CHERKIZOVO GROUP QUALITY FROM FARM TO FORK

Producing quality, delivering choice

Annual report 2006






Overview

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How we performed

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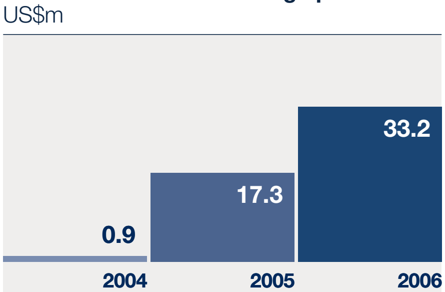
Cherkizovo is the leading vertically integrated provider of meat products, poultry and pork in the rapidly-growing Russian market

Business highlights

- > Successful IPO on the London Stock Exchange and Russia's RTS
- > Construction of four new state-of-the-art pig farms began: two in Lipetsk Region in February, two in Tambov Region in July
- > Lipetsk delivered its first pork to market in December. Since then more than 900 tonnes live-weight have been delivered
- > Successful five-year Rouble bond placed with a coupon of 8.85%, one of the lowest rates in the industry
- > Extensive programme to modernise storage and distribution facilities under way: new or completely refurbished facilities now operating in St Petersburg, Kazan, Samara, Ufa, Saratov, Ekaterinburg and Perm
- > Divisional management strengthened by the appointment of new Chief Operating Officer and new Poultry Division Manager
- > Implementation of Oracle ERP system began

Financial highlights

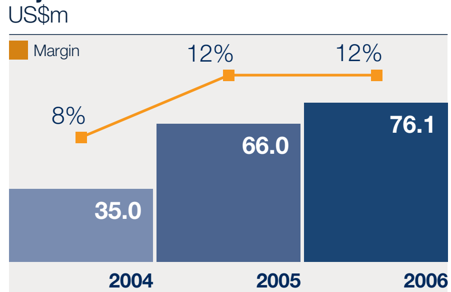
Net income from continuing operations
US$m



Percentage increase
2005-2006

+92%

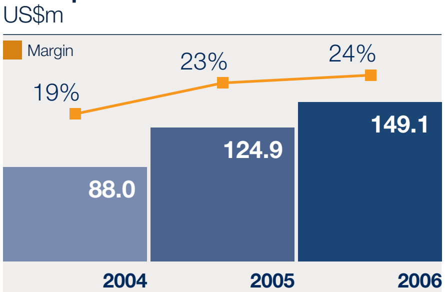
Adjusted EBITDA
US$m



Percentage increase
2005-2006

+15%

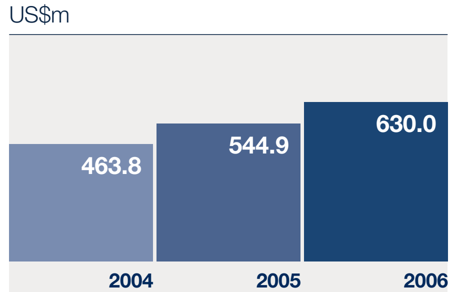
Gross profit
US$m



Percentage increase
2005-2006

+19%

Sales
US$m



Percentage increase
2005-2006

+16%

Cherkizovo at a glance...
an integrated story

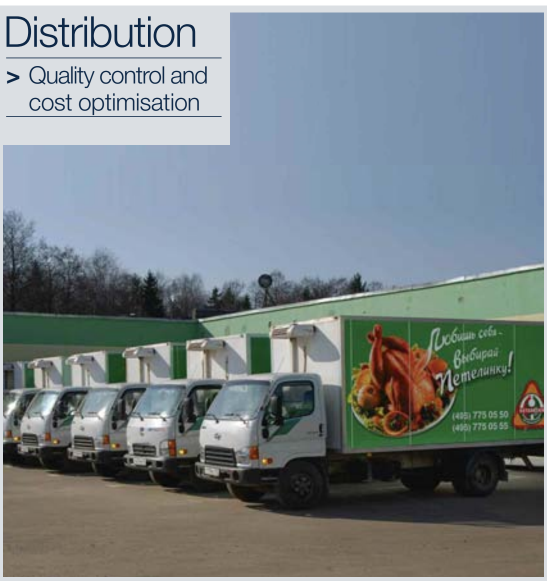
Vertically integrated

Fodder
> Quality and biological safety

Pork and Poultry
> Lower dependence on imports and suppliers

Meat Processing
> Capturing margins from value-added products

Distribution
> Quality control and cost optimisation



Meat Processing

Sales

$451.6m

Adjusted EBITDA

$33.7m

Contribution to Group sales

72%

Contribution to adjusted EBITDA

43%

Key products
- > Sausages
- > Salamis
- > Ready-to-cook products

Strategy
- > Develop high value-added products
- > Maximise benefits of vertical integration
- > Increase market share through acquisitions in core regions
- > Increase share of regional distribution
- > Optimise use of raw materials

Key facts
- > No.1 nationwide
- > 203,000-tonnes production capacity
- > 7,877 employees
- > Eight processing facilities

Brands

Best
Russian Brand 2006 nominated by Russian Brand Academy

Poultry

Sales

$151.0m

Adjusted EBITDA

$36.2m

Contribution to Group sales

24%

Contribution to adjusted EBITDA

46%

Key products

- > Chilled poultry, whole and in portions
- > Frozen poultry, whole and in portions

Strategy

- > Expand organically and through acquisition
- > Target modern retailers and HoReCa (Hotel/Restaurant/Café) sector
- > Focus on premium higher-margin value-added products

Key facts

- > No.1 in Moscow area
- > 70,000-tonnes slaughter weight total production capacity
- > 3,828 employees
- > Two production clusters

Brands

No.1
in Russian poultry market

Pork

Sales

$27.4m

Adjusted EBITDA

$9.1m

Contribution to Group sales

4%

Contribution to adjusted EBITDA

11%

Key products

- > Live pigs
- > Pork carcasses
- > Fresh pork cuts

Strategy

- > Develop greenfield projects
- > Become the leader in processed pork
- > Focus on high-quality products, packaging and marketing
- > Target modern retailers

Key facts

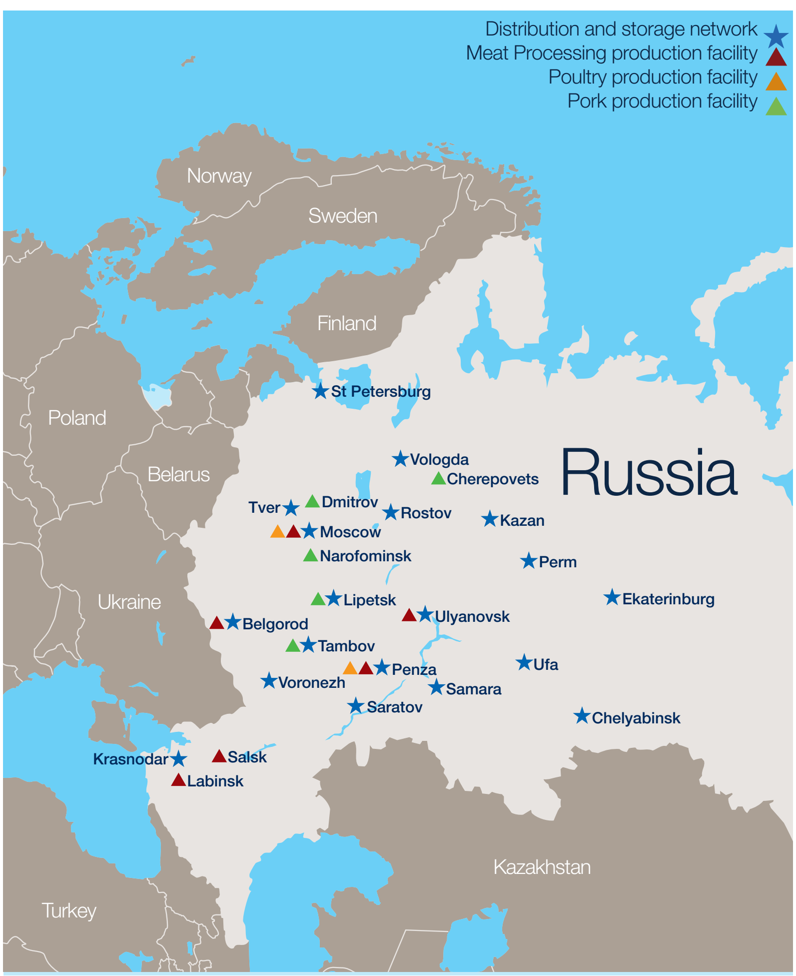
- > No.1 greenfield in Russia
- > 50,000-tonnes total production capacity
- > 755 employees
- > Four pig breeding and raising complexes

No.1
in greenfield projects

Our markets...
attractive market opportunities

The Group's geographical landscape covers Moscow and the Moscow Region, the regions of St Petersburg, Penza, Lipetsk, Vologda, Belgorod, Uyanovsk, Rostov, Tver, Chelyabinsk, Tambov, Voronezh and Krasnodar, Ufa, Saratov, Samara, Ekaterinburg, Perm and Kazan. Nationally, we are the market leader in sausage products, one of the leaders in chilled poultry products and the market leader in Moscow and the Moscow Region. We are also a leader in the highly-fragmented pork industry.

Operations by geography



Potential in a growing meat market

Russia is a "meat-eating" country and consumption is increasing rapidly. It is, however, still well below that of many other developed nations, particularly the United States, Australia and most European countries. Our products offer consumers a quality and choice not previously available in Russia. This puts us in an excellent position to succeed in this growing market.

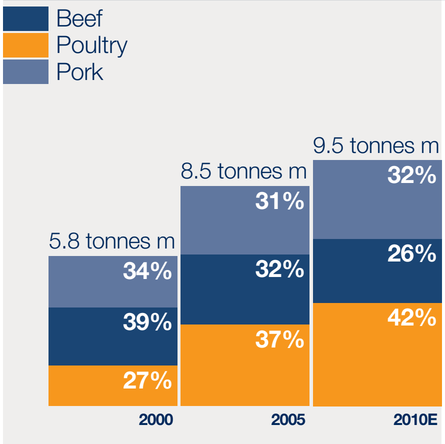
An opportunity for organic growth and consolidation

The fragmented state of the meat market in Russia makes it ripe for consolidation as well as for organic growth. No company has a market share of more than 9% – in processed meat, poultry or pork. The size and scale of our business enables us to take the lead in consolidation. Combined with our vertically-integrated structure, and focus on quality and choice, that puts us in an excellent position to capitalise on market conditions.

Excellent prospects for domestic producers

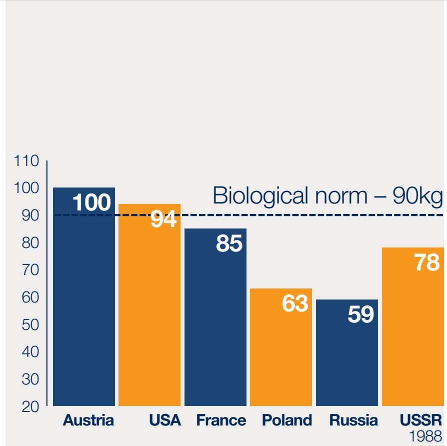
The Russian government is determined to encourage domestic production of meat and meat products. It is also determined to reduce imports, which currently account for 47% of poultry, 18% of beef and 21% of pork sales to consumers. Combined with increased levels of meat consumption, these measures put us in a excellent position to increase our market share.

Shift in Russian meat market structure



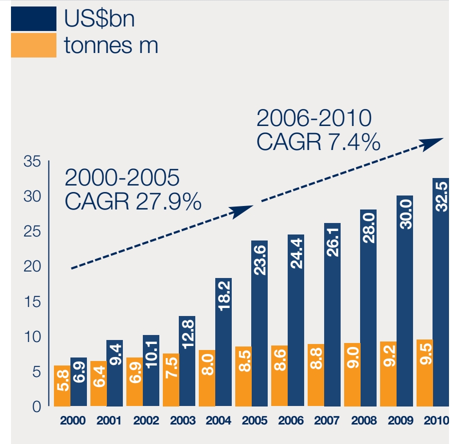
Source: Meat Union of Russia

Annual per capita meat consumption, kg
(2005E)



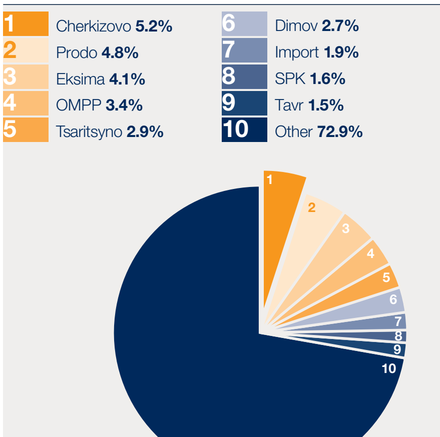
Source: Euromonitor, Meat Union of Russia

Russian meat market growth



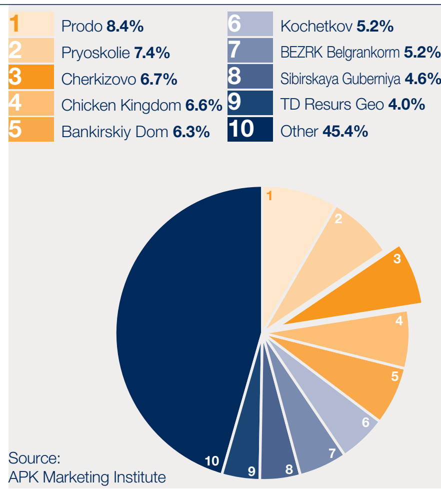
Source: Meat Union of Russia

Processed meat (in value terms, US$)
2006



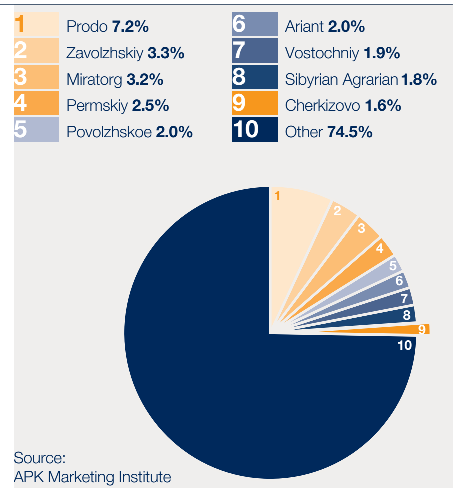
Source:
Meat Union of Russia

Poultry (in volume terms, slaughter weight)
2006



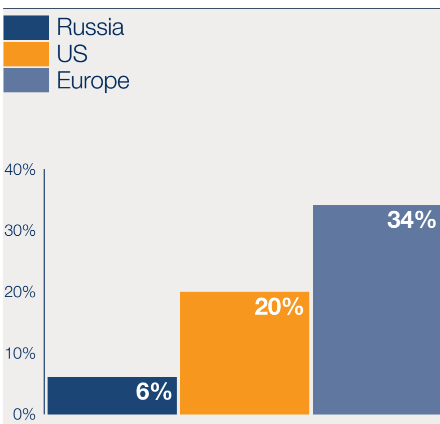
Source:
APK Marketing Institute

Pork (in volume terms, live weight)
2006



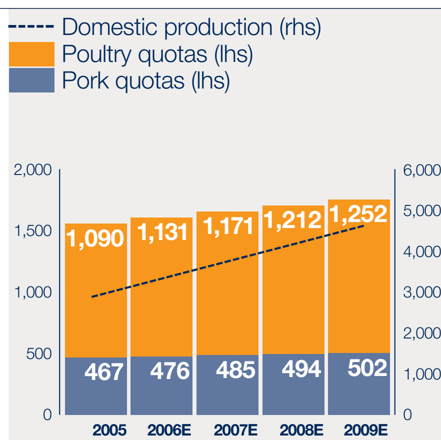
Source:
APK Marketing Institute

Government subsidies vs meat sales



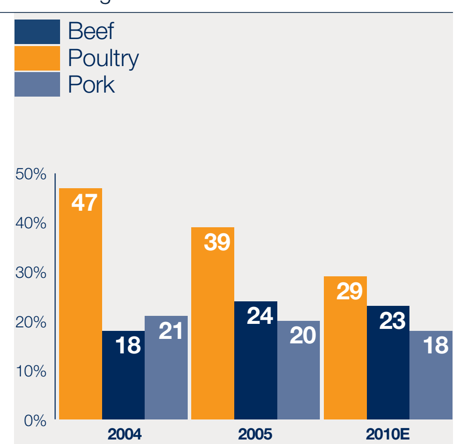
Source: OECD, FAEstat

Domestic production and quotas
(000 tonnes)



Source: Government of Russia Federation, Meat Union of Russia

Import to consumption 2003-2010
Percentage



Source: Meat Union of Russia

Chairman's statement...
focused on becoming Russia's leading meat producer

I am delighted to present Cherkizovo Group's annual report for 2006, our first report as a public company. During 2006 we made great strides towards realising our vision of becoming Russia's leading producer of meat and meat products.

To underscore our transformation into a modern company and to generate resources to enable our future development, we successfully listed Cherkizovo Group shares on the London and Moscow Stock Exchanges this spring. We subsequently embarked on the next stage of Cherkizovo's development, a period during which we aim to rapidly grow our market share and sales and increase overall profitability.

The market

I am proud to have worked in Russia's meat industry for the past 30 years, for the last 15 of which I have been carefully building the Company which is now Cherkizovo Group. Russia's meat industry continues to be characterised by relatively fragmented competition, expectations of continued strong growth and profitability, and a gradual trend toward consolidation. Russia still imports significant quantities of meat, although domestic meat production is increasing rapidly. Domestic production benefits from import quotas introduced in 2003, as well as from state subsidies and favourable tax rates. In addition, local input costs – including wheat and energy – are lower in Russia than in many other economies, contributing to the competitive advantages available to a well-run, modern Russian meat company such as Cherzkizovo.

In the past five years production and consumption of meat in Russia has increased. This, which follows a trend in other emerging markets, is driven by growth in disposable income and higher spending on food generally. Meat consumption per capita in Russia is, however, still only approximately 70% of that in many European countries, and only 60% of that in the United States. This suggests there is much room for Cherkizovo to grow, particularly since the Russian population is now not only eating more meat, but is becoming more health conscious, and is beginning to look for better quality and the wider variety of products which Cherkizovo offers.

Our business

From modest beginnings, through organic growth and strategic acquisitions, Cherkizovo Group has developed into one of Russia's leading meat processing companies. As a vertically-integrated meat producer, we focus on controlling quality and the cost of production at every stage, to enable us to deliver competitively priced, quality products to our customers, and attractive profits to our shareholders. It is our belief that we can build on our current strong market position, particularly in the fast-growing and dynamic poultry and pork sectors. We will continue to invest in new products, and in our brands, in promoting our products as a "single source of protein".

Group history
1993>2007

1993>1996

1993, our business was established through the privatisation of our controlling stake in the Open Joint Stock Company, Cherkizovsky Meat Processing Plant.

1995, we continued our growth when we acquired OJSC Biruliovsky Meat Processing Plant.

1996, we founded a new meat processing facility, LLC Cherkizovo-Kashira to increase our production capacity.

In Russia's meat industry close co-operation between government and the private sector continues to be very important. We work closely with regional governments in the pursuit of common interests and have benefited from this, for which we are grateful. Of special note has been our close co-operation with, and support we have received from, the Governors of Tambov and Lipetsk areas where we have invested in modern pork production facilities.

We believe our pork business offers great potential growth and our Lipetsk pork facilities set the local industry standard by incorporating the best international production practices. Once our Lipetsk and Tambov facilities are fully operational we will be able to introduce premium, chilled pork products. We expect our modern facilities and increased integration from farm to retail will offer consumers a wider range of higher-quality products and will deliver higher margins to the bottom line. Our Poultry Division today is one of the largest suppliers of chilled poultry products in Russia, and the largest in the Moscow Region. Our plan is to sell our poultry products across an even wider geographic area; to ensure that we are able to do this while, at the same time, controlling freshness and quality, we are building several modern distribution centres, and are modernising and expanding existing facilities.

We believe our Company is poised to capitalise on Russia's high-growth meat market – which provides us with the opportunity to drive our business to greater success. Moreover, with Russia's meat production industry ripe for consolidation – particularly the pork and poultry sectors – Cherkizovo's management intends to pursue a strategy designed for market leadership by leading this consolidation process.

The IPO

Cherkizovo's initial public offering (IPO) on The London Stock Exchange in May 2006 was the result of significant planning and hard work by many people over many years. This significant step represented a vote of confidence by international and Russian investors in Cherkizovo's historic results, its growth strategy, and the attractiveness of the markets it serves. The majority of proceeds from the IPO have enabled us to accelerate our growth rapidly through expansion and modernisation, and through the pursuit of strategic acquisitions. I thank our shareholders, business partners and executives for their support in helping us to achieve this important milestone in our development.

Dividend policy

As we stated at the time of our IPO, we do not expect to pay dividends for the foreseeable future, but instead plan to reinvest our net profits into the business. We are confident this is in the best long-term interests of the Company and its shareholders.

Our people

The determination and commitment of our management and employees has been essential in our progress to this point and will be critical to us achieving our vision. I thank them all for their hard work and support and look forward to working with them to achieve our potential. During 2006, we strengthened our senior management team with the appointment of Artur Minosyants as Chief Operating Officer, and the appointment of Joost Gerrits as Chief of Administration of our Poultry Division. Both have extensive industry experience and, the Board believes, will bring valuable skills and perspective to the Group.

Looking ahead

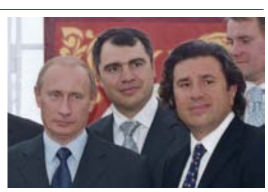
Russia's large, fragmented meat market is undergoing unprecedented changes and growth, and competition is expected to increase. We believe the current dynamics in our markets present us with enormous potential. Cherkizovo is now a well-established, well capitalised, and well-managed business. We focus on the efficient production and distribution of quality products through the introduction of best international practices and quality standards, with vertically-integrated production methods – from fodder, to breeding, processing and distribution. Our business looks ahead from a position of strength, and we will aggressively seek to build on our impressive record of organic growth and strategic acquisitions. I look forward to the future with confidence.

Igor Babaev
Chairman

2000, as part of our long-term strategy of vertical integration, we acquired Kuznetsovsky, the largest pork production facility in the Moscow Region; the leading poultry producer, Petelino; and the Mikhailovsky fodder factory.

1997>2000

1998, we established our management company APK Mikhailovsky to operate our agricultural business, improve efficiency and co-ordinate logistics.



2001>2004

2002, as part of our strategy of becoming Russia's best-in-class pork and poultry producer, we acquired the Penza and Botovo facilities, and began the construction of a pork facility on a greenfield site at Lipetsk.

2005>2007

2005, Cherkizovo Group formed after the consolidation and restructuring of AIC Cherkizovsky and AIC Mikhailovsky, in a move to increase transparency and make more efficient use of the corporate structure.

2006, in May we became a publicly-listed company when we floated on the UK stock market and on Russia's RTS.

Expansion continued with the construction of additional pig farms, first at Lipetsk in February, second at Tambov in July.

Chief Executive Officer's statement...

increasing efficiency, sales and margins

Cherkizovo operates in what is currently an under-developed market. That, in itself, creates opportunities, but with the size of Russia's population and its relatively low meat consumption added to the mix, we see huge potential for growth and greatly increased profitability.

Agriculture is a vital part of Russia's economy. After difficult times in the 1990s following the collapse of the managed economy, it has been recovering well. Our government understands its importance to the health of the economy, as well as of the population, and has introduced a number of measures to encourage investment and growth.

We are one of Russia's leading integrated diversified meat producers and I do not apologise for repeating that our strategy is to become *the* leading integrated producer. In the past year, we have made a number of investments to enable us to achieve that goal.

Investments

There is an increasing market for white meat in Russia. We were already breeding and raising poultry and selling chilled and frozen poultry products. When we acquired our first pork facility we saw the potential that pork offered. It is a high-margin product, but we quickly realised that it was impossible to compete with European producers unless we invested in modern facilities. In 2005 we signalled our intention to move into the pork market in earnest when we began to build our facility in the Lipetsk Region. This began to deliver in December 2006 – and we began construction of two additional farms in Lipetsk and a second facility in the Tambov Region in the second half of 2006.

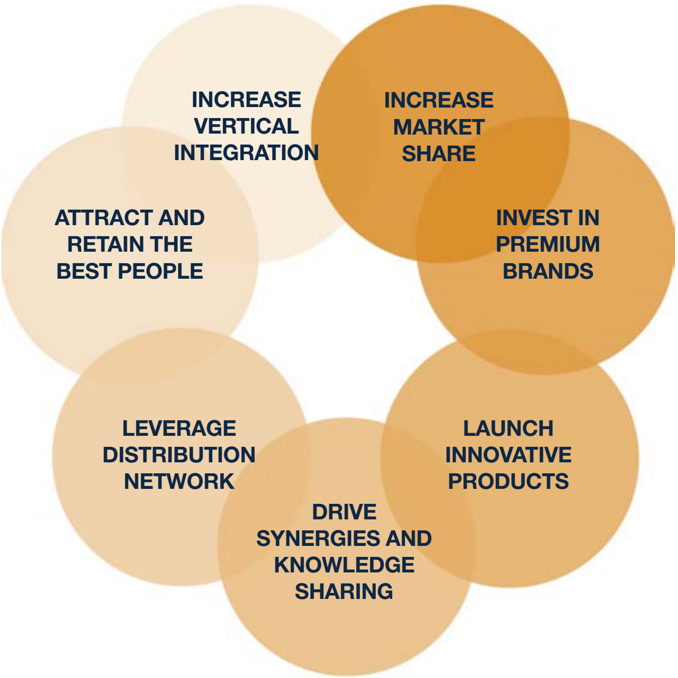
We also invested in upgrading existing sales and distribution centres and in building new ones to extend the geographic area we cover. In our drive to become one of a very few nationwide suppliers, our ability to deliver products from farm to shelf in less than 24 hours gives us a true competitive advantage.

Vertical integration

Efficient distribution is the final link in the vertical integration chain. We are passionate about protecting the integrity of our brands. To do this, we believe we need to control every stage of production, from raising breeding stock and controlling the feed mix, to slaughtering and delivery. Vertical integration enables us to control our costs and the selling price of our products.

In recent years, Russians simply could not afford to eat enough meat. As their disposable income increases and they eat more, we will focus on offering them a choice at affordable prices. Poultry is currently the cheapest option, and for us the most attractive because the production cycle is short. The poultry market will undoubtedly continue to grow but, once our facilities are at full production, we believe that pork will make the biggest difference to the success of our business because it offers the opportunity to make very high margins. We also believe that diversification is a wise strategy. If future generations choose to eat more or less poultry, pork or processed meat, they will still eat our products.

Group strategy



Risk management

We do, of course, face risks, the most obvious of which are the viral diseases which spread quickly around the world. In 2006, avian flu decimated flocks in many countries, but our poultry was unaffected. Russia's size, cold climate and its low concentration of people and animals per square km, make it more difficult for diseases to spread. In addition, we impose strict hygiene regulations, separate different stages of production, and keep our flocks in totally closed environments.

The opportunities

We operate in an industry which is not well understood in Europe – and our challenge is to make existing and potential shareholders understand what an attractive market it is. At around 143 million, Russia's population is huge and approximately 60% of that population lives within reach of our distribution network. We have a US$700 million share of a highly-fragmented market which is potentially worth around US$25 billion.

The Russian retail market is growing fast, but it is constrained by the limited number of producers who can provide good quality products. We have the infrastructure, high-quality brands and determination to fill the void in the market and become Russia's supplier of choice.

Sergei Mikhailov
Chief Executive Officer

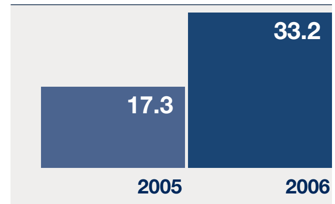
How we are performing against strategic objectives

Key Performance Indicators

Performance

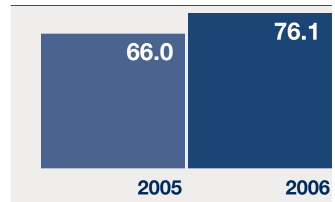
Net income from continuing operations, growth US$m

+92%



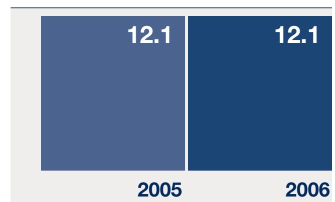
Adjusted EBITDA, growth US$m

+15%



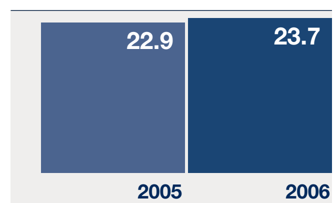
Adjusted EBITDA margin Percentage

12%



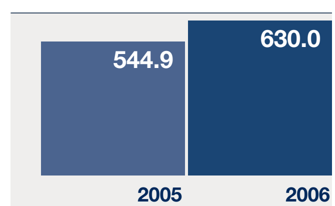
Gross margin, growth Percentage

+3%



Sales, growth US$m

+16%



Meat Processing

Russia's leading producer of processed meat products

Cherkizovo produces more than 300 different processed products, from cooked, cooked-smoked and semi-smoked sausages, to deli meats, hams and patés. We also produce ready-to-cook meatballs, burgers and minced-meat patties, as well as fresh, chilled and frozen meat.

Average price increase
2006
US$2.97

+15%
(2005: US$2.59)

Sales growth
2006
US$451.6m

+10%
(2005: US$409.3m)

Adjusted EBITDA
2006
US$33.7m

-3%
(2005: US$34.5m)

EBITDA margin
2006

7%
(2005: 8%)

Strategy

We focus on increasing the use of our existing capacity and on expanding our business by making selective acquisitions of high-quality branded producers in core regions. We promote the quality, convenience, freshness and taste of our existing products, and target each of our brands at a distinct market sector. We are producing more premium products, which sell at higher prices, and are introducing a range of new products, including delicacies, meat snacks, low-fat and diet, and ethnic products, as well as products specifically for children.

Production

We produce our products at eight facilities: three are in Moscow and the Moscow Region, the rest in other key markets in European Russia. The modern production lines and equipment we have installed at all these facilities enable us to maintain the high quality our customers have come to expect from us. Our products receive many commendations and our quality management system has been recognised by the award of the international GOST R 9001-2002 certificate.

Our largest facility, the Cherkizovsky plant in Moscow, was the first in Russia to use innovative technology to dry, rather than smoke, salamis; the Biruliovsky plant, also in Moscow, is one of the five top processing plants in Russia. While we have revived traditional recipes for raw sausages, we have also developed exciting new products flavoured with, for example, caraway, cinnamon, ginger, honey and cognac.

Marketing

We market our products under different brand names, and constantly develop new premium brands under the umbrella of our leading brands. We sell in different price brackets: for example, our flagship Cherkizovsky brand, which in 2006 accounted for more than 50% of our total sales of prepared meat products, is targeted at the premium and mid-price markets. Our equally well-established Biruliovsky brand, under which we sell our sausage products, patés, specialty meat sausages and ready-to-cook products, is targeted at the medium and lower-price markets. Some of our brands are national, but in some regional areas where we believe customers prefer familiar names, we also sell well-established local brands.

1 All our 5 Stars premium-brand products are made from chilled meat from our own pig farms, using sophisticated, high-quality natural spices

2 Cherkizovo Group is the only company to produce raw smoked sausages. We can afford to use the best quality chilled meat and have exclusive equipment to produce our raw smoked products

3 The quality of the meat from our pig farms is confirmed by "Ecological Product" certification

"We constantly strive to produce innovative new products: from taste tests to customer feedback, we use thorough review procedures to drive the development of our market-leading products."

Adylov Alisher
Head of department
Research and Development

4 We are the exclusive supplier of fresh meat to the international McDonald's chain of restaurants and undergo regular quality audits

5 Our production facilities use the industry's most up-to-date technology and equipment to produce high-quality products for our Russian customers

Poultry

increasing sales nationwide

Cherkizovo farms and processes poultry which is sold chilled or frozen, whole, in portions or ready-to-cook.

Volume, sales in tonnes increase 2006

69,191 tonnes

+36%

(2005: 51,054 tonnes)

Sales growth 2006

US$151.0m

+29%

(2005: US$117.1m)

Adjusted EBITDA growth 2006

US$36.2m

+28%

(2005: US$28.3m)

EBITDA margin 2006

23%

(2005: 22%)

Strategy

We have expanded our poultry production capacity over the past year and intend to continue to grow organically. We are also looking to consolidate the market by acquiring high-quality assets, which have strong brands and well-developed distribution networks.

Production

We raise chickens at two production clusters in the Moscow and Volga Regions, where we also process chilled products and, in the Moscow Region, frozen products. The process begins when we bring in day-old chicks of the French Isa breed. As part of our modern bio-safety techniques, they have been hatched at separate sites. At the age of 70 days, they are transferred to the parent flock and begin producing eggs which are incubated and hatched before being transferred to production sites. Around 40 days later they are slaughtered and processed into chilled or frozen products.

The welfare of our stock is a priority: air temperature and circulation, lighting and population density are carefully controlled; water is tested regularly; and feed is carefully balanced to improve productivity and reduce cost. To limit the opportunities for the spread of disease between generations, and between breed stock and poultry being raised for sale, each production stage is at a different site separated by minimum 5-km sanitation zones.

Marketing

We market our poultry products under a number of brand names, differentiated by product, price and geography. For example, our premium chilled brand, Petelinka, is targeted at Moscow and the Moscow Region where it has 80% brand awareness and a high level of customer loyalty; other brands are designed to appeal to the medium and lower-price markets. We also have a number of own-label contracts with leading retailers and supermarket chains and expect this to enable us to continue to increase our market share.

24 hours

Fodder
Chicken
Broil
Butcher
Distribution
Sell

We deliver our product from farm to shelf within 24 hours, guaranteed

Operational Key Performance Indicators

	2005	2006	% Change
Average liveweight, g	1,892	**1,948**	+3.0
Annual flock turnover, times	6.7	**7.1**	+6.3
Hatch, %	77.2	**76.7**	-0.6
Livability, %	92.3	**92.9**	+0.6
Average growing period, days	40.5	**40.3**	-0.6
Meat yield, %	71.2	**71.7**	+0.8
Average fodder conversion rate, kg per kg of weight gain	2.1	**2.0**	-3.6

1 Our poultry is available chilled or frozen, whole or in portions

2 Our products are distinguished by their quality, freshness and taste

3 We pack our poultry products in strictly-controlled conditions and distribute them from dedicated warehouses

"To grow our poultry division we have invested heavily in the production process by improving broiler breeds and poultry rations, staff recruitment and training, and by the modernisation of our equipment and buildings; this has resulted in a strengthened, more efficient infrastructure."

Joost Gerrits
Head of Poultry Division

From left:
Joost Gerrits
Head of Poultry Division
Vladimir Sedikh
Head of Moscow Poultry Block
Makeev Aleksey
Head of Penza Poultry Block

Pork

a rising star in the pork industry

How we performed

We breed and rear pigs to the highest Western standards at our four pig farms in the Moscow, Vologda and Lipetsk Regions. Live pigs and pork carcasses currently comprise the majority of our sales, but our strategy is also to become a leader in processed pork.

Average price increase
2006

US$2.14

+19%

(2005: US$1.79)

Sales growth
2006

US$27.4m

+48%

(2005: US$18.5m)

Adjusted EBITDA growth
2006

US$9.1m

+326%

(2005: US$2.1m)

EBITDA margin
2006

33%

(2005: 9%)

Strategy

Cherkizovo is one of the leaders in what is still a highly-fragmented industry, We intend to use the experience we have gained in building and operating our modern pig-raising facility in Lipetsk to expand into other geographic areas, and are already constructing a new facility in Tambov.

Production

We breed from our own sows or import stock from leading breeders in Denmark. When brood sows reach a weight of 90 kgs, they are transferred to one of our production sites where they are quarantined before going to an insemination site, and then to a delivery site. Since fodder represents the most significant cost in our pork operations, we produce our own.

We impose strict hygiene regulations at all our farms; these include limiting employees' movement between sites and travel to areas where diseases are prevalent.

Marketing

Consumers' increasing preference for high-quality, lean meat is creating a new market for pork products which sell at premium prices. Since there are very few pork producers in Russia, and most competition is local, we expect to be able to continue to increase our share of this growing market.

While the majority of our sales are currently of live pigs to other processors, our plan is to expand our product range to include premium chilled, and other processed, pork products.

Operational Key Performance Indicators

	Average 2005	Average 2006	differential 2006 vs 2005	Lipetsk (projected) 2006
Average marketable pig weight, kg	**105**	**113**	+8%	**110**
Average fattening period, days	**209**	**195**	-6%	**180**
Number of farrows per year	**2.2**	**2.3**	+5%	**2.30**
Number of pigs per farrow	**10.0**	**11.1**	+11%	**13.0**
Livability, %	**75.3**	**76.0**	+1%	**79.0**
Annual pork (live weight) yield per sow, kg	**700**	**2,175**	+211%	**2,598**
Average fodder conversion rate, kg per kg of weight gain	**4.30**	**3.5**	-19%	**3.29**

“We are excited to be at the forefront of Russia’s fastest-growing meat market. We are using Western practices, and increasing our operational efficiency, to grow this business organically.”

Andrey Bocharnikov
Director of Lipetskmyasoprom

1 Our Lipetsk pig farm has been built to Western standards on a greenfield site

2 Chairman Igor Babaev shows Oleg Korolev, the Governor of the Lipetsk Region, around our new facility

3 The Danish company, AIB Consult, advised on design and equipment at Lipetsk

4 We breed from our own sows, as well as from stock imported from Denmark, at our ultra-modern facility

Distribution

delivering a competitive advantage

We sell the majority of our products through our own storage and sales facilities. Our fleet of more than 870 refrigerated trucks enables us to deliver fresh products to our retail and wholesale customers on a daily basis.

1

Strategy

Our distribution network is a vital component in us achieving our vision of becoming Russia's leading producer of meat and/or, meat products. By making frequent deliveries, we ensure that our products capture more shelf space. That, in turn, helps to secure our leading position in the market. We plan to continue to develop the network and to increase our direct deliveries, particularly to the modern retail chains which are expanding rapidly in Russia. We will capitalise on the relationships our meat processing and poultry businesses hold with these chains to become their supplier of choice for an increasingly wide range of products.

We also plan to expand our sales to other outlets, such as the restaurant and hospitality markets, which are quickly becoming more established, particularly throughout European Russia.

Rationale

We set up our own distribution system as a result of the difficulties we encountered, particularly in the 1990s, in ensuring that our products were distributed efficiently. Controlling our own logistics is cost-efficient – an effective infrastructure for outsourcing does not exist in Russia – and gives us confidence that our customers receive our products in a condition and in the quantities they need to meet their customers' demands.

Logistics

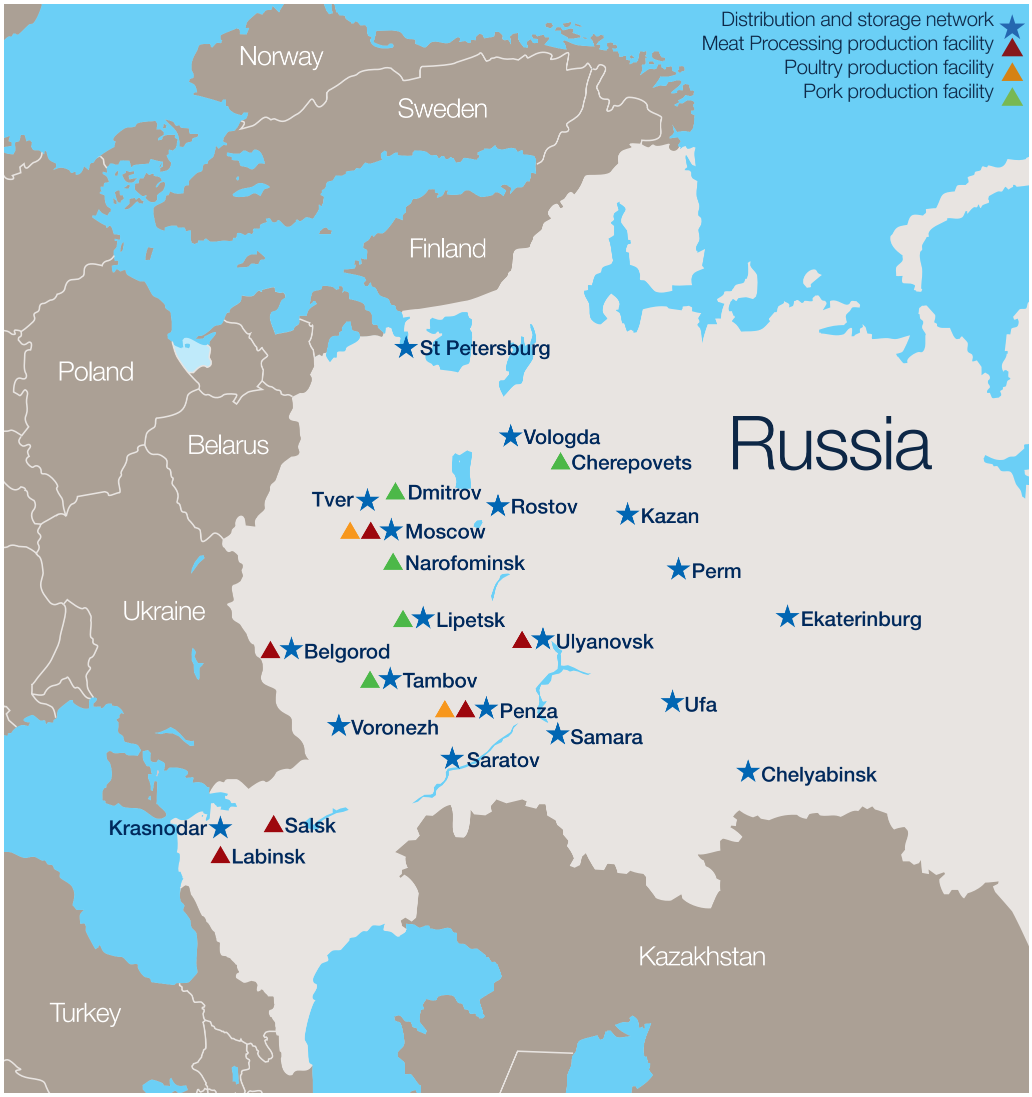
We prefer to sell direct to end retailers wherever possible and, particularly in Moscow and the Moscow and Volga regions, direct deliveries account for a high proportion of our sales. Our strong relationships with independent distributors are, however, also extremely important since they sell to smaller retailers as well as covering remote market areas.

The depth and scale of our distribution network helps ensure that a complete range of our products is available for consumers to buy and that the quality is maintained at the level we demand. Because fresh poultry has different characteristics and delivery needs from processed meat products, we operate separate systems, and use separate vehicles, to deliver them.

2

Our distribution network

Our distribution network covers the regions in which over 80% of Russia's population lives



Our customers

- Metro, a leading global cash-and-carry store
- Ashan, an international hypermarket chain
- Magnit, Russia's largest discount retailer
- Pyaterochka, a Russian discount chain
- Perekrestok, a quality supermarket chain
- Dixi, a large, low-price, self-service retail chain
- Ramstor, an international retail chain
- Kopeyka, a Russian discount chain
- 7th Continent, a leading Russian retail chain
- McDonalds, the world's leading fast-food chain

1 **Our storage and sales facilities ensure that the quality of our products is maintained at the level we demand**

2 **We operate separate systems and use different vehicles to deliver fresh poultry and processed meat products**

3 **We make daily deliveries to retail customers**

4 **Our well-packaged and high-quality fresh products enable us to capture more shelf space – and to increase sales**

3

4

Financial review
improving profitability

How we performed

Overview

Cherkizovo is one of the Russian Federation's leading integrated diversified meat producers. Our principal operations consist of the production and sale of processed meat products, primarily in European Russia; the breeding and raising of chickens, and the processing and sale of chilled and frozen poultry produced at facilities in the Moscow and Volga regions; and the breeding and raising of pigs at facilities in the Moscow, and other, regions. We also operate sales and distribution operations and produce fodder for our poultry and pork operations. In February 2006 we began operations at a new pig farm in the Lipetsk Region, and plan to expand our operations to include the production and sale of chilled pork products in Moscow, Lipetsk and other Russian regions.

Our operations are structured into three divisions (referred to as segments under US GAAP): meat processing, poultry, and pork. Our eight facilities in the Meat Processing Division process raw meat into fresh and ready-to-cook foods, sausages, hams and other processed meat products, and also carry out associated sales and trading operations. Our Poultry Division consists of two production clusters, a poultry processing company, a feed production plant, and associated sales and trading operations. Our Pork Division consists of four pig farms. We record expenses of our corporate headquarters, which are not material to our results of operations, under "corporate expenditures".

All three division are also involved in other non-core activities, including dairy farming and associated services. In September 2006, the Group decided to dispose of the non-core operations, CJSC Budenovets Agrifirm and CJSC Krugovskaya. The disposal was completed by the end of the year. During 2007, the Group will buy certain assets of these discontinued operations which it had been renting. For the purpose of preparing the financial statements, those fixed assets are considered to have remained in the Group at their historical book values.

Our total sales include sales of produced goods, goods for resale, and other sales and sales-volume discounts. They are net of returns which are attributable to the relevant divisions (see Note 12 to the financial statements).

Goods for resale include meat products, such as pelmeni (dumplings) and deli meats, the production of which is outsourced, as well as beverages and baked goods. We sell these non-core products, which complement our primary production lines, through the sales and distribution facilities in our meat processing and poultry divisions.

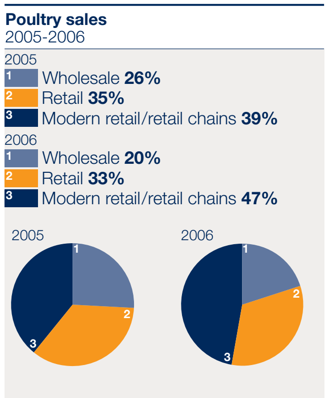
Other sales are principally services and other products of non-core operations. In the Meat Processing Division these are casings, fasteners, transportation services, and rent for property, plant and equipment. In our Poultry and Pork divisions they are dairy products, feed, eggs and cattle, as well as rent for property. Other sales were approximately 2% of sales, in 2006.

The terms of our agreements with our customers, particularly in the Meat Processing Division, also provide for certain discounts for volume purchases. These increased to US$9.9 million in 2006 (2005: US$3.4 million), as a result of an increasing number of large-volume customers, particularly modern retail chains, in our Meat Processing and Poultry divisions.

Consolidated selected financial data	Meat processing US$000	Poultry US$000	Pork US$000	Corporate assets/ expenditures US$000	Interdivision US$000	**Combined US$000**
Total sales	453,194	155,682	27,816	568		**637,260**
including other sales	1,474	10,213	2,113			**13,800**
including sales volume discount	(6,999)	(2,918)	–			**(9,917)**
Interdivision sales	(1,592)	(4,661)	(455)	(567)		**(7,275)**
Sales to external customers	451,602	151,021	27,361	1		**629,985**
Cost of sales	(371,281)	(98,841)	(17,509)	(3)	6,699	**(480,935)**
Gross profit	81,913	56,841	10,307	565	(576)	**149,050**
Gross margin	18%	37%	37%			**24%**
Operating expenses	(65,296)	(27,956)	(3,093)	(4,310)	589	**(100,066)**
Operating income	16,617	28,885	7,214	(3,745)	13	**48,984**
Operating margin	4%	19%	26%			**8%**
Other income and expenses, net	3,008	(1,016)	63	10,212	(7,811)	**6,488**
Interest expenses	(11,534)	(8,958)	(518)	(4,295)	7,767	**(17,538)**
Non-recurring expense	–	–	–	–		**–**
Division profit	8,091	20,943	6,759	2,172	(31)	**37,934**
Income tax expense	2,616	(791)	(119)	713	–	**2,419**
Depreciation expense	15,657	6,961	1,906	–		**24,524**
Loss on disposal of property, plant and equipment	1,395	365	(43)			**1,717**

Reconciliation between net division profit and income from continuing operations

Total net division profit	37,934
Minority interest	(2,319)
Income taxes	(2,419)
Consolidated income from continuing operations	**33,196**



In addition, customers are able to return damaged or sub-standard goods within one month of the day of shipment. These returns are accounted for as a deduction from sales which remained approximately constant, at 1% of sales, at US$6.9 million (2005: US$4.3 million).

In 2006, meat processing accounted for 72% of our sales, poultry for 24%, and pork for 4% (2005: meat processing 75%, poultry 21%, pork 4%). Practically all our sales are made in the Russian Federation.

State support for agricultural production

Agricultural production enterprises in Russia, including our poultry and pig production facilities, benefit from a favourable tax rate. This, which is at 0% from 2004 to 2007, is scheduled to increase to 6% for 2008 and 2009, 12% for 2010 and 2011, 18% for 2012 to 2014, and 24% from 2015, as against a general corporate profit tax rate of 24%. As a result of these reduced rates and other factors, our overall effective tax rate was 6% in 2006. Our non-production operations, such as the processing of chilled and frozen poultry, sales and distribution operations, and feed production, are not eligible for this reduced rate.

Agricultural enterprises are also entitled to reimbursements from the Russian federal authorities for interest payable on loans of up to two-thirds of the official Central Bank of Russia (CBR) refinancing rate, and from regional authorities of up to one-third of the official CBR refinancing rate. The CBR's refinancing rate has been 10.5% since 26 January 2006 (down from 11%, the rate set on 20 October 2005). We account for interest expense on these loans on a net basis, after taking account of the subsidies. At 31 December 2006, approximately 70% of the aggregate principal amount of our loans received these subsidies. These reduced our interest significantly.

Some agricultural operations, such as our Lipetsk pork production facility, also receive direct local government support in the form of subsidies.

The favourable tax rates and interest rate subsidies are not available to non-production agriculture-related operations, such as our sales and distribution, and meat and poultry processing operations.

Seasonality

Our business is significantly seasonal. Religious traditions have a considerable impact on meat consumption in Russia: Orthodox Christians fast for at least 40 days before Easter. As a result, sales volume and profitability in the first quarter are historically the lowest in the year. Sales and profitability in the fourth quarter, driven by the New Year holidays, have historically been the highest in the year. Seasonality also affects average selling prices as retail consumers generally buy more – and more expensive – high-quality products in the fourth quarter. In addition, because fodder costs are lower when crops are harvested, the second half of the year is notably more profitable for pork and poultry production.

Seasonality also affects net income, since most of the decisions concerning eligibility for reimbursement on loans come at the end of the year.

Results of operations

The Group performed strongly in the first half of 2006. Despite the heavy demands made on the management team by the IPO, and the uncertainties caused by avian flu which surrounded the poultry sector in general, the business has continued to operate well and is reporting strong results as a listed company.

Consolidated selected financial data	**Year ended 31 December 2006 US$000**	Year ended 31 December 2005 US$000
Sales	**629,985**	544,897
Cost of sales	**(480,935)**	(420,037)
Gross profit	**149,050**	124,860
Gross margin	**24%**	23%
Selling, general and administrative expenses	**(98,349)**	(80,187)
Other operating expenses	**(1,717)**	(1,104)
Operating income	**48,984**	43,569
Operating margin	**8%**	8%
Other income and expense, net	**6,488**	(1,301)
Interest expenses	**(17,538)**	(15,605)
Income before provision for income taxes and minority interest	**37,934**	26,663
Provision for income taxes	**(2,419)**	(7,973)
Minority interest in net income/(losses) of combining companies	**(2,319)**	(1,387)
Income from continuing operations	**33,196**	17,303
Loss from discontinued operations	**(199)**	(306)
Net loss on disposal of discontinued operations	**(2,813)**	–
Extraordinary gain	**–**	79
Net income	**30,184**	17,076
Consolidated adjusted EBITDA* reconciliation		
Income before income tax, minority interest and extraordinary item	**37,934**	26,663
Add:		
Interest expense	**17,538**	15,605
Interest income	**(2,570)**	–
Loan origination fees	**1,690**	–
Interest expense related to early repayment of EBRD loan	**898**	–
Gain from debt extinguishment	**(801)**	(982)
Currency remeasurement loss/gain	**(4,567)**	2,219
Other financial income and expenses	**(1,138)**	64
Depreciation expense	**24,524**	20,162
Loss on disposal of property, plant and equipment	**1,717**	637
Unusual loss related to privatisation of a subsidiary	**–**	467
Other items	**839**	1,162
Consolidated adjusted EBITDA	**76,064**	65,997
Adjusted EBITDA* margin	**12%**	12%

Financial review
continued

Overall sales increased by 16% to US$630.0 million in 2006 (2005: US$544.9 million). Meat processing accounted for 72% of total sales, poultry for 24% and pork for 4%. Our Pork and Poultry divisions showed the most aggressive growth in the year: pork grew at 48%, poultry at 29%.

Gross profit increased 19% to US$149.1 million (2005: US$124.9 million), while gross margins increased to 24% (2005: 23%). Net income from continuing operations increased 92% to US$33.2 million (2005: US$17.3 million).

In September 2006 we made a decision to dispose of the non-core business operations of CJSC Budenovets Agrifirm and CJSC Krugovskaya ("the discontinued entities") for US$162,000 in cash. The disposal was completed by the end of 2006. Legal obligations of approximately US$2.3 million (as of the balance sheet date) exist for the Group to purchase fixed assets owned by these discontinued entities in 2007. These fixed assets as well as the liability relating to their purchase were included in the calculation of the gain/loss resulting on the sale of the discontinued operations. Despite the loss from disposal of discontinued operations, our net income in 2006 increased by 77% to US$30.2 million (2005: US$17.1 million).

Adjusted EBITDA* increased 15% year-on-year to US$76.1 million (2005: US$66.0 million) and adjusted EBITDA* margin remained constant at 12%. We consider adjusted EBITDA to be an important supplemental measure of our operating performance. It represents divisional profit plus depreciation; loss on disposal of property, plant and equipment; extraordinary loss related to the privatisation of a subsidiary; and other items, which are primarily expenses relating to financing, the IPO and restructuring activities.

***Adjusted EBITDA**
Adjusted EBITDA is not a measure of financial performance under US GAAP, and it should not be considered as an alternative to net profit as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of adjusted EBITDA may be different from the calculation used by other companies and therefore comparability may be limited.

Meat Processing Division

In response to market demands, we have moved our product mix to more high-margin, value-added products. This is reflected in the significant increase in average selling prices. We have increased volumes of premium high-margin products, such as semi-smoked and cooked smoked sausages, deli and meat retail format, and decreased low-value low-margin volume drivers. Volumes decreased by 4% year-on-year as a result of the lower production of low-margin volume drivers. Average prices increased by 15% to US$2.97 per kg (2005: US$2.59 per kg), excluding VAT. In roubles (RUR) the price increased by 10% to RUR80.80 (2005: RUR73.37), excluding VAT. As a result, sales in our Meat Processing Division increased by 10% to US$451.6 million (2005: US$409.3 million), principally as a result of significantly higher selling prices.

Meat Processing Division income statement data	**Year ended 31 December 2006 US$000**	Year ended 31 December 2005 US$000
Total sales	**453,194**	410,179
Interdivision sales	**(1,592)**	(870)
Sales to external customers	**451,602**	409,309
Cost of sales	**(371,281)**	(336,816)
Gross profit	**81,913**	73,363
Gross margin	**18%**	18%
Operating expenses	**(65,296)**	(52,663)
Operating income	**16,617**	20,700
Operating margin	**4%**	5%
Other income and expenses, net	**3,008**	(1,244)
Interest expenses	**(11,534)**	(8,430)
Division profit	**8,091**	11,026
Meat Processing Division adjusted EBITDA* reconciliation		
Division profit	**8,091**	11,026
Add:		
Interest expense	**11,534**	8,430
Interest income	**(405)**	–
Loan origination fees	**1,690**	–
Interest expense related to early repayment of EBRD loan	**898**	–
Gain from debt extinguishment	**(500)**	(783)
Currency remeasurement (gain)/loss	**(4,509)**	1,963
Other financial income and expenses	**(182)**	65
Depreciation expense	**15,657**	13,354
Loss on disposal of property, plant and equipment	**1,395**	483
Meat Processing Division adjusted EBITDA*	**33,669**	34,538
Adjusted EBITDA* margin	**7%**	8%

Adjusted EBITDA* reconciliation	Meat processing US$000	Poultry US$000	Pork US$000	Corporate assets/ expenditures US$000	Interdivision US$000	**Combined US$000**
Division profit	8,091	20,943	6,759	2,172	(31)	**37,934**
Add:						
Interest expense	11,534	8,958	518	4,295	(7,767)	**17,538**
Loss from disposal of consolidated entities		–	–	–	–	**–**
Interest income	(405)	(7)	–	(9,971)	7,813	**(2,570)**
Loan origination fees	1,690	–	–	–	–	**1,690**
Interest expense related to early repayment of EBRD loan	898	–	–	–	–	**898**
Gain from debt extinguishment	(500)	(130)	(20)	(151)	–	**(801)**
Currency remeasurement loss/(gain)	(4,509)	(58)	(43)	43	–	**(4,567)**
Other financial income and expenses	(182)	(822)	–	(134)	–	**(1,138)**
Depreciation expense	15,657	6,961	1,906	–		**24,524**
Loss on disposal of property, plant and equipment	1,395	365	(43)			**1,717**
Unusual loss related to privatisation of a subsidiary						
Other items	–	–	–	839		**839**
Adjusted EBITDA*	33,669	36,210	9,077	(2,907)	15	**76,064**
Adjusted EBITDA* margin	7%	23%	33%			**12%**

Despite these reduced volumes and higher raw material costs, higher average prices resulted in the division's gross profit increasing by 12% to US$81.9 million (2005: US$73.4 million). Gross margin remained constant at 18%.

In addition to expanding its own sales and distribution facilities, the Group continues to develop relationships with modern retail chains. Retail chains' share of our sales increased from 12% to 15%. As a result, marketing and distribution costs increased, as did the costs associated with opening new – and refurbishing old – regional sales and distribution centres. We believe these initiatives will bring long-term benefits to the division. These costs are mainly reflected in increased divisional operating expenses (SG&A) as a percentage of sales year-on-year from 13% to 14%. As a result, operating income in the Meat Processing Division decreased to US$16.6 million (2005: US$20.7 million), while divisional operating margin decreased to 4% (2005: 5%).

Financial expenses in 2006 fell, mainly as the result of a US$4.5 million foreign-exchange gain. Interest increased by US$3.1 million, principally because of an increase in the LIBOR rate. In June the EBRD loan, which had a LIBOR-linked interest rate, was repaid in full with a Rouble Bond.

All these factors resulted in the Meat Processing Division's profit decreasing to US$8.1 million (2005: US$11.0 million). Adjusted EBITDA decreased slightly, by 3%, to US$33.7 million (2005: US$34.5 million). The adjusted EBITDA margin also decreased slightly to 7%.

Poultry Division

Results in the Poultry Division were primarily driven by a 36% increase in volumes – a result of earlier investment – as well as improved operational efficiency and economy of scale. As we expected, there was an excellent recovery in our poultry prices in the second half of the year. Compared with the first half, average prices increased by more than 7%, bringing them back to where they were before the avian flu outbreak. Compared with 2005's unusually strong prices, average prices decreased by only 1% in 2006 to US$2.15 per kg (2005: US$2.16 per kg), excluding VAT. In roubles the price decreased by 5% to RUR58.30 per kg (2005: RUR61.22 per kg), excluding VAT. As a result, sales in our Poultry Division increased by 29% to US$151.0 million (2005: US$117.1 million).

Modernisation of poultry equipment and buildings, and changes in the feed mix, significantly improved the Poultry Division's operational KPIs. The average fodder conversion rate, which shows how much feed is used per kg of weight gain, decreased to 1.98 kgs per kg (2005: 2.06 kgs). The annual flock turnover increased to 7.1 times (2005: 6.7 times) and survival rates increased to 93% (2005: 92%). As a result of efficient purchasing of raw materials and improved operational efficiency, gross profit increased 18% to US$56.8 million (2005: US$48.0 million) despite higher raw materials prices and lower selling prices. Gross margins decreased slightly to 37% (2005: 38%).

Operating expenses decreased as a percentage of sales year-on-year from 20% to 18%, primarily through economy of scale. As a result, operating income in the division increased 28% to US$28.9 million (2005: US$22.6 million), while divisional operating margin increased to 19% (2005: 18%) in the corresponding period.

Poultry Division income statement data	Year ended 31 December 2006 US$000	Year ended 31 December 2005 US$000
Total sales	**155,682**	127,641
Interdivision sales	**(4,661)**	(10,520)
Sales to external customers	**151,021**	117,121
Cost of sales	**(98,841)**	(79,592)
Gross profit	**56,841**	48,049
Gross margin	**37%**	38%
Operating expenses	**(27,956)**	(25,486)
Operating income	**28,885**	22,563
Operating margin	**19%**	18%
Other income and expenses, net	**1,016**	(28)
Interest expenses	**(8,958)**	(6,723)
Division profit	**20,943**	15,812
Poultry Division adjusted EBITDA* reconciliation		
Division profit	**20,943**	15,812
Add:		
Interest expense	**8,958**	6,723
Interest income	**(7)**	
Gain from debt extinguishment	**(130)**	(199)
Currency remeasurement (gain)/loss	**(58)**	228
Other financial income and expenses	**(822)**	(1)
Depreciation expense	**6,961**	4,965
Loss on disposal of property, plant and equipment	**365**	263
Non-recurring expense		467
Poultry Division adjusted EBITDA*	**36,210**	28,258
Adjusted EBITDA* margin	**23%**	22%

Interest payments increased to US$9.0 million (2005: US$6.7 million). Profit was up 32% to US$20.9 million (2005: US$15.8 million) as a result of the above factors. Adjusted EBITDA increased by 28% to US$36.2 million (2005: US$28.3 million), while adjusted EBITDA margin increased to 23% (2005: 22%).

Pork Division

The reorganisation of operations in our Pork Division had a significant effect on results in previous years. We believe, however, that the changes have improved the efficiency and the quality of the division's operations. The environment for pork sales was favourable throughout 2006 and prices exceeded our expectations. Sales increased 48% to US$27.4 million (2005: US$18.5 million), while the average selling price per kg of live weight improved by 19% to US$2.14 (2005: US$1.79), excluding VAT. In roubles, prices increased by 15% to RUR58.16 per kg (2005: RUR50.78 per kg), excluding VAT.

Financial review
continued

Volumes from existing facilities in the Pork Division increased by 7%, in line with our forecasts.

The restructuring and modernisation of facilities and livestock requirements had a significant impact on the division's operational KPIs, such as average fodder conversion rate and improved survival rate. Average fodder conversion decreased to 3.5kgs per kg of weight gain (2005: 4.3kgs) and the survival rate improved to 76% (2005: 75%). This had an effect on our cost of sales and, as a result, gross margin increased to 37% (2005: 14%). We expect the new pork facilities at Lipetsk to make a further improvement in operational KPIs in 2007. The division's operating expenses decreased as a percentage of sales year-on-year to 11% (2005: 13%).

The division generated operating income of US$7.2 million (2005: US$0.4 million), while operating margin increased to 26% and profit increased significantly to US$6.8 million (2005: loss US$0.1 million). The division generated adjusted EBITDA of US$9.1 million and an adjusted EBITDA margin of 33% in the year.

We have begun to develop a second pork production facility in Tambov. Combined with the farm in Lipetsk, this will give the Group the most advanced facilities in Russia, and ones which are on a par with most in Europe. The investment and developments at Lipetsk and Tambov will further improve the division's KPIs and margins.

Pork Division income statement data	Year ended 31 December 2006 US$000	Year ended 31 December 2005 US$000
Total sales	**27,816**	24,297
Interdivision sales	**(455)**	(5,830)
Sales to external customers	**27,361**	18,467
Cost of sales	**(17,509)**	(20,831)
Gross profit	**10,307**	3,466
Gross margin	**37%**	14%
Operating expenses	**(3,093)**	(3,071)
Operating income	**7,214**	395
Operating margin	**26%**	2%
Other income and expenses, net	**63**	(18)
Interest expenses	**(518)**	(453)
Division profit/(loss)	**6,759**	(76)
Pork Division adjusted EBITDA* reconciliation		
Division profit	**6,759**	(76)
Add:		
Interest expense	**518**	453
Gain from debt extinguishment	**(20)**	–
Currency remeasurement (gain)/loss	**(43)**	18
Other financial income and expenses	**–**	–
Depreciation expense	**1,906**	1,843
Loss on disposal of property, plant and equipment	**(43)**	(108)
Pork Division adjusted EBITDA*	**9,077**	2,130
Adjusted EBITDA* margin	**33%**	9%

Liquidity and capital resources

Capital requirements

In addition to needing cash to meet our working capital requirements, we require capital to finance:

- capital expenditures, particularly the further development of our pork division;
- potential acquisitions; and
- repayment of debt.

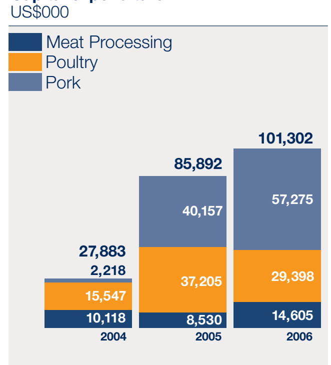
We anticipate that capital expenditure, potential acquisitions and repayment of long-term debt will represent the most significant uses of funds for several years to come.

Our total capital expenditure (capex) in 2006, excluding acquisitions, amounted to US$101.3 million. This includes cash and other payments for property, plant and equipment excluding changes in accounts payable for equipment. Capex in our Meat Processing Division, of US$14.6 million, related to improvements at our existing regional meat processing and storage facilities. Capex in our Poultry Division, of US$29.4 million, related principally to the expansion of production capacity at our poultry farms in the Moscow and Volga regions. Capex in our Pork Division, of US$57.3 million, was primarily related to the construction of a new pork facility in Lipetsk and the start of construction of a second new facility in Tambov.

Capital expenditure, excluding acquisitions

We have developed a capex plan to the end of 2007. We are focusing investment on completing and bringing to full operating capacity our pig production facilities in Lipetsk and Tambov, on constructing new pig raising facilities and on constructing facilities to produce fresh cut pork products. In our Meat Processing Division we plan to focus on improving and maintaining our existing facilities to improve efficiency and expand distribution. In our Poultry Division, we expect to focus on increasing production capacity, completing the upgrading of our facilities in the Moscow and Volga regions, expanding our distribution network and improving our feed production facilities.

Capital expenditure
US$000



Capital resources

We generally finance capex and acquisitions from operating cash flow and bank loans. In 2006, the major sources of funds were operating cash flow, proceeds from the IPO and long-term borrowing. Our investment activities were primarily financed with long-term borrowing.

Net cash used in continuing operating activities in 2006 amounted to US$33.1 million compared with net cash from operating activities of US$13.6 million in 2005. Increases in inventories, livestock and trade receivables, and decreases in trade accounts and tax payable, resulted in an outflow of cash in 2006 compared with 2005. The increase in inventory balances is principally a result of the beginning of operations at our Lipetsk pig production facility and of an increase in raw materials at our feed production facilities. The beginning of operations in Lipetsk and higher volume in the Poultry Division resulted in an increase in the cost of livestock to US$28.8 million (2005: US$13.3 million).

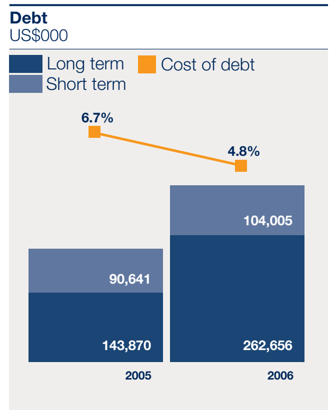
The increase in trade accounts receivable is mainly a result of increased sales and a higher proportion of pork and poultry products being distributed through retail chains. During the year, trade accounts payable decreased by US$14.9 million (2005: increase of US$16.9 million). This was primarily as a result of moving our procurement activities to TIC Cherkizovo Ltd (Cherkizovo-2) which usually pays suppliers in advance in order to obtain more favourable prices.

Tax payable also decreased by US$6.6 million resulting from a change in the VAT regulations, which allows us to offset input VAT against VAT payable at an earlier date. An increase in other assets is primarily attributable to an increase in advances resulting from a change in our procurement pattern, and is offset by the reduction of VAT receivable as a result of the change in the tax regulations.

In addition, there was a net cash outflow from operating activities associated with the discontinued operations, CJSC Budenovets Agrifirm and CJSC Krugovskaya, of US$2.0 million (2005: inflow associated with these operations of US$0.7 million).

Investment activities constituted a net use of cash of US$122.2 million (2005: US$71.1 million). The increased use of cash during 2006 was primarily attributable to an increase to US$112.9 million (2005: US$76.5 million) for purchases of property, plant and equipment; a reduction in proceeds from the sale of property, plant and equipment to US$0.3 million (2005: US$1.5 million); and a reduction of proceeds from the repayment of short-term loans.

Our net cash flow from financing activities associated with continuing operations increased in 2006 to US$257.0 million (2005: US$59.1 million). This was primarily driven by the receipt of proceeds from the IPO and an increase to US$187.8 million (2005: US$69.9 million) in the proceeds from long-term loans offset by the repayment of notes payable of US$2.5 million. In line with our strategy of increasing long-term debt as a source of financing, long-term debt increased to 72% (2005: 61%) of total debt. This significantly improved our maturity profile and reduced the cost of debt to 4.8% (2005: 6.7%).



During June 2006 the Group raised RUR2.0 billion through an issue of callable bonds with a nominal value of RUR1,000. The bonds were sold at their nominal value and are due in 2011. The coupon rate, payable semi-annually, was set at 8.85% a year for the first three years, with the rate for the subsequent years to be set by the Group at a later date. Investors in bonds have the right to put the bonds to the Group at the time of the interest rate reset.

Liquidity

At 31 December 2006, the Group had total cash and cash equivalents of US$107.0 million, all denominated in roubles. At 31 December 2006 the Group had positive working capital of US$148,495 (2005: negative US$40,138). The increase arose mainly from the issuance of new shares together with long-term bonds which led to a large increase in cash balances, an increase in advances, and repayment of current debt and trade payables.

Ludmila Mikhailova
Chief Financial Officer

Board of Directors and Executive management
strong leadership

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Board of Directors

1 Igor E Babaev
Chairman, 57

Mr Babaev became Chairman of the Group on 30 June 2006. He had been President of Cherkizovsky Meat Processing Plant (CMPP) since 2000 and was previously Chief Engineer, a position he had held since 1988. Before joining CMPP, he was Senior Engineer at Essentuki Canning Plant after positions as Head of Production at Nalchik Meat Processing Plant, Engineer-in-Chief at Stavropol Meat Canning Plant, Chief Engineer-Technologist at Simferopol Poultry Processing Plant and Engineer-in-Chief at NPO Komplex of the Gosagroprom of the USSR. Mr Babaev is a graduate of Krasnodar Polytechnic Institute and holds a PhD from Moscow Technological Institute of Meat and Milk Processing Industry. He is an "Honoured Worker of the Food Industry of the Russian Federation" and has been a member of the Russian Engineering Academy since 1994. Since 1998 he has been Chief Executive Officer of AIC Cherkizovsky and AIC Mikhailovsky. He is also a director of CJSC AIC Ptitesprod.

2 Sergei I Mikhailov ✣
Chief Executive Officer, 28

Mr Mikhailov was appointed Chief Executive Officer on 30 June 2006. He had been Deputy President and Chief Executive Officer of CMPP since 2000. He joined AIC Cherkizovsky as Deputy President of Marketing and Sales in 2004 and in the same year was appointed General Director of Cherkizovsky Trade House. In 1998 he was a founder of the US telecommunications company, aTelo, Inc. and served as a director until 2001. He was previously a financial analyst, first at Goldman Sachs, then at Morgan Stanley. Mr Mikhailov holds a degree in finance from Georgetown University, Washington, DC. He is also a director of Cherkizovsky Group Ltd and of Ptitseprod.

3 Yury N Dyachuk✣
Head of Legal Department, 39

Mr Dyachuk has been Head of the Legal Department since 2006 and was appointed a director on 30 June 2006. For the previous ten years, he was Head of Legal for the Group's sub-divisions. He joined the Legal Department of CMPP in 1996 and from 2001 was Head of the Legal Department of AIC Cherkizovsky. In 2005, he acted as legal counsel in charge of the restructuring of the Cherkizovo Group. Mr Dyachuk is a graduate of the Moscow State Law Academy where he specialised in Civil Law.

4 Evgeny I Mikhailov✣
Director, 24

Mr Mikhailov was appointed to the Board on 30 June 2006. He joined OJSC AIC Mikhailovsky as Deputy General Director in 2004 and became Chairman in the same year. He was previously a financial analyst at Morgan Stanley and before that was assistant to the Vice President at US telecommunications company, aTelo, Inc. He is an economics graduate from the University of California, Los Angeles. He is Vice President of Cherkizovsky Group Limited and a director of Ptitseprod.

5 Esben Juhl
Non-executive Director, 52

Mr Juhl was appointed to the Board on 30 June 2006. Since 2000 he has been Managing Director of Danish agricultural consulting company, AIB Consult. He was previously a director of Globe Meat Technology Limited, Denmark, and before that, was a projects director at Gerekem International Limited. He is a graduate of the agricultural department of Bygholm University, Copenhagen, Denmark.

✣ Member of the Board and Executive management

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6 Samuel B Lipman
Non-executive Director, 62

Mr Lipman joined the Board on 30 June 2006. He founded, and is currently President of, The Lipman Company, which provides consulting services to the broiler industry. Between 2004 and 2006, he was Chief Executive Officer of the Russian Limited Liability company Broiler Buduschego, a subsidiary of US business, Stromyn Breeders Limited, and before that was President of Stromyn Breeders, LLC. He founded Golden Rooster LLC in Lipetsk, Russia, and was President and Chief Executive Officer from 1996 to 2000. He is an English graduate of Colby College, Maine, US.

7 Musheg L Mamikonian
Non-executive Director, 47

Mr Mamikonian was appointed to the Board on 30 June 2006. Mr Mamikonian has been President of the Russian Meat Union since 1998. Since 2003, he has been Chief Executive Officer of OJSC Lianozovsky Sausage Plant and of CHSC Myasnoy Aliance, and Chairman of OJSC Dmitrovsky Meat Plant. In 1998, he was Chief Executive Officer of CJSC Eko-Torg and from 1997 to 1998 was Deputy President of CMPP. Mr Mamikonian, who holds more than 100 patents for technical and technological inventions, is an engineering graduate of Yerevan K Marx Polytechnic and has a PhD from the Moscow Technological Institute of Milk and Milk Industry. He holds a Russian Federation State award for achievements in Science and Technology.

Executive management

8 Ludmila I Mikhailova
Chief Financial Officer, 31

Ms Mikhailova joined CMPP as Deputy President in July 2004. She was Deputy Chief Financial Officer from September 2005 to February 2006, after being Deputy Chief Executive of LLC Group Cherkizovo and, before that, First Deputy President of AIC Cherkizovsky. She was previously a financial analyst at General Mills Corporation Canada in Toronto, worked at ING Barings, London, UK, and McFarlane Gordon Inc., Toronto, Canada. Ms Mikhailova is a graduate of the Financial Academy of the Government of the Russian Federation, completed a Canadian Securities Course at the Canadian Securities Institute and holds an MBA from the Schulich School of Business, York University, Canada.

9 Artur Minosyants
Chief Operating Officer, 42

Mr Minosyants was appointed Chief Operating Officer in August 2006. He was previously First Deputy President for Finance and Economics at Cherkizovsky MPP and, from 1996 to 2000 was Finance and Economics Director of Biruliovsky Meat Process Plant. Before joining Biruliovsky, he was Head of Finance of Alvamir City Administration. Mr Minosyants is a graduate of the Moscow Plekhanov Institute for the National Economy and holds a PhD in Economics.

Corporate social responsibility

Cherkizovo considers itself to be a good corporate citizen. We aim to reduce the impact we make on the environment and make positive connections with the communities in which we operate. We make considerable efforts to communicate with our shareholders, suppliers and employees.

Health, safety and the environment

We comply with applicable environmental legislation and observe biological and veterinary safety requirements in our poultry and pig-farming operations.

Comfort A comfortable environment stimulates healthy growth and development of poultry and pigs. We maintain a comfortable environment for our stock by controlling air temperature and circulation, lighting and humidity levels.

Traceability To ensure that our products are high quality, we control all stages of the production process, from the making of fodder to breeding, processing and distribution.

Balanced feed We produce fodder to special formulas to ensure that it contains the best balance of energy and protein, microelements, vitamins and amino acids.

Territorial specialisation and separation The separation of sites helps to prevent the transfer of diseases between generations of animals and from breeding to production animals. All stages of production are at separate sites, divided by a minimum 5-km sanitation zone. We take prevailing winds into consideration when choosing locations.

All full/all empty This principle involves filling an entire production site with animals of the same generation. This enables us to clean and disinfect sites between production periods.

Preventative measures

We undertake a number of measures to ensure that our sites are safe and to prevent the spread of disease. These include:

- strictly controlling access to sites;
- limiting the number of visitors, including foreign delegations;
- prohibiting staff from moving between sites;
- ensuring that all veterinary and sanitary stations are operating effectively;
- providing staff with work shoes and clothing;
- using disposable packaging for deliveries;
- prohibiting staff from visiting countries where pig and poultry diseases are present;
- eliminating potential carriers of disease, such as mice and insects, regularly;
- examining blood samples from our pigs and chickens regularly;
- clinically examining and taking veterinary care of stock;
- vaccinating to prescribed procedures.

We seek to operate our agricultural facilities to international best practice standards to limit stocks' susceptibility to disease.

We have in place measures to control waste water, air pollution and energy consumption.

Employment policies

We consider our employees to be our most valuable asset and pursue a policy of objective and systematic assessment of their skills. Our personnel policy is targeted towards recruiting and retaining high-quality people at all levels of the business.

We do not consider age, colour, ethnic origin, gender, political or other opinion, religion or sexual orientation to be a barrier to employment.

Our employees work a 40-hour week, including an hour for lunch each day. Each of our facilities has a staff canteen at which food is available at no charge. In addition, each employee is given a food hamper every month as well as at New Year, and on national Women's and Men's Days.

Benefits We reward our employees for particularly good work: for reaching their output targets, and for exceeding them; for long service (we have some employees who have worked for the Company for 60 years); and for outstanding contribution. Women are entitled to 120 days' paid maternity leave, receive a cash gift, and their jobs are kept open for three years. We also give financial assistance on marriage, and in instances of invalidity or bereavement.

The Company organises, and partly funds, summer camps for employees' children, and many of our operations have a gym or facilities for football and tennis.

Health Our employees are given medical examinations three times a year and those who work with raw meat also have extra examinations and inoculations. All employees are given flu injections in the autumn. We have medical centres at which all employees can receive help, although all Russians have government medical insurance which entitles them to free treatment. Our medical centres also provide employees with the certificates that are needed for them to use swimming pools, and to obtain driving and gun licences.

Training When new people join the Group, they are given introductory training on the Company and its history, as well as on production, distribution, sales and our quality policy. Further stages are devoted to professional development. We work closely with final-year students in educational institutions in a drive to attract the best people to work with us.

Corporate governance

Cherkizovo's shares are listed on the Moscow Stock Exchange (MSE), the Russian Trading System Stock Exchange (RTS), and the London Stock Exchange (LSE). We are, therefore, required to comply with the corporate governance requirements of our home country. These include:

- the obligation to have at least one non-executive director
- the formation of an Audit Committee;
- the adoption of the law on insider trading;
- the implementation of internal control procedures.

Composition and operation of the Board of Directors

Russia's Federal Law on Joint Stock Companies requires that an open joint stock company with less than 1,000 holders of common shares should have at least five directors on the Board. Our Board currently consists of seven directors. Directors are not obliged to hold shares in the Company.

Our charter provides that our entire Board of Directors may be re-elected at each Annual General Meeting of shareholders (AGM). It is elected through cumulative voting, under which each shareholder may cast an aggregate number of votes equal to the number of voting shares he or she holds, multiplied by the number of people to be elected to the Board. The shareholder is entitled to give all the votes to one candidate or to spread them out between a number of candidates. The directors may be removed as a group at any time before the end of their term of office, without cause, by a majority vote at a shareholders' meeting.

Role of the Board

The Federal Law on Joint Stock Companies (the Federal Law) prohibits a Board of Directors from acting on issues that fall within the exclusive competence of an AGM.

The Board directs the general management of the Company and has the exclusive power to determine:

- the Company's business priorities;
- the date, time and agenda of shareholders' meetings;
- the date of record for the shareholders entitled to participate in shareholders' meetings, except in certain circumstances specified under the Federal Law;
- the placement of the Company's bonds and other securities, except in certain circumstances specified under the Federal Law;
- the price of our property and of our securities to be placed or repurchased, as provided for by the Federal Law;
- the election and early termination of the powers of, and the establishment of compensation for, our sole executive body (the Chief Executive Officer);
- the recommendation of the amount of dividends and the payment procedure;
- the use of reserve and other funds;
- the creation of branches and representative offices;
- the approval of internal documents, except for those which fall within the competence of the AGM or the Chief Executive Officer;
- the approval of major and interested-party transactions in certain cases, as provided for the Federal Law;
- the increase of our charter capital by issuing additional shares within the limits of our authorised charter capital, except in circumstances specified under the Federal Law;
- the approval of decisions on the issuing of securities, and prospectuses relating to those securities, as well as of reports on the results of such issues, except in certain circumstances specified under the Federal Law;
- the participation of the Company in other organisations, with the exception of holding companies, commercial or industrial groups on which a shareholders' vote is required by our charter;
- other issues, as provided for by the Federal Law.

Our charter generally requires a majority of the directors present at a Board meeting to vote for an action for it to be approved, unless Russian legislation requires a qualified or unanimous vote, such as in the case of major transactions or interested-party transactions. A Board meeting is considered to be duly assembled and legally competent to act when a majority of the Board members is present.

Board committees

We formed Audit and Remuneration Committees in April 2006.

Chief Executive Officer

The Company's Chief Executive Officer is responsible for our day-to-day operations. He is elected by the Board for up to a five-year period. With the exception of matters exclusively assigned to the competence of an AGM, or the Board of Directors, he has executive authority over all our activities.

Internal control/risk management

The Board has established a continuous process for identifying, evaluating and managing risk. The Board of Directors also has overall responsibility for ensuring that the Company maintains an adequate system of internal control and risk management and for reviewing its effectiveness.

The function of internal control is carried out by the Revision Commission. The commission's activities are governed by our charter and revision commission regulations. It oversees and co-ordinates audits of our financial and economic activities. The commission's principal duties are to ensure that our activities comply with the applicable Russian legislation and do not infringe shareholders' rights, and that our accounting and reporting do not contain material misstatements. The members of the commission are elected for one year at the AGM and may not include members of the Board or the Chief Executive.

Directors' report

The directors present their annual report and audited financial statements for the year ended 31 December 2006.

Principal activities and review of the business

Cherkizovo is one of the leading integrated diversified meat producers in the Russian Federation. Operations are structured into three divisions: Meat Processing Division, Poultry Division and Pork Division. The meat processing operations consist of eight meat processing plants at which raw meat is processed into fresh and ready-to-cook meat products, and further processing into sausages, hams and other process meat products. The Poultry Division consists of two production clusters, a poultry processing company, a feed production plant and associated sales and trading operations. The Pork Division consists of four pig farms. All three divisions are involved in other business activities, including dairy, farming and accompanying services, which are all non-core activities.

More information about the business is set out in the Chairman's statement on pages 6 to 7, the Chief Executive Officer's statement on pages 8 to 9, and the financial review on pages 18 to 23.

Future developments

The Group's stated objective is to become the leading integrated diversified producer of meat and meat products in the Russian Federation. To achieve this aim, it will continue to modernise existing meat processing facilities. It will build new sales and distribution centres where those will increase its geographic spread. It will continue to invest in its poultry facilities, and is in the process of constructing a new pork facility in Tambov Region.

The management believes that there are opportunities for considerable expansion in what is a fragmented market, through acquisition as well as through organic growth.

Going concern

After reviewing the 2007 budget and longer-term plans, the directors are satisfied that, at the time of the approval of the financial statements, it is appropriate to adopt the going concern basis in preparing the financial statements of the Group.

Dividends

We do not expect to pay dividends for the foreseeable future, but plan to invest all our net profits into the business. We have no doubt that this will be to the long-term benefit of the company and its shareholders.

Directors in the year

The following served as directors of the Company during the year ended 31 December 2006.

Igor E Babaev, Chairman
Sergei I Mikhailov, Chief Executive Officer
Yury N Dyachuk, Head of Legal Department
Evgeny I Mikhailov, Executive director
Esben Juhl, Independent non-executive director
Samuel B Lipman, Independent non-executive director
Musheg L Mamikonian, non-executive director
Biographical details of the directors are set out on pages 24 to 25.

Election and re-election of directors

Our charter provides that our entire board of directors may be re-elected at each Annual General Meeting of shareholders (AGM). It is elected through cumulative voting, under which each shareholder may cast an aggregate number of votes equal to the number of voting shares he or she holds, multiplied by the number of people to be elected to the board. The shareholder is entitled to give all the votes to one candidate or to spread them out between a number of candidates. The directors may be removed as a group at any time before the end of their term of office, without cause, by a majority vote at a shareholders' meeting.

Disclosure of information to auditors

So far as each director is aware, there is no relevant audit information of which the company's auditors are unaware. Each director has taken all steps that he or she ought to have taken in his duty as a director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Consolidated financial statements and notes

Statement of management's responsibilities for the preparation and approval of the consolidated financial statements

For the years ended 31 December 2006 and 2005

The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on page 31, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of OJSC Cherkizovo Group (the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group at 31 December 2006 and 2005 and the results of its operations, cash flows and changes in shareholders' equity and comprehensive income for the years then ended, in compliance with accounting standards generally accepted in the United States of America ("US GAAP").

In preparing the consolidated financial statements, management is responsible for:
- selecting suitable accounting principles and applying them consistently;
- making judgements and estimates that are reasonable and fairly represent the most likely outcome of uncertainties;
- stating whether US GAAP has been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:
- designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with US GAAP;
- maintaining statutory accounting records in compliance with local legislation and accounting standards in the respective jurisdictions in which the Group operates;
- taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- preventing and detecting fraud and other irregularities.

The consolidated financial statements for the year ended 31 December 2006 were approved on 16 April 2007 by:

Sergei I Mikhailov
Chief Executive Officer

Ludmila I Mikhailova
Chief Financial Officer

Independent auditors' report

To the shareholders of OJSC Cherkizovo Group:

We have audited the accompanying consolidated balance sheets of OJSC Cherkizovo Group and its subsidiaries (hereinafter referred to as "the Group") as of 31 December 2006 and 2005 and the related consolidated statements of income, cash flows and changes in shareholders' equity and comprehensive income (hereinafter referred to as "the financial statements") for the years then ended. The financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 of the financial statements, the Group did not maintain historical cost records for property, plant and equipment acquired prior to 31 December 2001. On 31 December 2001, the Group established the carrying value of such assets based on the estimated fair values at such date. In our opinion, accounting principles generally accepted in the United States of America require that property, plant and equipment be stated at historical cost. The information needed to quantify the effects of these items on the financial position, results of operations, and cash flows of the Group is not reasonably determinable from the accounts and records.

In our opinion, except for the effects of including property, plant and equipment based on fair values as described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Group as of 31 December 2006 and 2005 and the consolidated results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche CIS

ZAO Deloitte & Touche CIS
16 April 2007

Consolidated balance sheets

As at 31 December 2006 and 2005

	Notes	2006 US$000	2005 US$000
Assets			
Current assets:			
Cash and cash equivalents	3	**106,988**	5,191
Trade receivables, net of allowance for doubtful accounts of $2,208 and of $3,023 as at 31 December 2006 and 2005, respectively		**62,783**	31,758
Advances paid, net of allowance for doubtful accounts of $320 and of $735 as at 31 December 2006 and 2005, respectively		**17,851**	8,505
Inventory	4	**89,116**	55,783
Short-term loans receivable		**2,628**	2,743
Deferred tax assets	18	**4,672**	3,656
Other receivables, net of allowance for doubtful accounts of $208 and of $522 as at 31 December 2006 and 2005, respectively		**9,216**	4,844
Other current assets	5	**27,837**	26,296
Total current assets of continuing operations		**321,091**	138,776
Current assets of discontinued operations		**–**	2,231
Total current assets		**321,091**	141,007
Non-current assets:			
Property, plant and equipment, net	6	**353,505**	249,983
Goodwill	7	**9,538**	8,725
Other intangible assets, net	7	**17,993**	13,969
Loans to affiliated companies		**1,553**	8
Deferred tax assets	18	**1,927**	388
Long-term notes receivable	8	**6,904**	–
VAT receivable		**13,353**	8,108
Total long-term assets of continuing operations		**404,773**	281,181
Long-term assets of discontinued operations		**–**	1,624
Total non-current assets		**404,773**	282,805
Total assets		**725,864**	423,812

The accompanying notes are an integral part of these financial statements.

	Notes	2006 US$000	2005 US$000
Liabilities and shareholders' equity			
Current liabilities:			
Trade accounts payable		**37,523**	47,218
Short-term loans and current portion of finance leases	9	**104,005**	90,641
Tax related payables	10	**8,134**	13,574
Deferred tax liabilities	18	**46**	–
Payroll related liability		**10,015**	7,541
Advances received		**1,965**	2,071
Payables for non-current assets		**2,831**	10,395
Interest payable		**2,316**	3,339
Other payables		**5,761**	4,233
Total current liabilities of continuing operations		**172,596**	179,012
Current liabilities of discontinued operations		**–**	2,133
Total current liabilities		**172,596**	181,145
Non-current liabilities:			
Long-term notes payable		**190**	3,559
Long-term loans and finance leases	9	**262,466**	140,311
Tax-related payables	10	**50**	46
Deferred tax liabilities	18	**19,843**	19,402
Long-term payables to shareholders	21	**1,133**	1,115
Other non-current liabilities		**11**	40
Total non-current liability of continuing operations		**283,693**	164,473
Total non-current liabilities of discontinued operations		**–**	812
Total non-current liabilities		**283,693**	165,285
Commitments and contingencies	24	**342**	326
Minority interest		**18,882**	14,548
Equity:			
Share capital	11	**14**	12
Additional paid-in capital	11	**209,861**	63,614
Other accumulated comprehensive loss	11	**(934)**	(13,114)
Retained earnings		**41,410**	11,996
Total equity		**250,351**	62,508
Total liabilities and equity		**725,864**	423,812

The accompanying notes are an integral part of these financial statements.

Consolidated income statements

For the years ended 31 December 2006 and 2005

	Notes	2006 US$000	2005 US$000
Sales	12	**629,985**	544,897
Cost of sales	13	**(480,935)**	(420,037)
Gross profit		**149,050**	124,860
Selling, general and administrative expenses	14	**(98,349)**	(80,187)
Other operating expenses	15	**(1,717)**	(1,104)
Operating income		**48,984**	43,569
Other income (expense), net	16	**6,488**	(1,301)
Interest expense, net	17	**(17,538)**	(15,605)
Income from continuing operations before income tax, minority interest and extraordinary item		**37,934**	26,663
Income tax	18	**(2,419)**	(7,973)
Minority interest		**(2,319)**	(1,387)
Income from continuing operations before extraordinary item		**33,196**	17,303
Loss from discontinued operations, net of income tax (expense) benefit of $(96) and $32, respectively	23	**(199)**	(306)
Loss on disposal of discontinued operations, net of income tax expense of $(25)		**(2,813)**	–
Extraordinary gain on purchase of interests in consolidating entities, net of income tax		**–**	79
Net income		**30,184**	17,076
Weighted average number of shares outstanding		**368,783**	328,216

	Notes	US$	US$
Earnings per share – basic and diluted:	2		
Income (loss) from continuing operations before extraordinary item		**90.02**	52.72
Loss from discontinued operations		**(0.54)**	(0.93)
Loss on disposal of discontinued operations		**(7.63)**	–
Extraordinary gain		**–**	0.24
Net income		**81.85**	52.03

Financial statements and notes

The accompanying notes are an integral part of these financial statements.

Consolidated cash flow statements

For the years ended 31 December 2006 and 2005

	2006 $000	2005 $000
Cash flows (used in) from operating activities:		
Income from continuing operations before extraordinary item	**33,196**	17,303
Adjustments to reconcile income from continuing operations before extraordinary item to net cash from (used in) operating activities:		
Amortisation of discount on loans from third parties	**18**	129
Depreciation	**24,524**	20,162
Bad debt recovery	**(206)**	(359)
Gain from debt forgiveness	**(801)**	(982)
Loss on disposal of property, plant and equipment	**1,717**	637
Minority interest	**2,319**	1,387
Foreign exchange (gain) loss	**(4,567)**	2,219
Deferred tax benefit	**(4,284)**	(1,893)
Other adjustments	**(185)**	(179)
Changes in operating assets and liabilities		
Increase in inventories, other than livestock	**(13,311)**	(6,758)
Increase in trade receivables	**(27,441)**	(25,632)
Increase in livestock	**(13,818)**	(5,875)
Increase in other assets	**(9,926)**	(18,821)
(Decrease) increase in trade accounts payable	**(14,867)**	16,894
(Decrease) increase in taxes payable	**(6,598)**	7,027
Decrease in VAT for property, plant and equipment	**(4,351)**	–
Increase in other current payables	**5,438**	8,315
Net cash (used in) from operating activities associated with continuing operations	**(33,143)**	13,574
Cash flows (used in) from discontinued operating activities:		
Loss from discontinued operations	**(199)**	(306)
Adjustments to reconcile loss from discontinued operations to net cash (used in) from operating activities associated with discontinued operations:		
Minority interest in net losses of discontinued operations	**(29)**	46
Deferred tax expense (benefit)	**121**	(54)
Loss (gain) on disposal of property, plant and equipment	**8**	(24)
Net change in operating assets and liabilities	**(1,945)**	1,012
Net cash used in (from) operating activities associated with discontinued operations	**(2,044)**	674
Total net cash (used in) from operating activities	**(35,187)**	14,248
Cash flows used in investing activities:		
Purchases of property, plant and equipment	**(112,895)**	(76,496)
Proceeds from sale of property, plant and equipment	**337**	1,469
Acquisition of minority interest in consolidating entities	**(137)**	(291)
Proceeds from sale of consolidated entities, net of cash disposed	**47**	–
Purchases of notes receivable	**(6,690)**	–
Proceeds from sale of investments	**184**	–
Long-term loans granted	**(4,874)**	–
Repayment on long-term loans granted	**2,508**	–
Acquisition of subsidiaries, net of cash acquired	**–**	56
Short-term loans granted	**(3,662)**	(6,382)
Repayments on short-term loans	**3,186**	10,998
Net cash used in investing activities associated with continuing operations	**(121,996)**	(70,646)

The accompanying notes are an integral part of these financial statements.

Consolidated cash flow statements continued

For the years ended 31 December 2006 and 2005

	2006 US$000	2005 US$000
Cash flows used in discontinued operations' investing activities		
Purchases of property, plant and equipment	**(180)**	(504)
Proceeds from sale of property, plant and equipment	**10**	75
Net cash used in investing activities associated with discontinued operations	**(170)**	(429)
Total net cash used in investing activities	**(122,166)**	(71,075)
Cash flows from financing activities:		
Proceeds from long-term loans	**187,793**	69,929
Repayment of long-term loans	**(79,955)**	(23,142)
Proceeds from long-term loans from related parties	**163**	28
Repayment of long-term loans from related parties	**(1,870)**	(450)
Repayment of notes payable	**(2,482)**	–
Proceeds from short-term loans	**289,901**	118,083
Repayment of short-term loans	**(281,858)**	(100,566)
Proceeds from shares issued	**146,249**	–
Cash distributed to shareholders	**(951)**	(4,823)
Net cash from financing activities associated with continuing operations	**256,990**	59,059
Cash flows (used in) from discontinued operations' financing activities:		
Repayment of long-term loans to related parties	**–**	(40)
Proceeds from short-term loans	**–**	852
Repayment of short-term loans	**(782)**	(32)
Net cash (used in) from financing activities associated with discontinued operations	**(782)**	780
Total net cash from financing activities	**256,208**	59,839
Total net cash from operating, investing and financing activities	**98,855**	3,012
Impact of exchange rate difference on cash and cash equivalents	**2,933**	(216)
Net increase in cash and cash equivalents	**101,788**	2,796
Cash and cash equivalents associated with continuing operations, at beginning of year	**5,191**	2,403
Cash and cash equivalents associated with discontinued operations, at beginning of year	**9**	1
Cash and cash equivalents associated with continuing operations, at end of year	**106,988**	5,191
Cash and cash equivalents associated with discontinued operations, at end of year	**–**	9
Supplemental information:		
Income taxes paid	**5,407**	9,350
Interest paid	**33,890**	15,853
Property, plant and equipment acquired on credit	**1,237**	1,637
Repayment of loan issued with notes receivable	**1,529**	–

The accompanying notes are an integral part of these financial statements.

Consolidated statements of changes in shareholders' equity and comprehensive income

For the years ended 31 December 2006 and 2005

	Notes	Share capital US$000	Additional paid-in capital US$000	Retained earnings US$000	Other accumulated comprehensive loss US$000	Total shareholders' equity US$000	Total comprehensive income US$000
Balances at 1 January 2005		11	37,461	5,841	(10,465)	32,848	
Net income for the year		–	–	17,076	–	17,076	17,076
Shares issued in exchange for minority interest		1	26,153	–	–	26,154	
Distribution to owners	11	–	–	(1,841)	–	(1,841)	
Net distribution to shareholders through spin-off		–	–	(9,080)	–	(9,080)	
Translation loss		–	–	–	(2,649)	(2,649)	(2,649)
Balances at 31 December 2005		12	63,614	11,996	(13,114)	62,508	
For the year ended 31 December 2005							$14,427
Balances at 1 January 2006		12	63,614	11,996	(13,114)	62,508	
Net income for the year		–	–	30,184	–	30,184	30,184
New share issue		2	146,247	–	–	146,249	
Distributions to owners	11	–	–	(770)	–	(770)	
Translation gain		–	–	–	12,180	12,180	12,180
Balances at 31 December 2006		14	209,861	41,410	(934)	250,351	
For the year ended 31 December 2006							42,364

No dividends were declared or paid for the years ended 31 December 2006 and 2005.

Financial statements and notes

The accompanying notes are an integral part of these financial statements.

Notes to the consolidated financial statements

For the years ended 31 December 2006 and 2005

1 Business and environment

Business

Incorporation and history

OJSC Cherkizovo Group and subsidiaries (further "the Group") trace their origins back to the transformation of a formerly state-owned enterprise, Cherkizovsky Meat Processing Plant (Moscow), into a limited liability partnership and subsequent privatisation in the early 1990s. At the time of privatisation, one individual became the majority shareholder in the enterprise. Over the next decade, this individual continued to acquire other meat processing and agricultural entities in the Russian Federation registering shareholding amounts personally as well as in the names of other immediate family members or friends of the family (collectively "the Control Group"). As the Group evolved with continuing acquisitions, two distinctive operating structures emerged made up of meat processing (APK Cherkizovsky) and agricultural entities (APK Mikhailovsky). The structure of the Group is presented in Note 23.

The business of the Group

Cherkizovo Group is a holding company which was formed in 2005 as a combination of two separate groups of companies – Cherkizovsky agro-industrial group and Mikhailovsky agro-industrial group. Cherkizovo is a leading Russian vertically-integrated agro-industrial company. Its operations spread over a full production cycle from feed production and breeding to meat processing and distribution. The operational facilities of the Group include eight meat processing plants, four pig production complexes, two poultry production complexes as well as one combined fodder production plant. It also operates two trading houses with subsidiaries in 13 major Russian cities.

The Group's geographical landscape covers Moscow and the Moscow region, the regions of St Petersburg, Penza, Lipetsk, Vologorod, Belgorod, Ulianovsk, Rostov, Tver, Chelyabinsk, Tambov, Voronezh, Krasnodar, Ufa, Saratov, Samara, Ekaterinburgh, Perm and Kazan. The Group is well represented in the European part of Russia through its own distribution network; the logistical reach of this network is further aided by its own fleet of over 870 trucks.

The Group owns locally recognised brands which include «Черкизовский» (Cherkizovsky), "Петелинка" (Petelinka) and «Империя вкуса» (Imperia vkusa).

At 31 December 2006 and 2005, the approximate number of staff employed by the Group was 12,511 and 12,066, respectively.

Environment

General

The principal business activities of the Group are within the Russian Federation. The Russian Federation's legal system and legislation are in a developmental stage. Weaknesses in the legal system could affect the Group's ability to enforce its rights, or to defend itself against claims by others.

Recently, the Russian Federation's economy has experienced positive trends, such as an increase in the gross domestic product, a relatively stable national currency, strong domestic demand, rising real wages and a reduced rate of inflation. However, the Group's assets and operations could be at risk should any adverse changes materialise in the political and business environment.

Currency exchange and control

Foreign currencies, in particular the US dollar, play a significant role in the underlying economics of many business transactions in Russia. The following table summarises the exchange rates of the rouble to US$1 at 31 December 2006 and 2005.

	Exchange rate
31 December 2005	28.7825
31 December 2006	26.3311

Management has not entered into any transactions designed to hedge against foreign currency risk. The Group's future operating cash flows will be generated in Russian roubles. Future movements in the exchange rate between the rouble and the US dollar will affect the carrying value of the Group's rouble-denominated monetary assets and liabilities and the US dollar amounts of revenues and expenses. Such changes may also affect the Group's ability to realise assets as represented in terms of US dollars in the accompanying consolidated financial statements.

1 Business and environment continued

Interest rates

The APK Cherkizovsky sub-group's principal interest rate risks relate to the fact that interest rates on certain loans are fixed at 3% for euro loans and in the range of 4% to 16.5% for rouble loans. Management has not entered into any transactions designed to hedge against such interest rate risks.

The APK Mikhailovsky sub-group's principal interest rate risks relate to the fact that interest rates on certain loans are fixed at 0% to 16% for rouble loans. Management has not entered into transactions designed to hedge against interest rate risk.

Liquidity and financial resources

At 31 December 2006 the Group had positive working capital of US$148,495 compared with a negative working capital of US$40,138 at 31 December 2005. The increase in working capital arose mainly from the issuance of new shares and long-term debt, which led to a large increase in cash balances, as well as repayment of current obligations. Note 9 contains additional information relating to debt structure, liquidity and refinancing.

2 Summary of significant accounting policies

Accounting principles

The Group's companies maintain their accounting books and records in Russian roubles in accordance with Russian statutory accounting regulations. The accompanying consolidated financial statements have been prepared in order to present the consolidated financial position and consolidated results of operations and cash flows of the Group in accordance with accounting principles generally accepted in the United States of America ("US GAAP") and expressed in terms of US dollars (paragraph "Translation methodology" below). The accompanying consolidated financial statements differ from the financial statements prepared for statutory purposes in Russia in that they reflect certain adjustments that are appropriate to present the financial position, results of operations and cash flows in accordance with US GAAP.

Basis of consolidation of subsidiaries

The consolidated financial statements of the Group include companies controlled by the Control Group through direct and indirect ownership of the majority of the voting interests as described in Note 23 Acquisitions, divestitures, investments in affiliates.

Beginning 1 January 2005, the Group amended its consolidation policy to include any variable interest entities where management determined the Group to be the primary beneficiary. As at 31 December 2006, management believes that no variable interest entities exist where the Group is the primary beneficiary.

The purchase method of accounting is used for acquired businesses. Companies acquired or disposed of during the year are included in the consolidated financial statements from the date of acquisition or to the date of disposal.

All significant inter-company balances and transactions are eliminated on consolidation.

Investments in certain companies that are not material to the consolidated financial position and results of operations are stated at cost or excluded from the consolidated financial statements.

Fiscal year

The Group's fiscal year end is the last day of each calendar year.

Translation methodology

The Group follows a translation policy in accordance with SFAS No. 52, "Foreign Currency Translation" and has determined the rouble to be its functional currency.

The Group determined the US dollar to be its reporting currency and translates its functional currency financial statements into US dollars. Assets and liabilities are translated at year-end exchange rates, equity, other than retained earnings, at the rate effective on the later of 1 January 2003 (date of change in functional currency due to cessation of hyperinflation) or the date when the transaction occurred, while income and expense items are translated at average rates of exchange prevailing during the year. The resulting translation adjustment is recorded as a separate component of other comprehensive income (loss).

2 Summary of significant accounting policies continued

Management estimates

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

The principal management estimates underlying these financial statements include an estimation of discounted future cash flows used in assessing the existence of impairment of goodwill, allowances for bad debts, valuation allowances for deferred tax assets and valuation of intangible assets determined to have an indefinite life.

Reclassifications

Certain comparative information, presented in the consolidated financial statements for the year ended 31 December 2005, has been reclassified in order to achieve comparability with the presentation used in the consolidated financial statements for the year ended 31 December 2006. The most significant reclassifications relate to the discontinued operations of the Group which were sold in 2006 and where financial position and results of operations have been separately disclosed as at and for the years ended 31 December 2006 and 2005.

Cash and cash equivalents

Cash and cash equivalents represent cash on hand and in bank accounts and short-term investments having original maturities of less than three months.

Accounts receivable and allowance for doubtful accounts

Accounts receivable are stated at their net realisable value, which approximates their fair value.

Group companies provide an allowance for doubtful accounts based on management's periodic review of accounts, including the ageing of account balances. Accounts receivable are written off when evidence exists that they will not be collectible.

Inventory

Inventories, including work-in-process, are valued at the lower of cost or market value. Cost is the price paid or the consideration given to acquire the asset. Cost is determined on the basis of weighted average cost. For processed inventories, cost is the sum of the expenditures and charges, direct and indirect, in bringing goods to their existing condition or location. It includes the applicable allocation of fixed production and variable overhead costs. Market value is the current replacement cost, whether by purchase or by reproduction, limited to the estimated selling price less any costs of completion and disposal (net realisable value) at the maximum level, and net realisable value, less an allowance for normal profit at the minimum level. Net realisable value is the selling price in the ordinary course of business, less costs to complete, market and distribute. Write downs are made for unrealisable inventory in full.

Livestock

Animals with short productive lives, such as poultry and pigs are classified as inventory on the statement of financial position. Full cost absorption is used in determining the asset value of livestock.

Newborn cattle, pigs and other immature animals purchased for breeding are initially accounted for as inventory. Immature cattle and pigs are not considered to be in service until they reach maturity, at which time their accumulated cost becomes subject to depreciation. The Group treats breeding animals as fixed assets with costs to be depreciated over their useful lives, as follows:

	Age of transfer into main herd, years	Depreciation, years
Sows	0.5	2
Cattle	2	7

Value Added Tax

Value Added Tax ("VAT") related to sales is payable based upon invoices issued to customers. Input VAT incurred on purchases may be offset, subject to certain restrictions, against VAT related to sales.

Input VAT related to purchase transactions that are subject to offset against taxes payable after the financial statement date are recognised on the statement of financial position, gross.

2 Summary of significant accounting policies continued

Property, plant and equipment

Due to the state of the records relating to the construction and acquisition of a significant portion of the assets of the Group companies, their carrying amounts as at 31 December 2001 were determined through valuation and are stated based on estimated fair value. For companies acquired through business combinations, estimated fair value of property, plant and equipment was retrospectively applied to determine the fair value of acquired net assets. Certain fixed assets were adjusted for the excess of the value of net assets acquired over the purchase price paid in business combinations or adjusted to fair value as at the date of such combinations occurring subsequent to 31 December 2001. Assets acquired subsequent to 31 December 2001 are stated at historical cost.

Depreciation is calculated on a straight-line basis over the estimated remaining useful lives of the related assets, as follows:

Buildings and infrastructure	10-39 years
Machinery and equipment	3-22 years
Vehicles	3-7 years
Cattle	7 years
Pigs	2 years
Other	3-10 years

Impairment of long-lived assets

When events and circumstances occur indicating that the carrying amount of a long-lived asset (group) may not be recoverable, the Group estimates the future undiscounted cash flows expected to be derived from the use and eventual disposition of the asset (group). If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the long-lived asset (group), the Group then calculates impairment as the excess of the carrying value of the asset (group) over the estimate of its fair market value.

Goodwill and other intangible assets

Goodwill represents the purchase price for businesses acquired in excess of the fair value of identifiable net assets acquired.

Goodwill and intangible assets deemed to have indefinite lives are subject to annual impairment tests at fiscal year end in accordance with SFAS No. 142. Other intangible assets with determinable useful life are amortised over their useful lives.

In the Group's assessment of goodwill, management makes assumptions regarding estimates of future cash flows and other factors to determine the fair value of the respective assets. Other intangible assets principally represent trademarks acquired that have been determined to have an indefinite life. Management evaluates a number of factors to determine whether an indefinite life is appropriate, including product history, operating plans and the macroeconomic environment.

The fair value of the Group's trademarks is determined using a royalty rate method based on expected revenues by trademark.

Investments

The Group holds equity interests in certain companies, which are not readily marketable securities and are valued at cost. Management periodically assesses the ability of the Group to realise the carrying values of investments and records any impairment as required.

The equity accounting method is used when the Group has the ability to exercise significant influence over the investee.

Notes receivable purchased by the Group are classified as held to maturity. Such notes are valued at cost upon acquisition with any discounts or premiums arising on purchase reported in the balance sheet as direct deductions/additions to the face value. Amortisation of such discounts/premiums are recorded as additions/reductions to interest income.

Product guarantees

The Group offers product guarantees to its customers, providing them with an option to return damaged and non-conforming goods and goods of initial improper quality. The period that goods may be returned is set to a maximum of one month from the date of shipment. Returns are accounted for as deductions to sales (Note 12).

2 Summary of significant accounting policies continued

Revenue recognition
Revenue is recognised when it is probable that the economic benefits associated with a transaction will flow to the Group, delivery has occurred or services have been rendered, the amount of the revenue can be measured reliably and the collectibility of the revenue is reasonably assured.

Sales are recognised, net of VAT and discounts, when goods are shipped to customers. At the time of shipment, in accordance with the Group's standard sales terms, title is transferred and the customer assumes the risk and rewards of ownership. In contracts with certain large retail chains, title changes upon acceptance of goods by the customer at delivery. Sales made under these contracts are recognised upon acceptance.

The Group grants discounts to customers primarily based on the volume of goods purchased. Such discounts range up to 12% of the sales amount and are graduated to increase with purchases made. Discounts are accrued against sales and accounts receivable in the month earned. Other strategically targeted discounts are immaterial.

Any consideration given to direct or indirect customers of the Group in the form of cash, such as listing fees, are included in the consolidated statement of operations as deductions from sales.

Shipping and handling costs
Shipping and handling costs incurred by the Group are reflected in selling and distribution expenses in the accompanying consolidated statements of operations.

Marketing expenses
Marketing costs are expensed as incurred. Marketing expenses are reflected in selling and distribution expenses in the accompanying consolidated statements of operations.

Interest expense
The Group capitalises interest costs on qualifying fixed assets acquired in accordance with the provisions of SFAS No. 34 "Capitalisation of Interest Costs". Interest capitalised in the years ended 31 December 2006 and 2005 was US$2,534 and US$1,016, respectively.

Taxation
Deferred tax assets and liabilities are recognised for the expected future tax consequences of existing differences between the financial and tax reporting basis of assets and liabilities, as well as loss carry forwards, using enacted tax rates expected to be in effect at the time these differences are realised. Valuation allowances are recorded for deferred tax assets where it is more likely than not that such assets will not be realised.

Earnings per share
Earnings per share for 2005 have been determined using the number of Group shares issued on foundation of the holding company on 22 September 2005, to the members of the Control Group, as if those shares had been outstanding for that period. Earnings per share for the year ended 31 December 2006 have been determined using the weighted average number of Group shares outstanding over the period.

There are no securities to consider for dilution.

2 Summary of significant accounting policies continued

Fair value of financial instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and short-term notes and loans receivable and payable reported in the consolidated statement of financial position approximate fair values due to the short maturity of those instruments.

The fair values of long-term notes and loans payable were estimated by discounting future cash flows using a discount rate that reflects the estimated market borrowing rates. Market borrowing rates on locally sourced funds available to the Group at 31 December 2006 and 31 December 2005 were estimated at 11% and 14%, respectively, for rouble-denominated loans and 11% at both period ends for US dollar and euro denominated loans.

As at 31 December 2006	Book value US$000	Fair value US$000
Lines of credit	**227,822**	**233,014**
Bonds	**75,956**	**75,956**
Loans from government agencies	**46,183**	**43,144**
Bank loans	**14,196**	**14,196**
Other borrowings	**1,471**	**1,471**
As at 31 December 2005		
Lines of credit	117,529	117,529
Loans from government agencies	28,988	26,216
Bank loans	79,447	79,447
Other borrowings	3,684	3,684

Further disclosures of long-term notes payable and loans are contained in Note 9.

Concentration of credit risk

Financial instruments that potentially expose the Group to concentration of credit risk consist primarily of cash and cash equivalents, accounts receivable from customers and advances paid to vendors. As at 31 December 2006 86% of the total cash balance is held on deposit in one Russian financial institution.

As at 31 December 2006, the Group's risk associated with external customers is diversified due to a large customer base with approximately 10% of the Group's net accounts receivable balance due from one customer. No other single customer or customer group represents greater than 10% of net accounts receivable. No concentration of credit risk was noted in net accounts receivable as at 31 December 2005.

As at 31 December 2006, approximately 15% and 17% of net advances paid were outstanding with two vendors, respectively. No other single customer or customer group represents greater than 10% of net advances paid. No concentration of credit risk was noted in net advances paid as at 31 December 2005.

The maximum amount of loss due to credit risk, based on the fair value of the financial instruments that the Group would incur if affiliated companies failed to perform according to the terms of the contracts, is US$9,381.

Minority interest

Minority interest is accounted for at historical value, which is the minority's share in the book value of a subsidiary's net assets at the date control over a subsidiary was established. If control over a subsidiary is lost and subsequently re-established, the minority interest is accounted for at the historical value determined at the time the company was first consolidated.

2 Summary of significant accounting policies continued

New accounting pronouncements

In July 2006, the FASB issued interpretation No. 48, "Accounting for Uncertainty in Income Taxes", ("FIN 48"), to clarify the accounting for uncertain tax positions stated in SFAS No. 109. FIN 48 applies to all tax positions that are within the scope of FAS No. 109 and requires a two-step approach for recognising and measuring tax benefits. FIN 48 establishes a "more-likely-than-not" recognition threshold that must be met before a tax benefit can be recognised in the financial statements. To meet this threshold, the enterprise must determine that upon examination by the taxing authority, the tax position is more likely to be sustained than not, based on the technical merits of the position. Once the recognition threshold has been met, enterprises are required to recognise the largest amount of tax benefit that is greater than 50% likely of being realised upon ultimate settlement with the taxing authority. In both steps, enterprises must presume that the taxing authority has full knowledge of all relevant information. FIN 48 also requires enterprise to make explicit disclosures at the end of each reporting period about uncertainties in their income tax positions, including a detailed rollforward of tax benefits taken that do not qualify for financial statement recognition. FIN 48 is effective for fiscal years beginning after 15 December 2006, and should be applied to all tax positions upon initial adoption. The cumulative effect of applying the provisions of FIN 48 should be reported as an adjustment to the opening balance of retained earnings for that fiscal year. The Group is currently assessing the impact of adopting FIN 48.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement", ("the Statement"). The Statement provides a single definition of fair value, along with a framework for measurement and requires additional disclosure about using fair value to measure assets and liabilities. The Statement emphasises that fair-value measurement is market-based, not entity-specific, and establishes a fair-value hierarchy in which the highest priority is quoted prices in active markets. Under the Statement, fair-value measurements are disclosed according to their level within this hierarchy. While the Statement does not add any new fair-value measurements, it does change practice as follows: requiring entities to include their own credit standing when measuring their liabilities, modifying the transaction price assumption, prohibiting broker-dealers and investment companies from using block discounts when valuing large blocks of securities and requiring entities to adjust the value of restricted stock for the effect of the restriction even when the restriction lapses within one year. The Statement is effective for financial statements issued for fiscal years beginning after 15 November 2007. The Group is currently assessing the impact of adopting the Statement.

3 Cash and cash equivalents

	2006 US$000	2005 US$000
Rouble cash	**222**	252
Rouble bank accounts	**106,766**	4,939
Total cash and cash equivalents	**106,988**	5,191

Cash and cash equivalents at bank as at 31 December 2006, include deposits of US$92,286 earning 5.2% annual interest with a two-month original maturity.

4 Inventory

Inventory as at 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Raw materials and goods for resale	**49,931**	29,672
Work in-process	**6,603**	5,698
Finished goods	**3,826**	7,152
Livestock	**28,756**	13,261
Total inventory	**89,116**	55,783

Finished goods intended for use by other Group companies are classified as raw materials. Inventory pledged under loan agreements (Note 9) totalled US$15,139 and US$17,556 as at 31 December 2006 and 31 December 2005, respectively. On 31 December 2006, the pledged amount consisted of raw materials in the amount of US$5,367, finished goods of US$1,209 and livestock of US$8,563.

5 Other current assets

Other current assets as at 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
VAT and other taxes receivable	**18,570**	21,371
Spare parts	**3,518**	2,247
Investments in notes receivable (effective annual interest rate of 9.67%)	**3,456**	165
Prepaid expenses	**2,293**	2,513
Total other current assets	**27,837**	26,296

6 Property, plant and equipment

The carrying amounts of property, plant and equipment as at 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Buildings and infrastructure	**172,573**	104,073
Machinery and equipment	**78,953**	62,726
Vehicles	**14,594**	6,782
Cattle	**567**	382
Sows	**4,879**	2,462
Other	**1,824**	1,747
Advances paid for property, plant and equipment	**22,120**	8,041
Construction in progress and equipment for installation	**57,995**	63,770
Total property, plant and equipment, net	**353,505**	249,983

Accumulated depreciation amounted to US$98,403 and US$67,997 as at 31 December 2006 and 2005, respectively. Depreciation expense amounted to US$24,524 and US$20,162 for the years ended 31 December 2006 and 2005, respectively, and includes depreciation of leased equipment.

Machinery and equipment includes US$3,965 and US$4,396 of leased equipment as at 31 December 2006 and 2005. Accumulated depreciation of leased equipment amounted to US$835 and US$981 as at 31 December 2006 and 2005, respectively.

Property, plant and equipment pledged under loan agreements totalled US$49,947 and US$126,056 as at 31 December 2006 and 31 December 2005, respectively.

7 Goodwill and other intangible assets, net

Goodwill arose on the purchase by the Group of its controlling stake in JSC BMPP and relates to the Meat Processing Division of the business.

Other intangibles include the "Cherkizovsky" («Черкизовский») and "Biruliovsky" («Бирюлевский») trademarks acquired by the Group and computer software with a net book value of US$774 and US$447 as at 31 December 2006 and 2005, respectively. Management has determined that the trademarks have indefinite useful lives and are, therefore, not subject to amortisation. Software is amortised over its useful life of two years.

Management does not believe that goodwill or indefinite life trademarks are impaired as at 31 December 2006.

8 Long-term notes receivable

During June 2006, the Group purchased notes receivable from Gazprombank with a maturity date in June 2014. As at 31 December 2006, the balance comprised:

	Book value	Discount	Face value	Effective %
Gazprombank notes receivable	6,904	(6,219)	13,123	8.36%

9 Borrowings

Borrowings of the Group as at 31 December 2006 and 2005 comprised:

	2006		2005	
	Current US$000	**Non-current US$000**	Current US$000	Non-current US$000
Lines of credit (interest rates 6%-16%)	**65,586**	**162,236**	45,849	71,680
Bonds (interest rate 8.85%)	**–**	**75,956**	–	–
Loans from government agencies (interest rates 0%-6%)	**28,874**	**17,309**	20,692	8,296
Bank loans (interest rates 11%-16.5%)	**7,360**	**6,836**	21,340	58,107
Other borrowings (interest rates 0%-0.1%)	**1,471**	**–**	1,700	1,984
Finance leases (interest rates 8%-24%)	**714**	**129**	1,060	244
	104,005	**262,466**	90,641	140,311
Total borrowings		**366,471**		230,952

Maturity of the non-current portion of borrowings is as follows:

	2008 US$000	2009 US$000	2010 US$000	2011 US$000	2012 US$000	>2012 US$000	**Total US$000**
Total borrowings	25,972	117,232	64,119	15,916	717	38,510	**262,466**

The Group's borrowings are denominated in roubles (US$364,118), euros (US$1,742) and US dollars (US$611).

Finance leases

As at 31 December 2006 and 2005, the Group operated certain fixed assets under leasing contracts that qualified for treatment as finance leases. The lower of the incremental borrowing and the rate implicit in the lease agreement was used in capitalising the leases.

The total minimum lease payments due under these lease agreements comprised:

	2006		2005	
Payments falling due	**Total minimum lease payments US$000**	**Portion related to interest US$000**	Total minimum lease payments US$000	Portion related to interest US$000
Within one year	**760**	**46**	1,140	80
In year two	**123**	**5**	230	13
In year three	**11**	**–**	27	–
	894	**51**	1,397	93

Bonds

During June 2006, the Group raised 2 billion roubles through an issue of callable bonds with a nominal value of 1,000 roubles. The Bonds were sold at their nominal value and are due in 2011.

The coupon rate, payable semi-annually, was set at 8.85% per annum for the first three years, with the rate for subsequent years to be set by the Group at a later date. Investors in the bonds have the right to put the bonds to the Group at the time of the interest rate reset.

9 Borrowings continued

Bank loans
Gazprombank
Borrowings from Gazprombank consist of one short and two long-term rouble denominated loans with interest rates ranging from 11.5% to 12% per annum. Property, plant and equipment in the amount of US$176 and notes receivable with a carrying value of US$6,904 were pledged as collateral under these loan agreements.

EBRD and Raiffeisen loans
In June 2006 the Group opted for the early repayment of EBRD and Raiffeisen loans in full. According to the loan agreement the Group was required to pay an early repayment fee which was set at 2% of the outstanding balance on Tranches Two A and Two B of the loan (Note 16).

Savings Bank of Russia
Borrowings from the Savings Bank of Russia consist of seven short-term loans with interest ranging from 11% to 14% per annum. Inventory and livestock with a carrying amount of US$4,799 were pledged as collateral under these loan agreements.

Lines of credit
Savings Bank of Russia
Borrowings from the Savings Bank of Russia consist of 34 credit lines with interest ranging from 10% to 15% per annum. Property, plant and equipment in the amount of US$27,399 and inventory with a carrying amount of US$6,293 were pledged as collateral under these agreements.

Gazprombank
Borrowings from Gazprombank consist of two credit lines with interest ranging from 11.5% to 14.2% per annum. Property, plant and equipment in the amount of US$8,326 were pledged as collateral under these agreements.

Shares of and participating interests in the following Group companies are pledged as collateral under the facility:

- JSC Lipetskmyasoprom – 100%
- JSC Vasiljevskaya – 51%
- CJSC Petelinskaya – 51%
- LLC Budenovets Agrifirm – 51%
- LLC Mikhailovsky Feed Milling Plant – 51%
- LLC Kuznetsovsky Kombinat – 51%
- LLC Ardymsky Feed Milling Plant – 51%
- CJSC Botovo – 51%

51% of outstanding shares of a related party are also pledged as collateral.

Raiffeisen
Borrowings from Raiffeisen consist of one unsecured loan facility bearing interest at 6% per annum.

Total amount of unused credit as at 31 December 2006 is US$73,628.

Loans from government agencies
Regional treasury (Lipetsk)
Borrowings from the department of finance of the Lipetsk regional administration consist of one long-term loan bearing interest at 1% per annum. Property, plant and equipment in the amount of US$862 were pledged as collateral under these loan agreements.

Department of Food Supply of the City of Moscow
Borrowings from the Department of Food Supply of the City of Moscow consist of three loans with interest ranging from 3.67% to 4.3% per annum.

Shares of and participating interests in the following Group companies are pledged as collateral under the facility:

- JSC Biruliovsky meat processing plant (JSC BMPP) – 54.09%
- JSC Meat Processing Plant Ulyanovsky (JSC MPP Ulyanovsky) – 50% plus one share

9 **Borrowings** continued

Department of Taxes and Financial Policies, Moscow City Government
Borrowings from the Department of Taxes and Financial Policies of the Moscow City Government consist of two loans with interest ranging from 5.75% to 6% per annum.

Shares of and participating interests in the following Group companies are pledged as collateral under the facility:

- JSC Vasiljevskaya – 41%
- JSC Meat Processing Plant Ulyanovsky (JSC MPP Ulyanovsky) – 35.4%

Other borrowings
Other borrowings primarily represent unsecured loans from the Control Group with interest rates ranging from 0% to 0.1%.

10 Tax-related payables

Short-term tax-related payables as at 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Corporate income tax	**2,742**	1,290
Value added tax	**1,974**	9,513
Payroll-related taxes	**1,166**	981
Personal income tax withheld	**973**	684
Property tax payable	**950**	757
Transportation tax	**22**	38
Other taxes	**307**	311
Total short-term taxes payable	**8,134**	13,574

Long-term tax related payables as at 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Payroll-related taxes	**38**	46
VAT	**12**	–
Total long-term taxes payable under restructuring agreements	**50**	46

The schedule of tax repayment comprises:

	US$000
2010	18
2011	8
2012	8
2013	8
2014	8
	50

Notes to the consolidated financial statements

For the years ended 31 December 2006 and 2005

11 Shareholders' equity

During the second half of 2005 all direct ownership in Group companies was contributed by the Control Group into the share capital of OJSC Cherkizovo Group (except entities distributed to shareholders in the spin-off).

As at 31 December 2005, 547,026 shares of ordinary stock were authorised, of which 328,216 were issued and outstanding with a par value of 1 rouble.

In May 2006 the Group made an offering of global depositary receipts on the London Stock Exchange. As part of this process, the Group issued an additional 67,427 shares of common stock with a par value of 1 rouble in exchange for US$146,249. As at 31 December 2006, 547,026 shares of ordinary stock were authorised, of which 395,643 were issued and outstanding. All issued and outstanding shares have equal voting rights. Cherkizovsky Group Ltd. owned 67.1% of outstanding share capital. The Group is authorised to issue preferred shares not exceeding 25% of its ordinary stock. No such shares are currently issued or outstanding.

In accordance with Russian legislation, earnings available for dividends are limited to retained profits calculated in accordance with statutory rules in local currency.

The Group accrued US$770 and US$1,841 during the years ended 31 December 2006 and 2005, respectively, in the form of remuneration to shareholders not functioning in management roles.

12 Sales

Sales for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Produced goods and goods for resale	**644,980**	548,157
Other sales	**1,774**	4,373
Sales volume discounts	**(9,917)**	(3,378)
Sales returns	**(6,852)**	(4,255)
Total sales	**629,985**	544,897

During the years ended 31 December 2006 and 2005 the Group's sales to related parties comprised:

	2006 US$000	2005 US$000
Produced goods and goods for resale	**4,344**	2,081
Other sales	**1,138**	142
Total sales to related parties	**5,482**	2,223

13 Cost of sales

Cost of sales for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Raw materials and goods for resale	**391,563**	346,156
Personnel (excluding pension costs)	**40,338**	33,218
Depreciation	**20,870**	17,096
Utilities	**11,805**	10,025
Pension cost (Note 19)	**6,615**	6,000
Other	**9,744**	7,542
Total cost of sales	**480,935**	420,037

14 Selling, general and administrative expenses

Selling, general and administrative expenses for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Personnel (excluding pension costs)	**42,171**	33,830
Advertising and marketing	**8,636**	4,801
Transportation	**7,438**	6,021
Materials and supplies	**7,303**	5,678
Pension costs	**6,244**	5,022
Taxes (other than income tax)	**5,378**	4,831
Audit, consulting and legal fees	**3,852**	2,772
Depreciation	**3,654**	3,066
Security services	**2,814**	2,621
Utilities	**1,504**	975
Bank charges	**1,493**	1,663
Information technology and communication services	**647**	665
Insurance	**848**	879
Other	**6,367**	7,363
Total general and administrative expenses	**98,349**	80,187

15 Other operating expenses

Other operating expenses for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Loss on disposal of property, plant and equipment	**1,717**	637
Unusual loss related to privatisation of subsidiary	**–**	467
	1,717	1,104

In April 2004 LLC Ardymsky Feed Milling Plant entered into litigation related to the privatisation of the company and legal title to certain property, plant and equipment. In 2005, in accordance with a court's decision, legal title on some of the assets in dispute was transferred to the plaintiff. However LLC Ardymsky Feed Milling Plant was able to reach an out-of-court settlement with the plaintiff for US$467. As a result, the plaintiff waived all rights to the assets in question and LLC Ardymsky Feed Milling Plant became their lawful owner. This amount has been included above as an unusual loss related to privatisation of the subsidiary.

16 Other income (expense), net

Other income and expense for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Loan origination fees (EBRD loan)	**(1,690)**	–
Bank fees related to early repayment of EBRD loan	**(898)**	–
Foreign exchange gain (loss)	**4,567**	(2,219)
Interest income	**2,570**	–
Gain from debt forgiveness	**801**	982
Other financial income (expense)	**1,138**	(64)
Total other income (expense), net	**6,488**	(1,301)

Gain on debt forgiveness relates to creditors, with whom the Group has not been able to make contact and where the statute of limitations on such debts have expired.

17 Interest expense, net

	2006 US$000	2005 US$000
Interest expense	**17,390**	15,189
Finance lease expenses	**130**	287
Amortisation of discount	**18**	129
Total interest expense, net	**17,538**	15,605

In accordance with Russian legislation, enterprises engaged in agricultural activities and enterprises in certain areas purchasing meat receive subsidies to repay their interest expense. The Group has accounted for such subsidies by reducing the interest expense on associated loans by US$5,805 and US$3,729 for the years ended 31 December 2006 and 2005, respectively.

18 Income tax

The charge for income tax for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Current provision	**6,703**	9,866
Deferred tax benefit	**(4,284)**	(1,893)
Provision for income tax	**2,419**	7,973

The statutory income tax rates for the meat processing and agricultural sub-groups for the years presented are 24% and 0%, respectively, under Russian legislation.

The agricultural sub-groups will be subject to income tax starting 1 January 2008 as follows:

Years	Income tax rate
2008-2009	6%
2010-2011	12%
2012-2014	18%
Thereafter	24%

18 Income tax continued

Income tax charge reconciled to the theoretical tax provision at the statutory rate for the years ended 31 December 2006 and 2005 is:

	2006 US$000	2005 US$000
Income from continuing operations before income tax, minority interest and extraordinary item	**37,934**	26,663
Income from continuing operations before income tax, minority interest and extraordinary item of entities taxed at agricultural rates	**28,363**	14,951
Income from continuing operations before income tax, minority interest and extraordinary item of generally taxed entities	**9,571**	11,712
Statutory tax rate (agricultural)	**0%**	0%
Statutory tax rate (general)	**24%**	24%
Theoretical income tax expense at statutory rate	**2,297**	2,811
Expenses not deductible for Russian statutory taxation purposes, net	**3,152**	4,881
Tax deductible remunerations	**(133)**	(312)
Change in agricultural tax rates	**290**	–
Other permanent differences	**(1,261)**	520
Change in valuation allowance	**(1,926)**	73
Actual income tax provision	**2,419**	7,973

	2006 US$000	2005 US$000
Deferred tax assets/(liabilities) arising from tax effect of temporary differences:		
Intangibles	**(4,133)**	(3,185)
Property, plant and equipment	**(15,392)**	(15,809)
Construction in process	**1,458**	339
Trade receivables and advances paid	**815**	1,077
Other receivables	**1,039**	
Inventory	**632**	628
Payroll-related liabilities	**929**	588
Loss carryforward	**3,324**	3,886
Other	**(235)**	516
Valuation allowance	**(1,727)**	(3,398)
Net deferred tax liability	**(13,290)**	(15,358)
Analysed to:		
Deferred tax asset – long-term portion	**1,927**	388
Deferred tax liability – long-term portion	**(19,843)**	(19,402)
Long-term deferred tax liability, net	**(17,916)**	(19,014)
Deferred tax asset – current	**4,672**	3,656
Deferred tax liability – current	**(46)**	–
Current deferred tax asset, net	**4,626**	3,656
Total deferred tax liability, net	**(13,290)**	(15,358)

18 Income tax continued

The valuation allowance is attributable to loss carryforwards which are not expected to be utilised by management. Management's judgement regarding the realisability of tax loss carryforwards was impacted in the current year by a decision of the tax inspectorate regarding the realisability of such carryforwards relating to prior years. The Group's tax loss carry forwards expire as follows:

	2012 US$000	2013 US$000	2014 US$000	2015 US$000	2016 US$000	**Total US$000**
Tax loss carry forwards	1,264	94	468	473	1,025	**3,324**

The movements in net deferred tax liability for the years ended 31 December 2006 and 2005 comprised:

	2006 US$000	2005 US$000
Net deferred tax liability, beginning of the year	**(15,358)**	(13,160)
Impact of translation loss on beginning balance	**(2,221)**	130
Deferred tax in spun-off entities	**–**	(252)
Deferred tax acquired on acquisition of new consolidated entities	**–**	(23)
Deferred tax acquired on acquisition of minority interest in consolidated entities	**5**	(3,946)
Deferred tax benefit	**4,284**	1,893
Net deferred tax liability, end of the year	**(13,290)**	(15,358)

At the beginning of 2006 the Government delayed the introduction of income tax for agricultural companies until 2008. This resulted in a reduction of deferred income tax assets in the amount of US$290. The full amount of the change was expensed in 2006.

19 Pension costs

The Group makes payments for employees into the Pension fund of the Russian Federation. From 1 January 2005, all contributions to the Pension fund are calculated by the application of a regressive rate from 20% to 2% of the annual gross remuneration of each employee.

20 Related parties

Shareholders/Control Group

The structure of the Group prior to September 2005 was not united in the form of a legal holding. In order to show a fair presentation of the results of operations for periods prior to this date, management believes that it is necessary to combine the holdings of the Control Group for that period.

Management has determined which individuals should be included in the Control Group using the following principles:

1 Individuals who are members of the main shareholder's immediate family, but limited to two generations.

   a) Generation one is defined as the main shareholder, spouse and any brothers or sisters of these two individuals,

   b) Generation two is defined as the children of any persons in the generation one group,

   c) Generation two individuals with deceased parents who are brothers or sisters in the generation one group are not considered to be immediate family and are not included in the Control Group.

   d) Individuals with whom contemporaneous written agreement has been obtained demonstrating an obligation to act in concert with members of the Control Group.

During 2006 and 2005, related parties provided debt financing to the Group and served as guarantors for certain third-party debts.

20 Related parties continued

Entities disposed of to shareholders

Transactions with entities disposed of to shareholders mostly comprise purchases of raw materials from CJSC Penzamyasoprom and sale of mixed fodder to CJSC Penzamyasoprom. Settlements between related entities are generally made in cash. These related parties are under common ownership and the existence of that control could result in operating results or financial position of the Group significantly different from those that would have been obtained were the enterprises autonomous. Such transactions are expected to continue to play a role in the operations of the Group in the future.

Other related parties

Other related-party purchases during 2006 and 2005 are mostly represented by purchases of IT technology and security services.

As at 31 December 2006 and for the year then ended, balances and transactions with related parties are summarised as follows:

	Shareholders US$000	Companies disposed to shareholders and other related parties US$000	Total US$000
Balances			
Short-term loan receivable	–	2,544	2,544
Trade receivables	–	2,772	2,772
Advances issued	–	1,835	1,835
Other receivables and prepayments	–	1,561	1,561
Long-term loans receivable	12	657	669
Trade payables	–	(1,454)	(1,454)
Short-term loans	(72)	(247)	(319)
Other payables	(144)	(1,270)	(1,414)
Current portion of long-term loans payable	(879)	–	(879)
Long-term notes payable	(190)	–	(190)
Long-term loans payable	–	–	–
Long-term payables to shareholders related to lease agreements	(1,133)	–	(1,133)
Activities			
Sales	–	5,482	5,482
Rent income from related party	–	30	30
Purchase of IT services	–	(266)	(266)
Purchase of security services	–	(735)	(735)
Purchase of goods and services	–	(12,298)	(12,298)
Purchase of property plant and equipment	–	(138)	(138)

20 Related parties continued

As at 31 December 2005 and for the year then ended, balances and transactions with related parties are summarised as follows:

	Shareholders US$000	Companies disposed to shareholders and other related parties US$000	Total US$000
Balances			
Short-term loan receivable	–	1,880	1,880
Trade receivables	–	1,202	1,202
Advances issued	–	1,655	1,655
Other receivables and prepayments	–	1,396	1,396
Long-term loans receivable	–	8	8
Trade payables	–	(1,179)	(1,179)
Short-term loans	(66)	(417)	(483)
Other payables	–	(1,978)	(1,978)
Current portion of long-term loans payable	(752)	–	(752)
Long-term notes payable	(3,559)	–	(3,559)
Long-term loans payable	(1,663)	–	(1,663)
Long-term payables to shareholders related to lease agreements	(1,115)	–	(1,115)
Activities			
Sales	1	2,222	2,223
Rent income from related party	–	233	233
Purchase of IT services	–	(391)	(391)
Purchase of security services	–	(712)	(712)
Purchase of goods and services	–	(4,042)	(4,042)
Purchase of property plant and equipment	–	(652)	(652)

21 Long-term payables to shareholders

During 2005 certain Group companies were spun-off as a part of the restructuring transaction. Some property, plant and equipment that remained in distributed entities was necessary for the continuing operations of the Group. This equipment was partly transferred to the companies remaining in the Group. The equipment that was not possible to transfer due to timing issues was leased by the distributed companies on bargain terms. The lease terms include bargain options for the Group to continue the agreement over the life of the underlying equipment. For the purposes of calculating the lease term, the Group used the remaining useful life of the underlying assets. The value of property, plant and equipment at lease inception was US$4,137.

Payables to shareholders for leased property, plant and equipment as at 31 December 2006 comprise:

	US$000
Settlements with shareholders for leasing, long-term portion	**1,133**
Settlements with shareholders for leasing, current portion	**39**
Total settlements with shareholders for leasing	**1,172**

Movements in the liability for the year ended 31 December 2006 were:

	US$000
Liability to shareholders for leasing as at 1 January 2006	**1,147**
Interest accrued at 14% on leasing liability	**162**
Repayment of liability to shareholders	**(241)**
Translation gain	**104**
Liability incurred to shareholders in term of lease of this equipment as at 31 December 2006	**1,172**

22 Segmental reporting

The Group's operations are divided into three divisions by types of products produced: meat processing, poultry and pork. Substantially all the Group's operations are located within the Russian Federation. The pork and poultry segments share a common legal and organisational structure as well as a common chief operating decision maker. For the purpose of determining reportable segments, the Group has determined the chief operating decision maker of each division to be the individual responsible for allocating resources to and assessing the performance of each component of the business. Discrete information for each segment is presented to the respective decision makers and is significant in managing operations.

Segmental information at 31 December 2006 and for the year then ended comprised:

	Meat processing US$000	Poultry US$000	Pork US$000	Corporate assets/ expenditures US$000	Intersegment US$000	Combined US$000
Total sales	453,194	155,682	27,816	568	–	637,260
Including:						
Other sales	1,474	10,213	2,113	–	–	13,800
Sales volume discounts	(6,999)	(2,918)	–	–	–	(9,917)
Intersegment sales	(1,592)	(4,661)	(455)	(567)	–	(7,275)
Sales to external customers	451,602	151,021	27,361	1	–	629,985
Cost of sales	(371,281)	(98,841)	(17,509)	(3)	6,699	(480,935)
Gross profit	81,913	56,841	10,307	565	(576)	149,050
Operating expenses	(65,296)	(27,956)	(3,093)	(4,310)	589	(100,066)
Operating income	16,617	28,885	7,214	(3,745)	13	48,984
Other income and expenses, net	3,008	1,016	63	10,212	(7,811)	6,488
Interest expenses	(11,534)	(8,958)	(518)	(4,295)	7,767	(17,538)
Segmental profit	8,091	20,943	6,759	2,172	(31)	37,934
Expenditure for segment property, plant and equipment	14,605	29,398	57,275	24	–	101,302
Segmental assets	291,366	190,375	164,061	257,315	(177,253)	725,864
Supplemental information						
Depreciation expense	15,657	6,961	1,906	–	–	24,524
Income tax expense	2,616	(791)	(119)	713	–	2,419
Reconciliation between segmental profit and consolidated income from continuing operations						
Segmental profit	37,934					
Minority interest	(2,319)					
Income taxes	(2,419)					
Consolidated income from continuing operations	33,196					
Reconciliation between total segmental assets and total assets per financial statements						
Total segmental assets	725,864					
Assets of discontinued operations	–					
Total assets per financial statements	725,864					

22 **Segment reporting** continued

Segmental information at 31 December 2005 and for year then ended comprised:

	Meat processing US$000	Poultry US$000	Pork US$000	Corporate assets/ expenditures US$000	Intersegment US$000	Combined US$000
Total sales	410,179	127,641	24,297	–	–	562,117
Including:						
Other sales	2,591	7,217	6,918	–	–	16,726
Sales volume discounts	(2,503)	(875)	–	–	–	(3,378)
Intersegment sales	(870)	(10,520)	(5,830)	–	–	(17,220)
Sales to external customers	409,309	117,121	18,467	–	–	544,897
Cost of sales	(336,816)	(79,592)	(20,831)	–	17,202	(420,037)
Gross profit	73,363	48,049	3,466	–	(18)	124,860
Operating expenses	(52,663)	(25,019)	(3,071)	(10)	(61)	(80,824)
Non-recurring expense (Note 15)	–	(467)	–	–	–	(467)
Operating income	20,700	22,563	395	(10)	(79)	43,569
Other income and expenses, net	(1,245)	(28)	(18)	(10)	–	(1,301)
Interest expenses	(8,429)	(6,723)	(453)	–	–	(15,605)
Segmental profit	11,026	15,812	(76)	(20)	(79)	26,663
Expenditure for segment property, plant and equipment	8,530	37,205	40,157	–	–	85,892
Segmental assets	231,971	140,162	98,473	198	(50,847)	419,957
Supplemental information						
Depreciation expense	13,354	4,965	1,843	–	–	20,162
Income tax expense	7,246	465	262	–	–	7,973
Reconciliation between segment profit and consolidated income from continuing operations before extraordinary item						
Segmental profit	26,663					
Minority interest	(1,387)					
Income taxes	(7,973)					
Consolidated income from continuing operations before extraordinary item	17,303					
Reconciliation between total segmental assets and total assets per financial statements						
Total segmental assets	419,957					
Assets of discontinued operations	3,855					
Total assets per financial statements	423,812					

Corporate assets comprise cash at bank received from both the issuance of new shares and bond issue, and loans to Group companies.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Group evaluates performance based on profit or loss from operations before income taxes. The Group attempts to account for inter-segment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices.

22 Segment reporting continued

The Meat Processing Division is involved in the production of a wide range of meat products, including sausages, ham and raw meat.

Pork and poultry are strategic divisions that produce and offer distinctive products, such as semi-finished poultry products, raw meat, eggs and other poultry meat products in the poultry segment and raw pork meat in the pork segment.

All three divisions are involved in other business activities, including dairy, crop cultivation and related services, which are non-core business activities.

23 Acquisitions, divestitures, investments in affiliates

Subsidiaries
As at 31 December 2006, the Group controls the meat processing and agricultural sub-groups through its 100% ownership in AIC Cherkizovsky Ltd. and AIC Mikhailovsky Ltd.

APK Cherkizovsky is a sub-group consisting of meat processing plants, distribution companies and other companies registered and operating in the Russian Federation. On 31 December 2006 and 2005 the following principal companies were included in the APK Cherkizovsky sub-group:

Name of company	Legal form	Nature of business	Consolidated interest 31.12.2006 %	Consolidated interest 31.12.2005 %
JSC MPP Babaevskiy	Closed joint stock company	Meat processing plant	85	85
JSC Belmiaso	Open joint stock company	Meat processing plant	75	75
JSC Biruliovsky meat processing plant (JSC BMPP)	Open joint stock company	Meat processing plant	95	95
JSC Meat and Poultry Processing Plant Penzensky (JSC MPPP Penzensky)	Open joint stock company	Meat processing plant	95	95
JSC Meat Processing Plant Ulyanovsky (JSC MPP Ulyanovsky)	Open joint stock company	Meat processing plant	85	79
JSC Cherkizovsky meat processing plant (JSC CMPP)	Open joint stock company	Meat processing plant	87	87
AIC Cherkizovsky Ltd (CJSC Eko-Torg prior to 1 September 2004)	Limited liability company	Asset holding company	100	100
MPP Salsky Ltd	Limited liability company	Meat processing plant	81	81
TIC Cherkizovo Ltd (Cherkizovo-2)	Limited liability company	Procurement company	100	100
LLC Cherkizovo-Kashira (Cherkizovo-Kashira Ltd)	Limited liability company	Meat processing plant	99	99
JSC Trading Company of Agroindustrial Complex Cherkizovsky (JSC Trading Company of AIC Cherkizovsky)	Open joint stock company	Trading company: distribution of products of APK Cherkizovsky	100	100

Prior to September 2005, all companies listed above were under the control of the Control Group who owned, directly or indirectly, a majority of the voting rights in each company.

During September 2005, a restructuring of APK Cherkizovsky was performed in order to establish control over all meat processing companies solely through AIC Cherkizovsky Ltd, thereby eliminating all direct ownership in such companies by the Control Group. This was primarily accomplished by contributing the shares of companies held by the Control Group to the share capital of AIC Cherkizovsky Ltd. as at 31 December 2005, all companies listed above were under the control of AIC Cherkizovsky Ltd.

23 Acquisitions, divestitures, investments in affiliates continued

APK Mikhailovsky is a sub-group of companies registered and operating in the Russian Federation engaged in the production of various types of compound feed, raising of poultry, pigs and cattle and the distribution of meat. On 31 December 2006 and 2005 the following principal companies were included in the APK Mikhailovsky sub-group:

Name of company	Legal form	Nature of business	Consolidated interest 31.12.2006 %	Consolidated interest 31.12.2005 %
CJSC Budenovets Agrifirm (**)	Closed joint stock company	Pig breeding	–	73
CJSC Krugovskaya (**)	Closed joint stock company	Raising poultry	–	76
CJSC Petelinskaya	Closed joint stock company	Raising poultry	84	84
JSC Vasiljevskaya	Open joint stock company	Raising poultry	100	100
LLC Ardymsky Feed Milling Plant (Ardymsky Feed Milling Plant Ltd)	Limited liability company	Mixed fodder production	89	89
LLC Penzenskaya	Limited liability company	Raising poultry	100	100
LLC Petelino Trade House	Limited liability company	Trading company: distribution of products of APK Mikhailovsky	84	84
CJSC Botovo	Closed joint stock company	Pig breeding	76	76
LLC Petelinsky Poultry Factory	Limited liability company	Meat processing	84	84
LLC Trading House Petelino-Samara	Limited liability company	Trading company: distribution of products of APK Mikhailovsky	100	100
LLC Kuvak-Nikolskoie Poultry Factory	Limited liability company	Raising poultry	100	100
JSC Lipetskmyasoprom	Open joint stock company	Pig breeding	100	100
LLC Mikhailovsky Feed Milling Plant (*)	Limited liability company	Mixed fodder production	100	100
LLC Kuznetsovsky Kombinat (*)	Limited liability company	Pig breeding	100	100
LLC Agro-industrial Complex Mikhailovsky (AIC Mikhailovsky Ltd) (*)	Limited liability company	Holding company	100	100
LLC Tambovmyasoprom	Limited liability company	Pig breeding	99	–
LLC Budenovets Agrifirm	Limited liability company	Pig breeding	100	–

* Companies created in the process of restructuring
** Discontinued operations

As at 31 December 2006, all companies listed above with ownership interest as at that date were under the control of AIC Mikhailovsky Ltd which owned, directly or indirectly, a majority of the shares in each company.

In August 2006, the Group purchased an additional stake of 5.65% in JSC Meat Processing Plant Ulyanovsky for the total cash consideration of US$137. An excess of fair value over purchase price of US$21 arose at the purchase date.

In September 2006, management of the Group made a decision to dispose the non-core business operations of CJSC Budenovets Agrifirm and CJSC Krugovskaya ("the Discontinued Entities") in exchange for US$162 in cash. The disposal was completed by the end of 2006.

Legal obligations of approximately US$2,348 (as at the balance sheet date) exist for the Group to purchase fixed assets owned by the discontinued entities in 2007. Such fixed assets as well as the liability relating to their purchase were included in the calculation of the gain/loss resulting on sale of discontinued operations. The fixed assets remained at their historical book value in the accounting records and the related liability is included in other payables.

23 Acquisitions, divestitures, investments in affiliates continued

Net assets of discontinued operations were as follows as at the date of disposal:

	At disposal US$000
Trade receivables, net	2,751
Inventory	656
Livestock	752
Property, plant and equipment	1,616
Other assets	1,502
Total assets	7,277
Trade and other payables	(1,668)
Short and long-term loans	(1,868)
Other liabilities	(2,969)
Total liabilities	(6,505)
Net assets of discontinued operations	772

Results from discontinued operations were as follows:

	2006 US$000	2005 US$000
Sales	**1,377**	1,424
Cost of sales	**(1,082)**	(1,154)
Operating expenses	**(293)**	(588)
Operating income/(loss)	**2**	(318)
Gain from disposal of property, plant and equipment	**(8)**	24
Financial expenses, net	**(101)**	2
Loss before provision for income taxes and minority interest	**(107)**	(292)
Provision for income taxes	**(121)**	32
Minority interest	**29**	(46)
Loss from discontinued operations	**(199)**	(306)

24 Commitments and contingencies

Legal

As at 31 December 2006, several Group companies reported negative net assets in their statutory financial statements. In accordance with the Civil Code of the Russian Federation, a liquidation process may be initiated against a company reporting negative net assets. Management believes that it is remote that the liquidation process will be initiated against those companies.

The Group has been and continues to be the subject of legal proceedings and adjudications from time to time. Management believes that the resolution of all such outstanding matters will not have a material impact on the Group's financial position or results of operations.

Taxation

Laws and regulations affecting businesses in the Russian Federation continue to change rapidly. These changes are characterised by poor drafting, different interpretations and arbitrary application by the authorities. Management's interpretation of such legislation as applied to the activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. It is therefore possible that 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. Where uncertainty exists, the Group has accrued tax liabilities as management's best estimate of the probable outflow of resources which will be required to settle such liabilities. Management believes that it has provided adequately for tax liabilities based on its interpretations of tax legislation. However, the relevant authorities may have differing interpretations, and the effects could be significant. Management believes that the total amount of possible tax risks, in accordance with FAS 5 "Accounting for Contingencies," is US$3,615 as at 31 December 2006.

Environmental remediation costs

The Group's management believes that it is in compliance with applicable legislation and is not aware of any potential environmental claims; therefore, no liabilities associated with such costs are recorded as at 31 December 2006.

Capital commitments

At 31 December 2006, the Group had large capital projects in progress at JSC Lipetskmyasoprom and LLC Tambovmyasoprom. As part of these projects, commitments had been made to contractors of approximately US$72,826 and US$86,293, respectively, towards completion of the projects.

Also the Group is in the process of implementing an integrated management planning and accounting system related to the meat processing segment of the business. As part of this project, commitments have been made to contractors of approximately US$1,678 toward completion of the project.

25 Subsequent events

For the period from 1 January 2007 to 13 April 2007, the Group made repayments on short-term and long-term debt of approximately US$70,874. The Group also entered into additional agreements or received additional funds under existing short and long-term loan agreements over the same period totalling approximately US$88,899.

At a general meeting of the shareholders of the Group on 26 March 2007, a decision was made to split the issued shares of the Group by converting each issued share with a par value of 1 rouble into 100 shares with a par value of 0.01 roubles per share.

On 14 April 2007, the Group signed a Memorandum of Understanding anticipating the acquisition of 100% of the share capital in the holding company of OAO Chicken Kingdom. No further details of any pending transaction were made public.

Advisers and corporate information

Company Lawyer
Yuri Dyachuk

Registered office
Cherkizovo Group
5 Permskaya Street
Moscow 107143
Russian Federation

Tel: +7 (495) 788-3232
Fax: +7 (495) 788-3233
Website: www.cherkizovogroup.com

Registered number
1057748318473

Registrars
OJSC Obyedinennaya Registratsionnaya
Kompaniya (OJSC ORK)
70 Pyatnitskaya Street
Moscow 113095
Russian Federation

Tel: +7 (495) 745-78-91, + 7(495) 504-28-86

Brokers
Renaissance Capital
Capital Center
9th Floor
2-4 Archbishop Markarious III Avenue
Nicosia 1505
Cyprus

Auditors
ZAO Deloitte and Touche CIS
Business Center Mokhovaya
4/7 Vozdvizhenka St, bldg 2
Moscow 125009
Russian Federation

Depository
JPMorgan Chase Bank, N.A.
4 New York Plaza
13th Floor
New York
NY 10004
United States of America

Solicitors

English law
Cleary Gottlieb Steen & Hamilton LLP
City Place House
55 Basinghall Street
London EC2V 5EH
United Kingdom

Russian law
Cleary Gottlieb Steen & Hamilton LLP
(CGS&H Limited Liability Company)
Paveletskaya Square 2/3
Moscow 115054
Russian Federation

Public relations

UK
FD
Holborn Gate
26 Southampton Buildings
London WC2A 1PB
United Kingdom

Russian Federation
FD
Millennium House Business Centre
ul. Trubnaya 12
Moscow 107045
Russian Federation

Designed and produced by 85four www.85four.com

Cherkizovo Group
5 Permskaya Street
Moscow 107143
Russian Federation

Tel: +7 (495) 788-3232
Fax: +7 (495) 788-3233
Website: www.cherkizovogroup.com