consolidated statement of financial position on a gross basis and disclosed separately as a current asset and liability. Where provision has been made for impairment of receivables, an impairment loss is recorded for the gross amount of the debtor, including VAT.

***Borrowings.*** Borrowings are initially recognised at fair value, net of transaction costs incurred and are subsequently stated at amortised cost using the effective interest method. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

***Trade and other payables.*** Trade payables are accrued when the counterparty performed its obligations under the contract and are carried at amortised cost using the effective interest method.

***Investment grants.*** Investment grants are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Investment grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred income and are credited to the profit and loss on a straight-line basis over the expected lives of the related assets.

***Provisions for liabilities and charges.*** Provisions for liabilities and charges are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

***Asset retirement obligations.*** The estimated costs of dismantling and removing an item of property, plant and equipment (asset retirement obligations) are added to the cost of an item of property, plant and equipment when incurred either when an item is acquired or as the item is used during a particular period for purposes other than to produce inventories during that period. Changes in the measurement of an existing asset retirement obligation that result from changes in the estimated timing or amount of the outflows, or from changes in the discount rate adjust the cost of the related asset in the current period.

***Revenue recognition.*** Revenues from sales of goods are recognised at the point of transfer of risks and rewards of ownership of the goods, normally when the goods are shipped. If the Group agrees to transport goods to a specified location, revenue is recognised when the goods are passed to the customer at the destination point.

Revenues from the rendering of services are recognised in the period the services are provided. Sales are shown net of VAT and discounts. Revenues are measured at the fair value of the consideration received or receivable. Interest income is recognised on a time-proportion basis using the effective interest method.

***Employee benefits.*** Wages, salaries, contributions to the Russian Federation state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services, etc.) are accrued in the year in which the associated services are rendered by the employees of the Group.

***Earnings per share.*** Earnings per share is determined by dividing the profit and loss attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the reporting year.

***Segment reporting.*** A segment is a distinguishable component of the Group that is engaged either in providing products or services (operating segment). Segments whose sales or result are ten percent or more of all the segments are reported separately. Segment reporting is prepared in a manner consistent with the internal reporting provided to the chief operating decision-maker.

## 3 Critical accounting estimates, and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

***Taxation.*** Judgments are required in determining current income tax liabilities (Note 28). The Group recognises liabilities for taxes based on estimates of whether additional taxes will be due. Where the final outcome of various tax matters is different from the amounts that were initially recorded, such differences will impact the current income tax and deferred taxes provision in the period in which such determination is made.

## 3 Critical accounting estimates, and judgements in applying accounting policies (continued)

***Deferred income tax recognition.*** The net deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the consolidated statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future, management makes judgements and estimates based on the last three years' taxable profits and expectations of future income that are believed to be reasonable under the circumstances (Note 28).

The Group has not recognised a deferred tax liability in respect of temporary differences associated with investments in subsidiaries to the amount of RR 172,657 thousand (2009: RR 667,166 thousand) as the Group controls the timing of the reversal of those temporary differences and does not expect to reverse them in the foreseeable future.

***Land.*** Certain industrial premises of the Group's subsidiary OJSC Baltyiskie Generalnie Gruzy are located on land occupied under a short-term lease. The management believes that no losses will be sustained by the Group due to the short-term nature of the land lease since it will be able to either purchase the land or to secure its use via a long-term lease agreement in due course.

***Related party transactions.*** The Group enters into transactions with its related parties in the normal course of business. These transactions are priced predominantly at market rates. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining whether transactions are priced at market or non-market interest rates where there is no active market for such transactions. Judgements are made by comparing prices for similar types of transactions with unrelated parties and performing effective interest rate analyses.

## 4 Adoption of new or revised standards and interpretations

The following new standards, amendments to standards and interpretations became effective for the Group from 1 January 2010:

- IFRS 1, First-time Adoption of International Financial Reporting Standards (following an amendment in December 2008, effective for the first IFRS financial statements for periods beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Group concluded that the revised standard does not have any effect on its consolidated financial statements;

- IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 requires an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary has to be measured at its fair value. The effect on the consolidated financial statements as at 31 December 2010 was not material;

- IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 allows entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer has to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Acquisition-related costs are accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer has to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date are recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The effect on the consolidated financial statements as at 31 December 2010 was not material;

- IFRIC 17, Distribution of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009). The amendment clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets is recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 is currently not relevant to the Group's operations because it does not distribute non-cash assets to owners;

## 4 Adoption of new or revised standards and interpretations (continued)

- Eligible Hedged Items – Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment currently does not have any impact on the Group's consolidated financial statements as the Group does not apply hedge accounting;

- IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 does not impact the Group's consolidated financial statements;

- Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IAS 1, IAS 7, IFRS 8, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. In addition, the amendments clarifying classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary published as part of the Annual Improvements to International Financial Reporting Standards, which were issued in May 2008, are effective for annual periods beginning on or after 1 July 2009. The improvements do not have a material effect on the Group's consolidated financial statements;

- Group Cash-settled Share-based payment Transactions – Amendments to IFRS 2, Share-based Payment (effective for annual periods beginning on or after 1 January 2010). In addition to incorporating IFRIC 8 and IFRIC 11, the amendments expand on the guidance in IFRIC 11 to address the classifications of group arrangements that were not covered by that interpretation. These amendments are not relevant to the Group;

- Additional Exemptions for First-time Adopters – Amendments to IFRS 1, First-time Adoption of IFRS (effective for annual periods beginning on or after 1 January 2010). The amendments do not have any impact on the Group's consolidated financial statements;

- The International Financial Reporting Standard for Small and Medium-sized Entities (issued in July 2009). The Group does not intend to adopt the IFRS for SMEs.

A number of new standards, amendments to standards and interpretations are not yet effective as at 31 December 2010, and have not been early adopted:

- Amendment to IAS 24, Related Party Disclosures (issued in November 2009 and effective for annual periods beginning on or after 1 January 2011);

- IFRS 9, Financial Instruments Part 1: Classification and Measurement (issued in November 2009, effective for annual periods beginning on or after 1 January 2013, with earlier application permitted). The Group is currently assessing the impact of the amended standard on its consolidated financial statements;

- Improvements to International Financial Reporting Standards (issued in May 2010 and effective for the Group from 1 January 2011). The Group is currently assessing the impact of the amended standards on its consolidated financial statements;

- Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14 (effective for annual periods beginning on or after 1 January 2011);

## 4 Adoption of new or revised standards and interpretations (continued)

- Classification of Rights Issues – Amendment to IAS 32, Financial Instruments: Presentation (issued in October 2009 and effective for annual periods beginning on or after 1 February 2010);
- IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments (effective for annual periods beginning on or after 1 July 2010);
- Limited exemption from comparative IFRS 7 disclosures for first-time adopters - Amendment to IFRS 1 (effective for annual periods beginning on or after 1 July 2010);
- Recovery of Underlying Assets – Amendments to IAS 12 (issued in December 2010 and effective for annual periods beginning on or after 1 January 2012);
- Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters – Amendments to IFRS 1 (issued in December 2010 and effective for annual periods beginning on or after 1 July 2011);
- Disclosures – Transfers of Financial Assets – Amendments to IFRS 7 (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011).

Unless otherwise described above, the new standards, amendments to standards and interpretations are not expected to significantly affect the Group's consolidated financial statements.

## 5 Statement of cash flows

In managing the business, management focuses on a number of cash flow measures including "gross cash flow" and "free cash flow". Gross cash flow refers to the operating profit after taxes and adjusted for items which are not of a cash nature, which have been charged or credited to the profit and loss. The gross cash flow is available to finance movements in operating assets and liabilities, investing and financing activities. The gross cash flow for the year ended 31 December 2010 was RR 24,946,678 thousand (2009: RR 12,915,772 thousand).

Free cash flows are the cash flows available to providers of finance of the business, be this debt or equity. The free cash inflow for the year ended 31 December 2010 was RR 11,862,623 thousand (2009: outflow of RR 9,502,272 thousand).

Since these terms are not standard IFRS measures EuroChem Group's definition of gross cash flow and free cash flow may differ from that of other companies.

## 6 Segment information

The Group is a vertically integrated business with operations spanning mining, fertilizer manufacturing, organic synthesis products, sales and distribution. The Group's core business is fertilizers, with a wide product range including nitrogen and phosphate. On a monthly basis the Management Board reviews the financial reports of the Group, evaluates the operating results and allocates resources between the operating segments. Budgets and financial reports are prepared in a standard format according to the IFRS accounting policy adopted by the Group. Sales between segments are carried out on an arm's length basis. The Management Board assesses the performance of the operating segments based on, among others, a measure of profit before taxation adjusted by interest expense, depreciation and amortization, financial foreign exchange gain or loss, other non-cash and extraordinary items, excluding net profit for the period attributed to non-controlling interests (EBITDA). Since this term is not a standard IFRS measure EuroChem Group's definition of EBITDA may differ from that of other companies.

The development and approval of strategies, market situation analysis, the risk assessment, investment focus, technological process changes, goals and priorities are set and assessed in line with the segment structure of the Group:

- Nitrogen – the production and sale of nitrogen mineral fertilizers and organic synthesis products;
- Phosphates – the production and sale of phosphate mineral fertilizers and the extraction of ores to produce and subsequently sell baddeleyite and iron-ore concentrates;
- Potash – the development of several deposits of potassium salts ("potash") under the licenses acquired by the Group with a view to start production and marketing of potassium fertilizers. No sales have been recorded to date in this segment;
- Distribution – retail sales of mineral fertilizers (including those not produced by the Group), seeds, crop protection items etc via a number of retailers located within Russia and the CIS;
- All other – certain logistics and service activities, central management, investment income and other items.

_(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)_

## 6 Segment information (continued)

The segmental results for the year ended 31 December 2010 were as follows:

| | External sales | Internal sales | Total sales | EBITDA |
|---|---|---|---|---|
| Nitrogen | 40,315,242 | 6,906,632 | 47,221,874 | 13,568,863 |
| Phosphates | 46,475,125 | 2,027,108 | 48,502,233 | 16,791,934 |
| Potash | - | - | - | (420,652) |
| Distribution | 8,542,966 | 649 | 8,543,615 | 489,870 |
| Other | 2,454,200 | 17,500,796 | 19,954,996 | (225,390) |
| Elimination | - | (26,435,185) | (26,435,185) | (267,572) |
| **Total** | **97,787,533** | **-** | **97,787,533** | **29,937,053** |

The segmental results for the year ended 31 December 2009 were as follows:

| | External sales | Internal sales | Total sales | EBITDA |
|---|---|---|---|---|
| Nitrogen | 35,441,252 | 4,135,932 | 39,577,184 | 9,314,223 |
| Phosphates | 29,601,687 | 1,522,511 | 31,124,198 | 4,427,044 |
| Potash | - | - | - | (246,796) |
| Distribution | 5,389,809 | 5,127 | 5,394,936 | 22,400 |
| Other | 3,144,501 | 11,944,242 | 15,088,743 | 2,798,944 |
| Elimination | - | (17,607,812) | (17,607,812) | 200,422 |
| **Total** | **73,577,249** | **-** | **73,577,249** | **16,516,237** |

A reconciliation of total profit before taxation is provided as follows:

| | Note | 2010 | 2009 |
|---|---|---|---|
| EBITDA | | 29,937,053 | 16,516,237 |
| Depreciation and amortisation | 24 | (3,465,963) | (2,976,353) |
| Idle property, plant and equipment write-off | | (171,370) | (83,872) |
| Gain/(loss) on disposal of non-current assets held for sale | | (429,598) | 358,878 |
| Gain/(loss) on disposal of available-for-sale investments | | 1,407,261 | 966,640 |
| Financial foreign exchange gain/(loss) – net | | (389,660) | 748,903 |
| Interest expense | | (2,066,011) | (1,983,587) |
| Other financial income/(loss) – net | | 134,831 | 193,458 |
| Non-controlling interest | | 54,633 | (35,600) |
| **Profit before taxation** | | **25,011,176** | **13,704,704** |

Substantially all of the Group's operating assets are located in the Russian Federation. Operating assets, located in foreign countries are mainly represented by assets of the Group's production subsidiary Lifosa AB, located in Lithuania.

The analysis of non-current assets other than financial instruments and deferred tax assets by geographical locations was as follows:

| | 2010 | 2009 |
|---|---|---|
| Non-current assets, located in Russia | 76,355,779 | 59,649,410 |
| Non-current assets, located in foreign countries | 5,103,283 | 4,636,826 |
| **Total** | **81,459,062** | **64,286,236** |

The analysis of Group sales by geographical area was:

| | 2010 | 2009 |
|---|---|---|
| Export | 74,759,773 | 58,979,433 |
| Domestic | 23,027,760 | 14,597,816 |
| **Total sales** | **97,787,533** | **73,577,249** |

The analysis of Group sales by region was:

| | 2010 | 2009 |
|---|---|---|
| Russia | 23,027,760 | 14,597,816 |
| CIS | 12,566,964 | 9,031,643 |
| Asia | 18,634,080 | 17,761,986 |
| Europe | 18,371,193 | 15,285,533 |
| Latin America | 14,185,236 | 9,113,780 |
| North America | 8,402,679 | 3,729,779 |
| Africa | 2,305,478 | 3,539,876 |
| Australasia | 294,143 | 516,836 |
| **Total sales** | **97,787,533** | **73,577,249** |

The sales are allocated by regions based on the destination country. There were no sales in excess of 10% to any one country, except for Russia, during the year ended 31 December 2010 and 31 December 2009.

In 2010 and 2009 the Group had no external customers representing 10% or more of the Group's revenue.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 7 Property, plant and equipment

Movements in the carrying amount of property, plant and equipment were as follows:

| | Buildings | Land and Land Improvements | Transfer devices | Machinery and equipment | Transport | Other | Assets under construction | Total |
|---|---|---|---|---|---|---|---|---|
| **Gross carrying value** | | | | | | | | |
| **Balance at 1 January 2010** | **7,389,446** | **4,373,517** | **4,113,852** | **23,837,874** | **7,258,905** | **1,310,536** | **31,778,459** | **80,062,589** |
| Additions and transfers from assets under construction | 2,590,702 | 1,989,524 | 1,154,673 | 8,130,286 | 822,698 | 586,316 | 5,452,776 | 20,726,975 |
| Disposals | (10,116) | (4,153) | (5,599) | (396,225) | (64,679) | (29,297) | (8,389) | (518,458) |
| Idle property, plant and equipment write-off | (95,972) | (5,575) | (5,670) | (132,548) | (1,042) | (410) | (103,120) | (344,337) |
| Currency translation difference (Note 2) | (97,518) | (54,304) | (37,253) | (189,953) | (5,770) | (7,914) | (15,209) | (407,921) |
| **Balance at 31 December 2010** | **9,776,542** | **6,299,009** | **5,220,003** | **31,249,434** | **8,010,112** | **1,859,231** | **37,104,517** | **99,518,848** |
| **Accumulated Depreciation and Impairment** | | | | | | | | |
| **Balance at 1 January 2010** | **(2,438,128)** | **(1,560,251)** | **(2,313,315)** | **(13,880,982)** | **(2,740,503)** | **(746,993)** | **-** | **(23,680,172)** |
| Charge for the year | (348,185) | (244,324) | (261,536) | (1,867,825) | (583,109) | (187,535) | - | (3,492,514) |
| Disposals | 9,565 | 4,009 | 5,467 | 318,328 | 58,063 | 24,231 | - | 419,663 |
| Idle property, plant and equipment write-off | 45,433 | 4,372 | 5,662 | 116,323 | 829 | 348 | - | 172,967 |
| Currency translation difference (Note 2) | 20,410 | 32,401 | 15,333 | 104,824 | 2,472 | 7,334 | - | 182,774 |
| **Balance at 31 December 2010** | **(2,710,905)** | **(1,763,793)** | **(2,548,389)** | **(15,209,332)** | **(3,262,248)** | **(902,615)** | **-** | **(26,397,282)** |
| **Net Carrying Value** | | | | | | | | |
| **Balance at 1 January 2010** | **4,951,318** | **2,813,266** | **1,800,537** | **9,956,892** | **4,518,402** | **563,543** | **31,778,459** | **56,382,417** |
| **Balance at 31 December 2010** | **7,065,637** | **4,535,216** | **2,671,614** | **16,040,102** | **4,747,864** | **956,616** | **37,104,517** | **73,121,566** |

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 7 Property, plant and equipment (continued)

| | Buildings | Land and Land Improvements | Transfer devices | Machinery and equipment | Transport | Other | Assets under construction | Total |
|---|---|---|---|---|---|---|---|---|
| **Gross carrying value** | | | | | | | | |
| **Balance at 1 January 2009** | **6,880,694** | **3,844,224** | **3,743,631** | **21,635,860** | **6,617,319** | **1,212,101** | **18,348,561** | **62,282,390** |
| Additions and transfers from assets under construction | 418,404 | 620,614 | 399,282 | 2,348,081 | 717,543 | 137,262 | 13,440,670 | 18,081,856 |
| Acquisitions through business combinations | 160,048 | - | - | 15,567 | - | - | - | 175,615 |
| Disposals | (13,215) | (5,806) | (40,156) | (154,770) | (79,760) | (41,361) | (1,676) | (336,744) |
| Idle property, plant and equipment (write-off)/reversal of write-off | (100,581) | (41,816) | (11,399) | (73,602) | (219) | (593) | 3,520 | (224,690) |
| Currency translation difference (Note 2) | 44,096 | (43,699) | 22,494 | 66,738 | 4,022 | 3,127 | (12,616) | 84,162 |
| **Balance at 31 December 2009** | **7,389,446** | **4,373,517** | **4,113,852** | **23,837,874** | **7,258,905** | **1,310,536** | **31,778,459** | **80,062,589** |
| **Accumulated Depreciation and Impairment** | | | | | | | | |
| **Balance at 1 January 2009** | **(2,186,047)** | **(1,380,358)** | **(2,155,364)** | **(12,448,751)** | **(2,307,609)** | **(606,462)** | **-** | **(21,084,591)** |
| Charge for the year | (309,759) | (182,160) | (199,554) | (1,559,430) | (506,979) | (163,092) | - | (2,920,974) |
| Disposals | 1,685 | 590 | 38,104 | 114,319 | 75,457 | 24,879 | - | 255,034 |
| Idle property, plant and equipment write-off | 62,034 | 16,085 | 10,739 | 51,308 | 124 | 528 | - | 140,818 |
| Currency translation difference (Note 2) | (6,041) | (14,408) | (7,240) | (38,428) | (1,496) | (2,846) | - | (70,459) |
| **Balance at 31 December 2009** | **(2,438,128)** | **(1,560,251)** | **(2,313,315)** | **(13,880,982)** | **(2,740,503)** | **(746,993)** | **-** | **(23,680,172)** |
| **Net Carrying Value** | | | | | | | | |
| **Balance at 1 January 2009** | **4,694,647** | **2,463,866** | **1,588,267** | **9,187,109** | **4,309,710** | **605,639** | **18,348,561** | **41,197,799** |
| **Balance at 31 December 2009** | **4,951,318** | **2,813,266** | **1,800,537** | **9,956,892** | **4,518,402** | **563,543** | **31,778,459** | **56,382,417** |

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 7 Property, plant and equipment (continued)

The analysis of the Group's assets under construction is as follows:

| | 2010 | 2009 |
|---|---|---|
| Construction in progress | 31,791,727 | 26,335,154 |
| Advances given to construction companies and suppliers of property, plant and equipment | 5,312,790 | 5,443,305 |
| **Total assets under construction** | **37,104,517** | **31,778,459** |

During the year ended 31 December 2010 the Group's subsidiary Lifosa AB received a European Union Structural Assistance Grant to finance an increase in production capacity. The amount of the grant is equivalent to RR 146,764 thousand.

During the year ended 31 December 2010 the Group decided to mothball certain production equipment with a gross carrying value and accumulated depreciation of RR 344,337 thousand and RR 172,967 thousand, respectively, at 31 December 2010 (2009: gross carrying value of RR 224,690 thousand and accumulated depreciation of RR 140,818 thousand) and recognised a loss of RR 171,370 thousand in these consolidated financial statements (2009: RR 83,872 thousand) (Note 22).

The assets transferred to the Group upon privatisation did not include the land on which a number of the Group's factories and buildings, comprising the Group's principal manufacturing facilities, are situated. In 2001 all companies located in the Russian Federation were granted the option to purchase this land upon application to the state registration body or to continue occupying this land under a rental agreement. The purchase price of the land is calculated by reference to the cadastral value applied for property taxes and certain coefficients which are determined by local state authorities. This purchase price may significantly differ from its market value. According to the legislation the expiry date to exercise this option is 1 January 2012.

As at 31 December 2010 all of the Group's major Russian-based subsidiaries had acquired the land on which their main production facilities are located. Other subsidiaries which have not exercised the right of acquisition continue to occupy the land plots under lease agreements. For these land plots the future minimum lease payments under non-cancellable operating leases are as follows:

| | 2010 | 2009 |
|---|---|---|
| Shorter than 1 year | 151,398 | 137,827 |
| Between 1 and 5 years | 594,938 | 547,326 |
| Longer than 5 years | 3,934,046 | 3,765,733 |
| **Total** | **4,680,382** | **4,450,886** |

## 8 Goodwill

There were no movements in goodwill during the years ended 31 December 2010 and 31 December 2009.

*Goodwill Impairment Test*

Goodwill is allocated to cash-generating units (CGUs) which represent the lowest level within the Group at which the goodwill is monitored by management and which are not larger than a segment.

The recoverable amount of each CGU was determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five year period.

The 11.5% discount rate used is pre-tax and reflects risks relating to the relevant CGUs (2009: 14.0%).

The Group did not recognize any goodwill impairment at 31 December 2010 and 31 December 2009.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 9 Intangible assets

| | Acquired software and licenses | Other | Total |
|---|---|---|---|
| **Cost at 1 January 2009** | **409,728** | **224,208** | **633,936** |
| **Accumulated amortisation** | **(95,502)** | **(866)** | **(96,368)** |
| **Carrying amount at 1 January 2009** | **314,226** | **223,342** | **537,568** |
| Disposals cost | (3,632) | (14,458) | (18,090) |
| Accumulated amortisation on disposals | - | 511 | 511 |
| Amortisation charge | (83,453) | (900) | (84,353) |
| Currency translation difference | - | (8,179) | (8,179) |
| **Cost at 31 December 2009** | **406,096** | **201,571** | **607,667** |
| **Accumulated amortisation** | **(178,955)** | **(1,255)** | **(180,210)** |
| **Carrying amount at 31 December 2009** | **227,141** | **200,316** | **427,457** |
| Additions | 6,733 | 611,831 | 618,564 |
| Disposals cost and write-offs | - | (149,082) | (149,082) |
| Accumulated amortisation on disposals | - | 153 | 153 |
| Amortisation charge | (79,950) | (3,230) | (83,180) |
| Currency translation difference | 8 | 603 | 611 |
| **Cost at 31 December 2010** | **412,837** | **664,923** | **1,077,760** |
| **Accumulated amortisation** | **(258,905)** | **(4,332)** | **(263,237)** |
| **Carrying amount at 31 December 2010** | **153,932** | **660,591** | **814,523** |

The Group wrote-off the exclusive land lease agreement for the bulk-handling cargo dock in Murmansk previously recognized as an intangible asset with an indefinite useful life and with a carrying value of RR 148,974 thousand, as the key terms of the agreement were adversely amended to bring them in line with market conditions.

In December 2010 the Group acquired 100% of the share capital of OJSC Baltyiskie Generalnie Gruzy, a company located in Ust-Luga, Russian Federation. The purchase consideration comprised RR 586,804 thousand settled in cash. As of the acquisition date the acquired company had no significant assets or liabilities except for the right to construct a sea terminal. The Group considered this transaction an acquisition of an asset rather than a business and recognised an intangible asset with a carrying value RR 586,804 thousand.

No impairment was recognised for these assets at 31 December 2010 and 31 December 2009.

## 10 Available-for-sale investments, including shares pledged as collateral

At 31 December 2010 available-for-sale investments comprised the shares of K+S Group, a German manufacturer of potassium-based fertilizers (2009: shares of K+S Group and OJSC Sberbank).

Movements in the carrying amount of available-for-sale investments, including shares pledged as collateral, were:

| | 2010 | 2009 |
|---|---|---|
| **At 1 January** | **33,619,657** | **13,899,438** |
| Acquisition of available-for-sale investments | - | 25,405,127 |
| Revaluation of available-for-sale investments | 9,642,508 | 1,689,667 |
| Disposal of available-for-sale investments, including: | | |
| - available-for-sale investments at cost | (3,991,573) | (6,407,935) |
| - reclassification of revaluation to profit and loss | (1,407,261) | (966,640) |
| **At 31 December** | **37,863,331** | **33,619,657** |

Available-for-sale investments:

| | 2010 | 2009 |
|---|---|---|
| K+S Group ordinary shares | 36,954,062 | 33,602,943 |
| K+S Group ordinary shares pledged as collateral | 909,269 | - |
| Sberbank ordinary shares | - | 16,714 |
| **Total available-for-sale investments** | **37,863,331** | **33,619,657** |

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 10 Available-for-sale investments, including shares pledged as collateral (continued)

*K+S Group shares, including shares pledged as collateral*

At 31 December 2010 the Group held 16,656,595 shares, or 8.7% of the issued share capital (2009: 19,366,595 shares, or 10.12% of the issued share capital) of K+S Group with a fair value of RR 37,863,331 thousand (2009: RR 33,602,943 thousand) with reference to the share price quoted on the Xetra trading system of Euro 56.36 per share. The accumulated increase in the fair value of the investment of RR 13,330,264 thousand was recognised in equity at 31 December 2010 (2009: RR 5,078,388 thousand).

During the year ended 31 December 2010 the Group sold 2,710,000 ordinary shares of K+S Group on the open market for RR 5,382,667 thousand and recognised a gain of RR 1,391,179 thousand in the profit and loss.

In May 2010 the Group received dividend income from K+S Group of RR 147,946 thousand (2009: RR 2,168,715 thousand) before withholding tax of RR 7,397 thousand (2009; RR 108,436 thousand).

*K+S Group shares pledged as collateral*

In October and December 2010 the Group sold European call options over 1,400,000 K+S Group ordinary shares secured by these shares as collateral with a fair value of RR 3,182,443 thousand with reference to the share price quoted on the Xetra trading system (Note 18).

Out of these, 400,000 pledged shares with a fair value of RR 909,269 thousand have been reclassified to a separate line named "Available-for-sale investments pledged as collateral" in the consolidated statement of financial position, as the mortgagee has the right to use and dispose of the collateral and the Group holds economic exposure in relation to the encumbered shares. If the right of use is exercised, it is obliged to replace the original financial collateral by transferring equivalent financial collateral on or before the due date for the performance of the relevant financial obligations covered by the arrangement.

*Sberbank shares*

In June 2010 the Group sold 202,000 ordinary shares of OJSC Sberbank to a third party for RR 16,167 thousand and recognised a gain of RR 16,082 thousand in the profit and loss.

## 11 Mineral rights

| | 2010 | 2009 |
|---|---|---|
| Rights for exploration and production: | | |
| Verkhnekamskoe potash deposit | 4,087,166 | 4,087,166 |
| Gremyachinskoe potash deposit | 3,017,781 | 3,017,781 |
| Kovdorsky apatite deposits | 166,549 | 166,549 |
| Rights for exploration, evaluation and extraction: | | |
| Yuzhny hydrocarbon deposit | 24,495 | - |
| Perelyubsko-Rubezhinskiy hydrocarbon deposit | 22,116 | - |
| **Total mineral rights** | **7,318,107** | **7,271,496** |

In November 2010 the Group acquired licenses for the exploration, evaluation and extraction of crude hydrocarbons at the Perelyubsko-Rubezhinskiy and Yuzhny deposits located in the Russian Federation. The total consideration amounted to RR 46,611 thousand. As of 31 December 2010 both these licenses were in the exploration phase.

The Group also obtained licenses for exploration and evaluation of the Darganovsky and Ravninny potash fields. Expenses related to the exploration of these fields amounting to RR 144,833 thousand at 31 December 2010 (2009: nil) were recognised in profit and loss. Generally, these expenses are paid in the period the services are provided.

In accordance with the conditions of the licence agreements for developing the potash deposits, the Group has the following major commitments:

- to commence extraction of potash salt at the Gremyachinskoe potash deposit by 1 November 2014;
- to commence construction of an exploration complex at the Verkhnekamskoe potash deposit by 15 April 2012;
- to commence extraction of potash salt at the Verkhnekamskoe potash deposit by 15 April 2014.

The Group has started construction of the mining facilities. The management believes that each stage of the process will be completed according to the schedule. As of 31 December 2010 and 31 December 2009 Verkhnekamskoe and Gremyachinskoe potash deposits were in the development phase.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 11 Mineral rights (continued)

Under the terms of these licenses, the Group is required to comply with a number of conditions, including preparation of design documentation, commencement of the construction of mining facilities and commencement of the extraction of mineral resources by certain dates. If the Group fails to materially comply with the terms of the license agreements there are circumstances whereby the licences can be revoked. The management of the Group believes that the Group faces no material regulatory risks in relation to the validity and operation of any of its licenses.

## 12 Inventories

| | 2010 | 2009 |
|---|---|---|
| Materials | 3,872,290 | 3,050,401 |
| Work in progress | 832,876 | 813,971 |
| Finished goods | 3,891,113 | 3,207,001 |
| Catalysts | 1,558,325 | 1,413,464 |
| Less: provision for obsolete and damaged inventories | (326,712) | (379,770) |
| **Total inventories** | **9,827,892** | **8,105,067** |

## 13 Trade receivables, prepayments, other receivables and other current assets

| | 2010 | 2009 |
|---|---|---|
| **Trade receivables** | | |
| Trade receivables denominated in RR | 1,142,115 | 1,009,891 |
| Trade receivables denominated in US$ | 1,519,960 | 941,536 |
| Trade receivables denominated in Euro | 119,862 | 199,432 |
| Trade receivables denominated in other currencies | 94,520 | 225,165 |
| Less: impairment provision | (165,639) | (224,784) |
| **Total trade receivables – financial assets** | **2,710,818** | **2,151,240** |
| **Prepayments, other receivables and other current assets** | | |
| Advances to suppliers | 3,347,157 | 2,914,765 |
| VAT recoverable and receivable | 3,737,607 | 3,894,625 |
| Income tax receivable | 18,416 | 212,608 |
| Other taxes receivable | 32,076 | 25,847 |
| Other receivables | 511,926 | 541,407 |
| Less: impairment provision | (151,607) | (124,615) |
| **Subtotal non-financial assets** | **7,495,575** | **7,464,637** |
| Interest receivable | 27,557 | 10,531 |
| Other receivables | - | 154,934 |
| **Subtotal financial assets** | **27,557** | **165,465** |
| **Total prepayments, other receivables and other current assets** | **7,523,132** | **7,630,102** |
| **Total trade receivables, prepayments, other receivables and other current assets** | **10,233,950** | **9,781,342** |
| including | | |
| Financial assets | 2,738,375 | 2,316,705 |
| Non-financial assets | 7,495,575 | 7,464,637 |

Management believes that the fair value of accounts receivable does not differ significantly from their carrying amounts.

As of 31 December 2010, accounts receivable, prepayments and other current assets of RR 317,246 thousand (2009: RR 349,399 thousand) were individually impaired and an impairment provision was recognised. The individually impaired receivables mainly relate to counterparties which are facing significant financial difficulties. It was assessed that a portion of the receivables is expected to be recovered. The ageing of these receivables is as follows:

| | 2010 | 2009 |
|---|---|---|
| Less than 3 months | - | 25,388 |
| From 3 to 12 months | 12,689 | 19,047 |
| Over 12 months | 304,557 | 304,964 |
| **Total gross amount of impaired trade receivables, prepayments, other receivables and other current assets** | **317,246** | **349,399** |

As of 31 December 2010, trade receivables of RR 289,456 thousand (2009: RR 599,795 thousand) were past due but not impaired. The ageing analysis of these trade receivables from past due date is:

| | 2010 | 2009 |
|---|---|---|
| Less than 3 months | 175,959 | 407,396 |
| From 3 to 12 months | 97,316 | 152,406 |
| Over 12 months | 16,181 | 39,993 |
| **Trade accounts receivable past due not impaired** | **289,456** | **599,795** |

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 13 Trade receivables, prepayments, other receivables and other current assets (continued)

The movements in the provision for impairment of accounts receivable are:

| | | 2010 | | 2009 | |
|---|---|---|---|---|---|
| | Note | Trade receivables | Other receivables | Trade receivables | Other receivables |
| **As of 1 January** | | **224,784** | **124,615** | **120,295** | **44,212** |
| Provision charged | 23, 24 | 39,026 | 61,318 | 200,086 | 112,917 |
| Provision used | | (36,390) | (13,550) | (11,318) | (812) |
| Provision reversed | 23, 24 | (58,464) | (21,400) | (84,229) | (30,216) |
| Foreign exchange difference | | (3,317) | 624 | (50) | (1,486) |
| **Total provision for impairment of accounts receivable** | | **165,639** | **151,607** | **224,784** | **124,615** |

## 14 Cash and cash equivalents

| | 2010 | 2009 |
|---|---|---|
| Cash on hand and bank balances denominated in RR | 868,314 | 1,072,146 |
| Bank balances denominated in US$ | 1,378,554 | 1,993,965 |
| Bank balances denominated in Euro | 489,559 | 880,578 |
| Balances denominated in other currencies | 88,065 | 18,486 |
| Term deposits denominated in RR | 2,437,055 | 1,727,614 |
| Term deposits denominated in US$ | 3,255,216 | 2,594,479 |
| Term deposits denominated in Euro | 82,760 | 2,088,686 |
| Term deposits denominated in other currencies | 297,100 | 300,818 |
| **Total cash and cash equivalents** | **8,896,623** | **10,676,772** |
| Current restricted cash | 37,461 | 551,086 |
| Non-current restricted cash | 143,898 | 179,115 |
| **Total restricted cash** | **181,359** | **730,201** |

Term deposits at 31 December 2010 and 31 December 2009 have various original maturities but could be withdrawn on request without any restrictions.

No bank balances and term deposits are past due or impaired. Analysis of the credit quality of bank balances and term deposits is as follows:

| | 2010 | 2009 |
|---|---|---|
| A to AAA rated** | 6,033,888 | 7,523,781 |
| BB- to BBB+ rated** | 2,607,990 | 3,539,708 |
| B- to B+ rated** | 59,493 | 3,906 |
| Unrated | 375,126 | 337,584 |
| **Total*** | **9,076,497** | **11,404,979** |

* The rest of the balance sheet item 'cash and cash equivalents' is cash on hand.

** Based on the credit ratings of independent rating agencies Standard & Poor's and Fitch Ratings as at 25 January 2011.

At 31 December 2010 RR 37,461 thousand of current restricted cash was held at bank in compliance with the statutory regulations (2009: RR 551,086 thousand cash was held at banks to meet the next principal and interest payments on bank borrowings).

At 31 December 2010 non-current restricted cash totalling RR 143,898 thousand (2009: RR 179,115 thousand) consisted of RR 103,434 thousand (2009: nil) of cash held in an escrow account as a collateral for Lifosa AB shares squeeze-out and RR 40,464 thousand (2009: RR 179,115 thousand) was represented by letters of credit for equipment procurement and a deposit against possible environmental obligations as required under statutory Lithuanian rules.

The fair value of cash and cash equivalents is equal to their carrying amount.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 15 Equity

The nominal registered amount of the Company's issued share capital at 31 December 2010 is RR 6.8 billion (2009: RR 6.8 billion). The total authorised number of ordinary shares is 68 million shares (2008: 68 million) with a par value of RR 100 per share. All authorised shares have been issued and fully paid.

| | Number of ordinary shares | Share capital | Treasury shares | Total |
|---|---|---|---|---|
| **At 31 December 2008** | **68,000,000** | **6,800,000** | **(7,760)** | **6,792,240** |
| **At 31 December 2009** | **68,000,000** | **6,800,000** | **(7,760)** | **6,792,240** |
| **At 31 December 2010** | **68,000,000** | **6,800,000** | **(7,760)** | **6,792,240** |

***Treasury shares.*** LLC PG Phosphorit, a 100% subsidiary of the Group, held 68,000 ordinary shares of the Company at 31 December 2010 (2009: 68,000 shares). These shares represent 0.1% of the Company's share capital and carry voting rights in the same proportion as other ordinary shares. The voting rights of ordinary shares of the Company held by the entities within the Group are effectively controlled by the management of the Group.

***Profit distribution.*** In accordance with Russian legislation, the Company distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the net statutory profit as the basis for distribution. For the year ended 31 December 2010, the net statutory profit of the Company as reported in the published annual statutory accounting report was RR 8,442,616 thousand (2009: RR 30,234,442 thousand) and the closing balance of the accumulated profit including the net statutory profit totalled RR 56,292,392 thousand (2009: RR 53,709,147 thousand). However, this legislation and other statutory laws and regulations are open to legal interpretation in relation to the depletion of distributable reserves. Accordingly management believes that, at present, it would not be appropriate to disclose an amount for the distributable reserves in these consolidated financial statements.

***Other reserves.*** As at 31 December 2010 other reserves in the consolidated statement of changes in equity comprised an accumulated net gain from currency translation differences of RR 1,239,879 thousand (2009: RR 1,884,761 thousand) and an accumulated increase in the fair value of investments in the shares of K+S Group of RR 13,330,264 thousand (2009: accumulated increase in the fair value of K+S Group shares of RR 5,078,388 thousand and an accumulated increase in the fair value of the shares of OJSC Sberbank of RR 16,629 thousand) (Note 10).

***Dividends.*** Dividends declared and paid during the year were as follows:

| | 2010 | 2009 |
|---|---|---|
| **Dividends payable at 1 January** | - | - |
| Dividends declared during the year | 5,834,000 | - |
| Dividends paid during the year | (5,834,000) | - |
| **Dividends payable at 31 December** | - | - |
| **Dividends per share declared during the year** | - | - |

In September 2010 the shareholders approved an interim dividend of RR 1,598,440 thousand (RR 23.53 per share) for the first half 2010.

In November 2010 the shareholders approved an interim dividend of RR 4,235,560 thousand (RR 62.35 per share) for the third quarter 2010.

The total amount of dividends attributable to treasury shares have been eliminated. All dividends are declared and paid in Russian Roubles.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 16 Bank borrowings

| | 2010 | 2009 |
|---|---|---|
| **Balance as at 1 January** | **39,047,758** | **43,511,956** |
| Bank loans received, denominated in US$ | 5,882,093 | - |
| Bank loans received, denominated in Euro | 166,753 | 9,811,419 |
| Bank loans received, denominated in RR | 4,376,000 | 31,635 |
| Bank loans repaid, denominated in US$ | (18,031,409) | (9,755,831) |
| Bank loans repaid, denominated in Euro | (3,344,492) | (5,993,656) |
| Bank loans repaid, denominated in RR | (4,376,000) | (50,522) |
| Capitalisation and amortisation of transaction costs, net | 291,491 | 66,255 |
| Foreign exchange loss | 42,407 | 1,426,502 |
| **Balance as at 31 December** | **24,054,601** | **39,047,758** |

| | 2010 | 2009 |
|---|---|---|
| Current bank borrowings | | |
| Current portion of long-term bank loans in US$ | 12,757,772 | 12,660,364 |
| Less: short-term portion of transaction costs | (168,005) | (168,930) |
| **Total current bank borrowings** | **12,589,767** | **12,491,434** |
| | | |
| Non-current bank borrowings | | |
| Long-term bank loans, denominated in US$ | 25,259,687 | 35,871,029 |
| Long-term bank loans, denominated in Euro | 341,543 | 3,688,006 |
| Less: current portion of long-term bank loans in US$ | (12,757,772) | (12,660,364) |
| Less: long-term portion of transaction costs | (1,378,624) | (342,347) |
| **Total non-current bank borrowings** | **11,464,834** | **26,556,324** |
| **Total bank borrowings** | **24,054,601** | **39,047,758** |

At 31 December 2010 and 31 December 2009 the fair value of borrowings was not materially different from their carrying amounts.

The Group has not entered into any hedging arrangements in respect of its foreign currency obligations or interest rate exposures.

Under the terms of loan agreements, the Group is required to comply with a number of covenants and restrictions, including the maintenance of certain financial ratios, financial indebtedness and cross-default provisions.

*Interest rates and outstanding amount*

A syndicated loan facility, which was obtained in October 2008 for US$ 1.5 billion, bears a floating interest rate of 1 month Libor +1.8%. The outstanding amount at 31 December 2010 totalled US$ 767,442 thousand (2009: US$ 1,186,047 thousand).

A loan obtained in September 2009 for Euro 85 million, bearing a floating interest rate of 3 month Euribor +2.0%, was fully repaid in April 2010. This credit line was converted into a revolving committed facility with a credit limit of Euro 130 million, which expires in March 2011.

In March 2010 the Group signed a US$ 261 million, 10-year export credit agency-backed loan facility for financing the ongoing construction of the cage shaft at the Gremyachinskoe potash deposit by a South Africa-based company. At 31 December 2010 the facility has been utilised to the amount of US$ 61.4 million.

In April 2010 the Group signed an agreement for a 6 month unsecured loan facility in connection with a RR-denominated bond placement, amounting to US$ 100 million, which was available in US$ and Euro with an interest rate of 1 month Libor +3.25% and in RR with an interest rate of 1 month Mosprime +3.25%. The facility was utilised to RR 450 million and US$ 65 million. In July 2010 the loan was fully refinanced by bond proceeds in accordance with the loan agreement conditions.

In August 2010 the Group signed a US$ 250 million 5-year credit line agreement with a European commercial bank. The disbursed amount has been fully repaid in December 2010.

In August 2010 the Group obtained a loan for RR 3.9 billion from a Russian commercial bank. The loan was fully repaid in August 2010.

In August 2010 the Group signed a Euro 36.7 million, 13-year export credit agency-backed loan facility for financing the acquisition of permanent hoisting equipment for the cage and skip shafts of the Gremyachinskoe potash deposit development project from a Czech engineering company. At 31 December 2010 the facility has been utilised to Euro 8.5 million.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 16 Bank borrowings (continued)

*Collaterals and pledges*

At 31 December 2010 the Group did not hold any cash collaterals restricted by banks to secure the next principal and interest payments (2009: RR 551,086 thousand) (Note 14).

A bank loan of RR 23,389,249 thousand and RR 35,871,029 thousand at 31 December 2010 and 31 December 2009, respectively, was collateralized by future export proceeds of the Group under sales contracts with certain customers.

The Group's bank borrowings mature as follows:

| | 2010 | 2009 |
|---|---|---|
| - within 1 year | 12,589,767 | 12,491,434 |
| - between 1 and 2 years | 10,336,604 | 16,148,572 |
| - between 2 and 5 years | 344,285 | 10,407,752 |
| - more than 5 years | 783,945 | - |
| **Total bank borrowings** | **24,054,601** | **39,047,758** |

## 17 Bonds issued

| | 2010 | 2009 |
|---|---|---|
| 7.875% US$-denominated bonds due March 2012 | 8,838,300 | 8,770,818 |
| 8.9% RR-denominated bonds due July 2018 / callable by investors in July 2015 | 5,000,000 | - |
| 8.25 % RR-denominated bonds due November 2018 / callable by investors in November 2015 | 5,000,000 | - |
| Less: transaction costs | (65,920) | (45,923) |
| **Total bonds** | **18,772,380** | **8,724,895** |

On 21 March 2007 the Group placed through an offering to the public under an open subscription US$ denominated 7.875% bonds with a face value of US$ 300 million to be redeemed on 21 March 2012. The outstanding balance of the bonds was US$ 290 million at 31 December 2010 (2009: US$ 290 million), and the fair value was RR 9,197,136 thousand (2009: RR 8,836,599 thousand) with reference to Irish Stock Exchange quotations.

In July 2010 the Group issued RR-denominated bonds at a nominal value of RR 5 billion bearing a coupon of 8.9% p.a. maturing in June 2018. The bonds give investors the ability to demand from the borrower redemption at par value of the bonds in July 2015. The fair value of the outstanding bonds balance at 31 December 2010 was RR 5.15 billion with reference to MICEX Stock Exchange quotations.

In November 2010 the Group issued RR-denominated bonds at a nominal value of RR 5 billion bearing a coupon of 8.25 % p.a. maturing in November 2018. The bonds give investors the ability to demand from the borrower redemption at par value of the bonds in November 2015. The fair value of the outstanding bonds balance at 31 December 2010 was RR 5.005 billion with reference to MICEX Stock Exchange quotations.

## 18 Derivative financial assets and liabilities

In January and February 2010, the Group sold European call options over 1,200,000 K+S Group ordinary shares for a total premium of RR 106,750 thousand. The strike price was Euro 50.0 and the expiry dates for the options were 18 June 2010 and 17 September 2010. The options were not exercised and the Group recognised a gain of RR 106,750 thousand in the profit and loss.

In May 2010, the Group entered into US$/RR non-deliverable forward contracts for a nominal amount of US$ 450 million. In October 2010 the Group settled the forward contract for US$ 150 million against an opposite forward contract and recognised a gain of RR 48,708 thousand in the profit and loss. The contractual settlement dates of the remaining contracts are 31 March 2011 and 30 June 2011.

In October and December 2010 the Group sold European call options over 1,400,000 K+S Group ordinary shares for a total premium of RR 70,602 thousand. The expiry dates are 18 March 2011 for 200,000 and 17 June 2011 for 1,200,000 K+S Group ordinary shares call options. The options are secured by K+S Group shares as collateral represented by 1,400,000 shares with a fair value of RR 3,182,443 thousand with reference to the share price quoted on the Xetra trading system (Note 10).

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 18 Derivative financial assets and liabilities (continued)

In December 2010 the Group transacted a US$/RR cross currency swap in connection with its issue of a RR-denominated bond due November 2018 and callable by investors in November 2015 (Note 17), as a result of which the Group pays US$ fixed 3.85% and receives RR fixed 8.25% interest the latter being the coupon rate under the subject rouble bond. The swap will mature on 16 November 2015.

At 31 December 2010 the derivative financial assets were represented by assets arising on non-deliverable forward contracts accounted for at a fair value of RR 35,251 thousand and a cross currency swap accounted for at a fair value of RR 1,500 thousand. At 31 December 2010 the derivative financial liabilities were represented by call options accounted for at a fair value of RR 127,981 thousand.

## 19 Provision for land restoration

In accordance with the Russian legislation, the Group has an obligation to restore land disturbed as a result of mining operations after the expiration of the licenses.

The Group recorded a provision for these future expenses for RR 222,887 thousand which is included in other non-current liabilities and deferred credits with a corresponding increase in property, plant and equipment. The 11.5% discount rate used to calculate the net present value of the future cash outflows relating to the land recultivation at 31 December 2010 represents the pre-tax weighted average cost of capital for the Group and is considered appropriate to the Group in the economic environment in the Russian Federation at the end of the year.

## 20 Trade payables, other accounts payable and accrued expenses

| | 2010 | 2009 |
|---|---|---|
| **Trade payables** | | |
| Trade payables denominated in RR | 1,355,864 | 1,007,316 |
| Trade payables denominated in US$ | 327,972 | 141,685 |
| Trade payables denominated in Euro | 358,028 | 39,164 |
| Trade payables denominated in other currencies | 141,087 | 185,323 |
| **Total trade payables – financial liabilities** | **2,182,951** | **1,373,488** |
| **Other accounts payable and accrued expenses** | | |
| Advances received | 2,202,860 | 1,441,095 |
| Payroll and social tax | 292,364 | 262,643 |
| Accrued liabilities and other creditors | 3,088,472 | 1,648,544 |
| **Subtotal non-financial liabilities** | **5,583,696** | **3,352,282** |
| Interest payable | 277,179 | 222,240 |
| **Subtotal financial liabilities** | **277,179** | **222,240** |
| **Total other payables** | **5,860,875** | **3,574,522** |
| **Total trade payables, other accounts payable and accrued expenses** | **8,043,826** | **4,948,010** |
| including | | |
| Financial liabilities | 2,460,130 | 1,595,728 |
| Non-financial liabilities | 5,583,696 | 3,352,282 |

Trade payables include payables to suppliers of property, plant and equipment which amount to RR 694,911 thousand (2009: RR 324,073 thousand).

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 21 Sales

The components of external sales were as follows:

| | | 2010 | 2009 |
|---|---|---|---|
| **Nitrogen** | | | |
| | Nitrogen fertilizers | 29,579,048 | 26,274,056 |
| | Organic synthesis products | 6,425,351 | 5,041,872 |
| | Complex fertilizers group | 3,505,056 | 3,259,941 |
| | Other goods | 453,919 | 538,815 |
| | Other services | 351,868 | 326,568 |
| | | **40,315,242** | **35,441,252** |
| **Phosphates** | | | |
| | Phosphates | 25,071,344 | 17,153,958 |
| | Iron ore concentrate | 15,703,907 | 7,956,948 |
| | Feed phosphates group | 3,018,490 | 2,288,958 |
| | Apatite concentrate | 998,536 | 948,465 |
| | Baddeleyite concentrate | 605,341 | 439,118 |
| | Complex fertilizers group | 126,079 | 50,963 |
| | Other goods | 449,539 | 238,771 |
| | Other services | 501,889 | 524,506 |
| | | **46,475,125** | **29,601,687** |
| **Distribution** | | | |
| | Nitrogen fertilizers | 3,650,659 | 1,984,185 |
| | Phosphates | 1,341,643 | 1,199,879 |
| | Complex fertilizers group | 2,485,672 | 1,398,459 |
| | Feed phosphates group | 51,784 | - |
| | Other goods | 1,000,123 | 796,934 |
| | Other services | 13,085 | 10,352 |
| | | **8,542,966** | **5,389,809** |
| **Others** | | | |
| | Nitrogen fertilizers | 970,324 | 1,562,992 |
| | Organic synthesis products | 40,334 | 120,436 |
| | Complex fertilizers group | 70,280 | - |
| | Logistic services | 354,634 | 394,805 |
| | Other goods | 466,831 | 462,283 |
| | Other services | 551,797 | 603,985 |
| | | **2,454,200** | **3,144,501** |
| **Total sales** | | **97,787,533** | **73,577,249** |

## 22 Cost of sales

The components of cost of sales were as follows:

| | Note | 2010 | 2009 |
|---|---|---|---|
| Materials and components used or resold | | 28,351,341 | 21,888,921 |
| Energy | | 5,625,211 | 4,619,546 |
| Utilities and fuel | | 3,001,341 | 2,062,700 |
| Labour, including contributions to social funds | | 7,269,164 | 6,362,041 |
| Depreciation and amortisation | | 2,837,043 | 2,363,127 |
| Repairs and maintenance | | 620,044 | 531,614 |
| Production overheads | | 1,515,867 | 1,237,323 |
| Property tax, rent payments for land and related taxes | | 1,027,339 | 750,048 |
| Transportation expenses for logistics services | | 312,733 | 716,116 |
| Idle property, plant and equipment written-off | 7 | 171,370 | 83,872 |
| Reversal of provision for obsolete and damaged inventory and finished goods | | (53,058) | (6,293) |
| Changes in work in progress and finished goods | | (584,576) | 2,064,961 |
| Other costs | | 111,710 | 210,094 |
| **Total cost of sales** | | **50,205,529** | **42,884,070** |

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 23 Distribution costs

Distribution costs comprised:

| | Note | 2010 | 2009 |
|---|---|---|---|
| Transportation | | 15,405,937 | 14,218,317 |
| Export duties,other fees and commissions | | 192,903 | 336,900 |
| Labour, including contributions to social funds | | 800,696 | 710,094 |
| Depreciation and amortisation | | 311,999 | 339,519 |
| Repairs and maintenance | | 571,727 | 726,506 |
| Provision/(reversal of provision) for impairment of receivables | 13 | (12,470) | 111,549 |
| Other costs | | 514,105 | 501,536 |
| **Total distribution costs** | | **17,784,897** | **16,944,421** |

## 24 General and administrative expenses

General and administrative expenses comprised:

| | Note | 2010 | 2009 |
|---|---|---|---|
| Labour, including contributions to social funds | | 2,093,426 | 1,594,409 |
| Depreciation and amortisation | | 316,921 | 273,707 |
| Audit, consulting and legal services | | 194,035 | 205,611 |
| Rent | | 117,342 | 131,156 |
| Bank charges | | 138,339 | 110,141 |
| Social expenditure | | 66,295 | 79,011 |
| Repairs and maintenance | | 38,659 | 40,276 |
| Provision for impairment of receivables | 13 | 32,950 | 87,009 |
| Other expenses | | 756,482 | 740,078 |
| **Total general and administrative expenses** | | **3,754,449** | **3,261,398** |

The total depreciation and amortisation expenses included in all captions of the consolidated statement of comprehensive income amounted to RR 3,465,963 thousand (2009: RR 2,976,353 thousand). The total staff costs (including social expenses) amounted to RR 10,163,286 thousand (2009: RR 8,666,544 thousand).

The fees for the audit of the consolidated and statutory financial statements for the year ended 31 December 2010 amounted to RR 65,259 thousand (2009: RR 60,973 thousand). The auditors also provided the Group with consulting services amounting to RR 5,773 thousand (2009: RR 3,520 thousand).

## 25 Other operating income and expenses

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

| | 2010 | 2009 |
|---|---|---|
| (Gain)/loss on disposal of property, plant and equipment | (38,973) | 181,076 |
| Sponsorship | 417,697 | 202,847 |
| Foreign exchange gain | (208,168) | (679,113) |
| Other operating (income)/expenses | (153,861) | 70,161 |
| **Total other operating (income)/expenses** | **16,695** | **(225,029)** |

## 26 Disposal of non-current assets held for sale

In July 2010 the Group terminated the contract for the sale of its 100% subsidiary LLC Novomoskovsky Chlor which was concluded in June 2009, and recognized a loss of RR 429,598 thousand in the profit and loss as a result of this contract termination.

## 27 Other financial income

The components of other financial income were as follows:

| | 2010 | 2009 |
|---|---|---|
| Changes in the fair value of call options | 49,372 | - |
| Changes in the fair value of put options | - | 193,458 |
| Changes in the fair value of US$/RR non-deliverable forward contracts | 83,959 | - |
| Changes in the fair value of cross currency interest rate swap | 1,500 | - |
| **Total other financial income** | **134,831** | **193,458** |

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 28 Income tax

| | 2010 | 2009 |
|---|---|---|
| Income tax expense – current | 4,699,114 | 2,437,953 |
| Deferred income tax – reversal of temporary differences | 259,585 | 40,195 |
| Effect of the change in the tax rate | - | 151,108 |
| **Income tax expense** | **4,958,699** | **2,629,256** |

During the year ended 31 December 2010 the Group offset VAT and other taxes against income tax of RR 187,607 thousand (2009: RR 220,142 thousand).

The profit before taxation for financial reporting purposes is reconciled to the tax expense as follows:

| | 2010 | 2009 |
|---|---|---|
| **Profit before taxation** | **25,011,176** | **13,704,704** |
| Theoretical tax charge at statutory rate of 20% (2009 – 20%) | (5,002,235) | (2,740,941) |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| - Non deductible expenses | (372,333) | (447,168) |
| - Effects of different tax rates in other countries | 667,420 | 768,974 |
| - Unrecognized tax loss carry forward for the year | (251,551) | (59,013) |
| - Effect of the change in the tax rate | - | (151,108) |
| **Consolidated tax charge** | **(4,958,699)** | **(2,629,256)** |

Most companies of the Group were subject to a tax rate of 20% on taxable profits in the Russian Federation for 2010 (2009: 20%). Their deferred tax asset/liabilities are measured at the rate of 20% as at 31 December 2010 and 31 December 2009. Effective from 1 January 2010, the rate of profit tax payable by the company in Lithuania is 15% (2009: 20%). The respective deferred tax asset/liabilities are measured at the rate of 15% as at 31 December 2010 and 31 December 2009.

In the context of the Group's current structure, tax losses and current tax assets of the different companies may not be offset against current tax liabilities and taxable profits of other companies and, accordingly, taxes may accrue even where there is a net consolidated tax loss. Therefore, deferred tax assets of one company of the Group are not offset against any deferred tax liabilities of another company.

At 31 December 2010 the Group had RR 820,634 thousand (2009: RR 1,282,955 thousand) of accumulated tax losses carried forward and recognised a deferred tax asset of RR 510,070 thousand (2009: RR 1,223,942 thousand). The Group did not recognise deferred tax assets of RR 310,564 thousand (2009: RR 59,013 thousand) because it is not probable that future taxable profit will be available against which the Group can utilize benefits therefrom.

The Group has not recognised a deferred tax liability in respect of temporary differences associated with investments in subsidiaries of RR 172,567 thousand (2009: RR 667,166 thousand). The Group controls the timing of the reversal of these temporary differences and does not expect to reverse them in the foreseeable future.

The movement in deferred tax (assets) and liabilities during 2010 and 2009 was as follows:

| | 1 January 2010 | Differences recognition and reversals | Currency translation difference (Note 2) | 31 December 2010 |
|---|---|---|---|---|
| **Tax effects of (deductible)/ taxable temporary differences:** | | | | |
| Property, plant and equipment and Intangible assets | 2,201,245 | 76,042 | 1,390 | 2,278,677 |
| Accounts receivable | (27,059) | (5,570) | 246 | (32,383) |
| Accounts payable | (171,600) | (318,437) | 308 | (489,729) |
| Inventories | (1,243) | (277,569) | (807) | (279,619) |
| Other | (133,467) | 95,827 | 10,632 | (27,008) |
| Tax losses carried-forward | (1,282,955) | 437,741 | 24,580 | (820,634) |
| Unrecognized deferred tax assets | 59,013 | 251,551 | - | 310,564 |
| **Net deferred tax liability** | **643,934** | **259,585** | **36,349** | **939,868** |
| Recognised deferred tax assets | (1,328,848) | 327,711 | 32,073 | (969,064) |
| Recognised deferred tax liabilities | 1,972,782 | (68,126) | 4,276 | 1,908,932 |
| **Net deferred tax liability** | **643,934** | **259,585** | **36,349** | **939,868** |

## 28 Income tax (continued)

| | 1 January 2009 | Differences recognition and reversals | Business combinations | Currency translation difference (Note 2) | Effect of change in income tax rate | 31 December 2009 |
|---|---|---|---|---|---|---|
| **Tax effects of (deductible)/ taxable temporary differences:** | | | | | | |
| Property, plant and equipment and Intangible assets | 2,248,558 | (64,412) | 26,124 | (9,365) | 340 | 2,201,245 |
| Accounts receivable | (43,684) | 4,778 | - | 1,642 | 10,205 | (27,059) |
| Accounts payable | (516,403) | 337,807 | - | 1,417 | 5,579 | (171,600) |
| Inventories | (776,872) | 801,842 | - | (26,532) | 319 | (1,243) |
| Other | (34,505) | (97,791) | - | (1,552) | 381 | (133,467) |
| Tax losses carried-forward | (415,085) | (1,001,042) | - | (1,112) | 134,284 | (1,282,955) |
| Unrecognized deferred tax assets | - | 59,013 | - | - | - | 59,013 |
| **Net deferred tax liability** | **462,009** | **40,195** | **26,124** | **(35,502)** | **151,108** | **643,934** |
| Recognised deferred tax assets | (1,380,972) | (77,536) | - | (21,448) | 151,108 | (1,328,848) |
| Recognised deferred tax liabilities | 1,842,981 | 117,731 | 26,124 | (14,054) | - | 1,972,782 |
| **Net deferred tax liability** | **462,009** | **40,195** | **26,124** | **(35,502)** | **151,108** | **643,934** |

The amounts shown in the consolidated statement of financial position include the following:

| | 2010 | 2009 |
|---|---|---|
| Deferred tax assets expected to be recovered after more than 12 months | (265,180) | (657,265) |
| Deferred tax liabilities expected to be settled after more than 12 months | 1,943,371 | 1,880,528 |

The total amount of the deferred tax charge is recognised in profit and loss.

## 29 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year, excluding treasury shares (Note 15). The Company has no dilutive potential ordinary shares, therefore, the diluted earnings per share equals the basic earnings per share.

| | 2010 | 2009 |
|---|---|---|
| Net profit | 19,997,844 | 11,111,048 |
| Weighted average number of ordinary shares in issue (expressed in thousands) | 67,932 | 67,932 |
| **Basic and diluted earnings per share (expressed in RR per share)** | **294.38** | **163.56** |

## 30 Balances and transactions with related parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 “Related Party Disclosures”. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Related parties are represented by entities controlled by the common ultimate shareholders with the Group. The relationships with those related parties with whom the Group entered into significant transactions or had significant balances outstanding are detailed below:

| Financial statements caption | Nature of relationship | 2010 | 2009 |
|---|---|---|---|
| **Statement of financial position caption** | | | |
| Advances given to construction companies and suppliers of property, plant and equipment | Other related parties | 13,375 | - |
| Trade receivables | Other related parties | 15,861 | 16,104 |
| less: impairment provision on trade receivables | Other related parties* | (15,861) | (16,104) |
| Prepayments, other receivables and other current assets | Other related parties | 52,437 | 50,241 |
| less: impairment provision on other receivables | Other related parties* | (50,628) | (50,241) |
| Trade payables | Other related parties | 8,128 | 13,517 |
| Other accounts payable and accrued expenses | Other related parties | 1,380 | - |

*impaired trade and other receivables from an affiliated Ukraine-based company

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

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

| Financial statements caption | Nature of relationship | 2010 | 2009 |
|---|---|---|---|
| **Statement of comprehensive income caption** | | | |
| Sales | Other related parties | 200,068 | 145,830 |
| Purchases of materials and components | Other related parties | (61,894) | (60,008) |
| General and administrative expenses | Other related parties | - | (117,190) |
| Distribution costs | Other related parties | (81,621) | (16,104) |
| Interest income | Parent company | - | 59,376 |

| Financial statements caption | Nature of relationship | Note | 2010 | 2009 |
|---|---|---|---|---|
| **Statement of cash flows caption** | | | | |
| Decrease in trade receivables | Other related parties | | 243 | 40,745 |
| Increase in other receivables | Other related parties | | (2,196) | (24,959) |
| Decrease in trade payables | Other related parties | | (5,389) | - |
| Increase in advances from customers | Other related parties | | 1,380 | - |
| Capital expenditure on property, plant and equipment and other intangible assets | Other related parties | | (13,375) | - |
| Acquisition of available-for-sale investments | Parent company | | - | (19,605,626) |
| Proceeds from sale of available-for-sale investments | Parent company | | - | 4,529,819 |
| Repayment of originated loan | Parent company | | - | 6,568,110 |
| Interest received | Parent company | | - | 121,199 |
| Dividends paid | Parent company | 15 | (5,834,000) | - |

The total key management personnel compensation included in the profit and loss was RR 325,772 thousand and RR 177,338 thousand for the years ended 31 December 2010 and 2009, respectively. This compensation is paid to six individuals who are members of the Management Board, for their services in full time positions. Compensation is made up of an annual fixed remuneration plus a performance bonus accrual.

## 31 Acquisition of non-controlling interest

The Group increased its shareholding in Lifosa AB from 94.8% to 99.1%. The total purchase consideration comprised RR 448,983 thousand paid in cash.

## 32 Contingencies, commitments and operating risks

### i Capital expenditure commitments

As at 31 December 2010 the Group had contractual commitments for capital expenditures of RR 18,225,826 thousand (2009: RR 9,388,416 thousand), mostly denominated in US$ and Euro (RR 6,897,536 thousand and RR 3,916,782 thousand, respectively). The management estimates that, out of these, approximately RR 9.6 billion will represent cash outflows in 2011.

RR 10,272,954 thousand and RR 4,417,588 thousand out of the total amount relate to the development of potassium salt deposits and the construction of mining facilities at the Gremyachinskoe and Verkhnekamskoe potash license areas, respectively (2009: RR 5,700,730 thousand and RR 269,444 thousand, respectively).

### ii Tax legislation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged in the future by the relevant regional and federal authorities.

The Russian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged.

As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

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

### ii Tax legislation (continued)

Under Russian transfer pricing legislation it is possible for the tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all controllable transactions if the transaction price differs from the market price by more than 20%. Controllable transactions include transactions with interdependent parties, as determined under the Russian Tax Code, all cross-border transactions (irrespective of whether performed between related or unrelated parties), transactions where the price applied by a taxpayer differs by more than 20% from the price applied in similar transactions by the same taxpayer within a short period of time, and barter transactions. There is no formal guidance as to how these rules should be applied in practice. The arbitration court practice in this respect is contradictory.

Tax liabilities arising from intercompany transactions are determined using actual transaction prices. It is possible, with the evolution of the interpretation of the transfer pricing rules in the Russian Federation and the changes in the approach of the Russian tax authorities, that such transfer prices could potentially be challenged in the future. Given the nature of the current Russian transfer pricing rules, the impact of any such challenge cannot be reliably estimated; however, it may be significant.

Russian tax legislation does not provide definitive guidance in certain areas, specifically in extraction tax. From time to time, the Group adopts interpretations of such uncertain areas that may be challenged by the tax authorities, the impact of which cannot be reliably estimated; however, it may be significant to the financial condition or the overall operations of the Group.

As at 31 December 2010 management believes that its interpretation of the relevant legislation is generally appropriate and the Group's tax, currency and customs positions will be sustained. Where management believes that it is probable that certain tax positions taken by the Group may not be sustained if challenged by the tax authorities, the Group has recorded provisions for related taxes, interest and penalties. There were no such provisions recorded by the Group at 31 December 2010 and 31 December 2009.

In addition to the above matters, management estimates that the Group has other possible obligations from exposure to other than remote tax risks of RR 1,081,589 thousand (2009: RR 1,433,262 thousand). These exposures primarily relate to management services and other fees charged by the holding company to the Group subsidiaries.

### iii Insurance policies

The Group generally carries insurance as mandated by statutory requirements. The Group holds insurance policies covering directors' and officers' liabilities and trade operations, including export shipments. Insurance strategies covering the Group's assets are under review.

### iv Environmental matters

The environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations and an immediate response is formulated as required. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

### v Legal proceedings

During the reporting period, the Group was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding which could have a material effect on the results of operations or the financial position of the Group.

### vi Operating environment of the Group

The Russian Federation displays certain characteristics of an emerging market, including relatively high inflation and interest rates, as well as periodic volatility in the RR exchange rate.

In 2010, the Russian economy experienced a moderate recovery of economic growth. The recovery was accompanied by a gradual increase in household incomes, lower refinancing rates, stabilisation of the exchange rate of the Russian Rouble against major foreign currencies, and increased liquidity levels in the banking sector.

Management is unable to predict all developments in the economic environment which could have an impact on the Group's operations and consequently what effect, if any, they could have on the future financial position of the Group.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 33 Financial and capital risk management

### 33.1 Financial risk management

The Group's activities expose it to a variety of financial risks: market risk (including foreign currency exchange risk, interest rate risk and price risk), credit risk and liquidity risk. The overall risk management programme seeks to minimize potential adverse effects on the financial performance of the Group.

***(a) Market risk***

***(i) Foreign currency risk***

The Group's revenues, expenses, capital expenditure, investments and borrowings are denominated in foreign currencies as well as Russian Roubles. The Group is exposed to foreign exchange risk to the extent that its future cash inflows and outflows over a certain period of time are denominated in different currencies.

The objective of the Group's foreign exchange risk management is to minimize the volatility of the Group's cash flows arising from fluctuations in foreign exchange rates. Management focuses on assessing the Group's future cash flows in foreign currencies and managing the gaps arising between inflows and outflows.

Translation gains and losses arising from the revaluation of its monetary assets and liabilities are therefore not viewed as an indicator of the total impact of foreign exchange fluctuations on its future cash flows since such gains or losses do not capture the impact on cash flows of foreign exchange-denominated revenues, costs, future capital expenditure, investment and financing activities.

The table below summarises the Group's financial assets and liabilities which are subject to foreign currency risk at the reporting date:

| 31 December 2010 | US$ | Euro | Other foreign currency |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current financial assets:** | | | |
| Restricted cash | - | 6,092 | 107,476 |
| **Total non-current financial assets** | **-** | **6,092** | **107,476** |
| **Current financial assets:** | | | |
| Trade receivables | 1,519,960 | 49,633 | - |
| Restricted cash | - | - | 92 |
| Cash and cash equivalents | 4,633,770 | 531,135 | 22,880 |
| **Total current financial assets** | **6,153,730** | **580,768** | **22,972** |
| **Total financial assets** | **6,153,730** | **586,860** | **130,448** |
| **LIABILITIES** | | | |
| **Non-current liabilities:** | | | |
| Bank borrowings | 12,501,915 | 341,543 | - |
| Bonds issued | 8,838,300 | - | - |
| US$/RR cross currency swap (gross amount) | 4,848,377 | - | - |
| US$/RR non-deliverable forward contracts (gross amount) | 9,143,070 | - | - |
| **Total non-current financial liabilities** | **35,331,662** | **341,543** | **-** |
| **Current liabilities:** | | | |
| Bank borrowings | 12,757,772 | - | - |
| Trade payables | 327,972 | 349,335 | 41,636 |
| Other accounts payable and accrued expenses | 233,892 | 1,486 | - |
| **Total current financial liabilities** | **13,319,636** | **350,821** | **41,636** |
| **Total financial liabilities** | **48,651,298** | **692,364** | **41,636** |

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 33 Financial and capital risk management (continued)

### 33.1 Financial risk management (continued)

***(a) Market risk (continued)***

***(i) Foreign currency risk (continued)***

| 31 December 2009 | US$ | Euro | Other foreign currency |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current financial assets:** | | | |
| Restricted cash | 2,651 | 145,425 | - |
| **Total non-current financial assets** | **2,651** | **145,425** | **-** |
| **Current financial assets:** | | | |
| Trade receivables | 911,441 | 169,124 | 3,206 |
| Restricted cash | 548,357 | - | 2,729 |
| Cash and cash equivalents | 4,588,444 | 2,867,709 | 7,325 |
| **Total current financial assets** | **6,048,242** | **3,036,833** | **13,260** |
| **Total financial assets** | **6,050,893** | **3,182,258** | **13,260** |
| **LIABILITIES** | | | |
| **Non-current liabilities:** | | | |
| Bank borrowings | 23,210,665 | 3,688,006 | - |
| Bonds issued | 8,770,818 | - | - |
| **Total non-current financial liabilities** | **31,981,483** | **3,688,006** | **-** |
| **Current liabilities:** | | | |
| Bank borrowings | 12,660,364 | - | - |
| Trade payables | 141,685 | 34,783 | - |
| Other accounts payable and accrued expenses | 222,240 | - | - |
| **Total current financial liabilities** | **13,024,289** | **34,783** | **-** |
| **Total financial liabilities** | **45,005,772** | **3,722,789** | **-** |

The Group believes that it has significant positive foreign exchange exposure towards the US$/RR exchange rate given that its expected US$ denominated revenues exceed its planned outflows in US$, mostly related to servicing of debt and capital expenditure. Hence any depreciation of the RR against the US$ has a positive effect, while appreciation of the RR against the US$ has a negative effect on the Group's future cash flows.

The Group's sales for the years ended 31 December 2010 and 31 December 2009 are presented in the table below:

| | US$ | Euro | RR | Other foreign currency | Total |
|---|---|---|---|---|---|
| 2010 | 64,686,216 | 3,898,355 | 23,936,703 | 5,266,259 | 97,787,533 |
| | 66% | 4% | 25% | 5% | 100% |
| 2009 | 50,977,211 | 3,642,965 | 15,892,608 | 3,064,465 | 73,577,249 |
| | 69% | 5% | 22% | 4% | 100% |

At 31 December 2010, if the RR exchange rate against the US$ had been higher/lower by 10%, all other things being equal, after tax profit for the year would have been RR 3,407,203 thousand (2009: RR 3,148,136 thousand) lower/higher, purely as a result of foreign exchange gains/losses on translation of US$-denominated assets and liabilities and with no regard to the impact of this appreciation/depreciation on sales.

The Group is disclosing the impact of such a 10% shift in the manner set out above to ease the calculation for the users of these consolidated financial statements of the impact on the after tax profit resulting from subsequent future exchange rate changes.

During 2009 the Group did not hedge this exposure using financial instruments. In 2010 the Group entered into US$/RR non-deliverable forward contracts for a nominal amount of US$ 450 million to partially offset volatility of its cash flows from potential appreciation of the RR against the US$ in 2010-2011 (Note 18).

## 33 Financial and capital risk management (continued)

### 33.1 Financial risk management (continued)

***(a) Market risk (continued)***

***(ii) Interest rate risk***

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group's principal interest rate risk arises from long-term and short-term borrowings.

The Group is exposed to risk from floating interest rates due to the fact that it has RR 25,259,687 thousand of US$ denominated loans outstanding at 31 December 2010 (2009: RR 35,871,029 thousand) bearing floating interest rates of 1 month Libor +1.8% and 6 month Libor +2.5% (2009: 1 month Libor +1.8%) and RR 341,543 thousand of Euro denominated loans outstanding at 31 December 2010 (2009: RR 3,688,006 thousand) bearing a floating interest rate of 6 months Euribor +1.95% (2009: 3 months Libor +2%). The Group's profit after tax for the year ended 31 December 2010 would have been RR 25,706 thousand, or 0.13% lower/higher (2009: RR 33,569 thousand, or 0.30% lower/higher) if the US$ Libor interest rate was 10 bps higher/lower than its actual level during the year. The Group's profit after tax for the year ended 31 December 2010 would have been RR 770 thousand, or 0.004% lower/higher (2009: RR 1,441 thousand or 0.01% lower/higher) if the Euribor interest rate was 10 bps higher/lower than its actual level during the year. During 2009 and 2010 the Group did not hedge this exposure using financial instruments.

The Group does not have a formal policy of determining how much exposure the Group should have to fixed or variable rates for as long as the impact of changes in interest rates on the Group's cash flows remains immaterial. However, the Group performs a periodic analysis of the current interest rate environment and depending on this analysis at the time of raising new debt management makes decisions on whether obtaining finance on a fixed-rate or a variable-rate basis would be more beneficial to the Group over the expected period until maturity.

***(iii) Financial investments risk***

The Group is exposed to equity securities price risk because of investments held by the Group and classified on the consolidated statement of financial position as available-for-sale. At 31 December 2010 the Group held 16,656,595 shares, or 8.7% of the issued share capital (2009: 19,366,595 shares, or 10.12% of the issued share capital) of K+S Group with a fair value of RR 37,863,331 thousand (2009: RR 33,602,943 thousand) (Note 10). The fair value of the shares is determined based on the closing price of Euro 56.36 as of the reporting date in the Xetra trading system. The Group's other comprehensive income/loss for 2010 would have been RR 671,812 thousand (2009: RR 840,284 thousand) if the share price were 1 Euro higher/lower than its actual level as at reporting date. At 25 February 2010 the share price was Euro 55.48. During 2010 the Group did not hedge this exposure using financial instruments.

The Group is principally exposed to market price risks in relation to the investment in shares of K+S Group. Management reviews reports on the performance of K+S Group on a quarterly basis and provides recommendations to the Board of Directors on the advisability of further investments. The subscribed investment commitments in this respect are approved by the Board of Directors.

The Group does not enter into any transactions in financial instruments whose value is exposed to the value of any commodities traded on a public market.

***(b) Credit risk***

Credit risk arises from the possibility that counterparties to transactions may default on their obligations, causing financial losses for the Group. Financial assets, which potentially subject Group entities to credit risk, consist principally of trade receivables, cash and bank deposits. The objective of managing credit risk is to prevent losses of liquid funds deposited with or invested in financial institutions or the loss in value of receivables.

The maximum exposure to credit risk resulting from financial assets is equal to the carrying amount of the Group's financial assets, which at 31 December 2010 amounted to RR 11,816,357 thousand (2009: RR 13,971,571 thousand). The Group has no other significant concentrations of credit risk.

***Cash and cash equivalents*****.** Cash and short-term deposits are mainly placed in major multinational and Russian banks with independent credit ratings. No bank balances and term deposits are past due or impaired. See the analysis by credit quality of bank balances and term deposits in Note 14.

***Trade receivables.*** Trade receivables are subject to a policy of active credit risk management which focuses on an assessment of ongoing credit evaluation and account monitoring procedures. The objective of the management of trade receivables is to sustain the growth and profitability of the Group by optimising asset utilisation whilst maintaining risk at an acceptable level.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 33 Financial and capital risk management (continued)

### 33.1 Financial risk management (continued)

***(b) Credit risk (continued)***

The monitoring and controlling of credit risk is performed by the corporate treasury function of the Group. The credit policy requires the performance of credit evaluations and ratings of customers. The credit quality of each new customer is analyzed before the Group provides it with the standard terms of delivery and payment. The Group gives preference to customers with an independent credit rating. New customers without an independent credit rating are evaluated on a sample basis by an appointed rating agency. The credit quality of other customers is assessed taking into account their financial position, past experience and other factors. Customers that do not meet the credit quality requirements are supplied on a prepayment basis only.

Although the collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision already recorded (Note 13).

The major part of trade receivables that are neither past due nor impaired relates to wholesale distributors and steel producers for which the credit exposures and related ratings are presented below:

| Wholesale customers | Credit agency | Credit rating/Other | 2010 | 2009 |
|---|---|---|---|---|
| Wholesale customers | Credit Reform* | Good | 167,763 | 533,776 |
| Wholesale customers | Dun & Bradstreet Credibility Corp.* | Good | 231,137 | - |
| Wholesale customers and steel producers | - | Letter of credit | 687,516 | 296,317 |
| Wholesale customers and steel producers | Moody's Investor's Service | 2010: Ba3 to Baa3<br>2009: Aa2 to Ba2 | 973,928 | 331,434 |
| **Total** | | | **2,060,344** | **1,161,527** |

* Independent credit agencies used by the Group for evaluation of customers' credit quality.

The rest of trade receivables is analysed by management who believes that the balance of the receivables is of good quality due to strong business relationships with these customers. The credit risk of every single customer is monitored.

***(c) Liquidity risk***

Liquidity risk results from the Group's potential inability to meet its financial liabilities, such as settlements of financial debt and payments to suppliers. The Group's approach to liquidity risk management is to maintain sufficient readily available reserves in order to meet its liquidity requirements at any point in time.

In order to take advantage of financing opportunities in the international capital markets the Group has obtained credit ratings from Fitch and Standard & Poor's. As of 31 December 2010 these institutions have rated the Group as BB with stable outlook (2009: BB with stable and negative outlooks, respectively).

Cash flow forecasting is performed throughout the Group. Group finance monitors rolling forecasts of the Group's liquidity requirements to ensure it has sufficient cash to meet operational needs while maintaining sufficient headroom on its undrawn committed borrowing facilities (Note 16) at all times so that the Group does not breach borrowing limits or covenants on any of its borrowing facilities. Such forecasting takes into consideration the Group's debt financing plans, covenant compliance and compliance with internal balance sheet ratio targets.

The table below analyses the Group's financial liabilities into the relevant maturity groupings based on the time remaining from the balance sheet date to the contractual maturity date.

| | Less than 1 year | Between 1 and 2 years | Between 2 and 5 years | More than 5 years | Total |
|---|---|---|---|---|---|
| **As of 31 December 2010** | | | | | |
| Trade payables | 2,182,951 | - | - | - | **2,182,951** |
| *Gross-settled swap:*** | | | | | |
| - inflows | (398,938) | (411,370) | (6,234,110) | - | **(7,044,418)** |
| - outflows | 183,033 | 188,737 | 5,414,587 | - | **5,786,357** |
| Derivative financial liabilities | 127,981 | - | - | - | **127,981** |
| Bank borrowings* | 13,564,674 | 10,873,071 | 999,495 | 1,490,726 | **26,927,966** |
| Bonds issued* | 1,551,231 | 9,867,505 | 12,565,600 | - | **23,984,336** |
| | | | | | |
| **As of 31 December 2009** | | | | | |
| Trade payables | 1,373,488 | - | - | - | **1,373,488** |
| Bank borrowings* | 13,604,955 | 17,295,880 | 10,863,770 | - | **41,764,605** |
| Bonds issued* | 690,702 | 690,702 | 8,926,226 | - | **10,307,630** |

* The table above shows undiscounted cash outflows for financial liabilities (including interest together with the borrowings) based on conditions existing as of 31 December 2010 and 31 December 2009, respectively.

** Payments in respect of the gross settled swap will be accompanied by related cash inflows.

*(all amounts are presented in thousands of Russian Roubles, unless otherwise stated)*

## 33 Financial and capital risk management (continued)

### 33.1 Financial risk management (continued)

***(c) Liquidity risk (continued)***

The Group controls the minimum required level of cash balances available for short-term payments in accordance with the financial policy of the Group adopted in alignment with economic realities on 29 April 2009 by the Board of Directors. Such cash balances are represented by current cash balances on bank accounts, bank deposits, short-term investments, cash and other financial instruments, which may be classified as cash equivalents in accordance with IFRS.

The Group assesses liquidity on a weekly basis using a twelve-month cash flow rolling forecast.

### 33.2 Capital risk management

The Group's objectives when managing capital are to safeguard its ability to continue as a going concern, to provide returns for shareholders and benefits for other stakeholders, to have available the necessary financial resources for investing activities and to maintain an optimal capital structure in order to reduce the cost of capital. The Group considers total capital under management to be equity as shown in the IFRS consolidated statement of financial position. This is considered more appropriate than alternatives, such as the value of equity shown in the Company's statutory financial (accounting) reports.

The Group monitors capital on the basis of the gearing ratio. Additionally, the Group monitors the adequacy of its debt levels using the net debt to EBITDA ratio.

***Gearing ratio***

The gearing ratio is determined as net debt to net debt plus shareholders' equity.

The gearing ratio as of 31 December 2010 and 31 December 2009 is shown in the table below:

| | **2010** | **2009** |
|---|---|---|
| Total debt | 42,826,981 | 47,772,653 |
| Less: cash and cash equivalents | 8,934,084 | 11,227,858 |
| **Net debt** | **33,892,897** | **36,544,795** |
| **Equity attributable to the holders of the Company** | **94,180,622** | **72,436,377** |
| **Net debt and shareholders' equity** | **128,073,519** | **108,981,172** |
| **Gearing ratio %** | **26%** | **34%** |

***Net Debt/EBITDA***

The Group has established a policy that the ratio of the Group's net debt to its 12 months' rolling EBITDA should not exceed two and a half times. For this purpose net debt is determined as the sum of short-term borrowings, long-term borrowings and bonds balance outstanding, less cash and cash equivalents.

The ratio of net debt to EBITDA as of 31 December 2010 and 31 December 2009 is shown in the table below:

| | **Note** | **2010** | **2009** |
|---|---|---|---|
| **EBITDA** | 6 | **29,937,053** | **16,516,237** |
| Net debt | | 33,892,897 | 36,544,795 |
| **Net debt/EBITDA** | | **1.13** | **2.21** |

Since EBITDA is not a standard IFRS measure, EuroChem Group's definition of EBITDA may differ from that of other companies.

## 34 Fair value of financial instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price.

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value of financial instruments.

***Financial instruments carried at fair value.*** Trading and available-for-sale investments are carried on the consolidated statement of financial position at their fair value.

Effective from 1 January 2009, the Group adopted the amendment to IFRS 7 for financial instruments that are measured in the consolidated statement of financial position at fair value. This requires disclosure of fair value measurements by three levels, depending on fair value measurements. Fair values of trading and available-for-sale investments were determined based on quoted market prices and were included in level 1. Fair values of derivatives financial assets and liabilities were determined based on derived of quoted market prices and were included in level 2.

Cash and cash equivalents are carried at amortised cost which approximates current fair value.

***Financial assets carried at amortised cost.*** The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. The discount rates used depend on the credit risk of the counterparty. The carrying amounts of trade receivables approximate their fair values.

***Liabilities carried at amortised cost.*** The fair value is based on quoted market prices, if available. The estimated fair values of fixed interest rate instruments with a stated maturity, for which quoted market prices were not available, were estimated based on expected cash flows discounted at current interest rates for new instruments with similar credit risks and remaining maturities. The fair value of liabilities repayable on demand or after a notice period ("demandable liabilities") is estimated as the amount payable on demand, discounted from the first date that the amount could be required to be paid. At 31 December 2010 and 2009 the fair value of the current and non-current borrowings is not materially different from their carrying amounts. The fair value of the issued bonds is disclosed in Note 17.