

WIMM BILL DANN FOODS OJSC  
Form 20-F  
June 25, 2007

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### Form 20-F

- Registration Statement pursuant to Section 12(b) or (g) of the Securities Exchange Act of 1934
- or
- Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2006
- or
- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
- or
- Shell company report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number: 1-31232

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## WIMM-BILL-DANN FOODS OJSC

(Exact name of Registrant as specified in its charter)

**RUSSIAN FEDERATION**

(Jurisdiction of incorporation or organization)

**16 Yauzsky Boulevard, Moscow 109028, Russian Federation**

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

**Title of Each Class**

**AMERICAN DEPOSITARY SHARES, EACH  
REPRESENTING ONE SHARE OF COMMON STOCK  
COMMON STOCK, PAR VALUE  
20 RUSSIAN RUBLES PER SHARE**

**Name of Each Exchange on Which Registered**

**NEW YORK STOCK EXCHANGE  
NEW YORK STOCK EXCHANGE(1)**

Securities registered or to be registered pursuant to Section 12(g) of the Act:

**NONE**

(Title of Class)

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Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

**NONE**

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

44,000,000 shares of common stock, par value 20 Russian rubles each, as of December 31, 2006.

14,405,337 American Depositary Shares, each representing one share of common stock, as of December 31, 2006.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes:

No:

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes:

No:

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes:

No:

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer:

Accelerated filer:

Non-accelerated filer:

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17

Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes:

No:

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(1) Listed, not for trading or quotation purposes, but only in connection with the registration of ADSs pursuant to the requirements of the Securities and Exchange Commission

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Unless the context otherwise requires, references to WBD, Company, we, us, or our refer to Wimm-Bill-Dann Foods OJSC and its subsidiaries.

In this annual report, references to U.S. dollars or \$ are to the currency of the United States, references to rubles or RUR are to the currency of the Russian Federation, and references to or euro are to the lawful currency of the member states of the European Union that adopted a single currency in accordance with the Treaty of Rome establishing the European Economic Community, as amended by the treaty on the European Union, signed at Maastricht on February 7, 1992.

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

Matters discussed in this document may constitute forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides safe harbor protections for forward-looking statements in order to encourage companies to provide prospective information about their businesses. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts.

We desire to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and are including this cautionary statement in connection with this safe harbor legislation and other relevant laws. This document and any other written or oral statements made by us or on our behalf may include forward-looking statements, which reflect our current views with respect to future events and financial performance. The words believe, expect, anticipate, intend, estimate, forecast, project and similar expressions identify forward-looking statements. Forward-looking statements appear in a number of places including, without limitation,

Item 3. Key Information D. Risk Factors, Item 4. Information on Our Company and Item 5. Operating and Financial Review and Prospects, and include statements regarding: strategies, outlook and growth prospects; future plans and potential for future growth; liquidity, capital resources and capital expenditures; growth in demand for our services; economic outlook and industry trends; developments of our markets; the impact of regulatory initiatives; and the strength of our competitors.

The forward-looking statements in this document are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management's examination of historical operating trends, data contained in our records and other data available from third parties. Although we believe that these assumptions were reasonable when made, because these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond our control, we may not achieve or accomplish these expectations, beliefs or projections. In addition to these important factors and matters discussed elsewhere herein and in the documents incorporated by reference herein, important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements including the achievement of the anticipated levels of profitability, growth, cost and synergy of our recent acquisitions, the timely development and acceptance of new products, the impact of competitive pricing, the ability to obtain necessary regulatory approvals, the impact of general business and global economic conditions and other important factors described from time to time in the reports filed by us with the Securities and Exchange Commission.

Except to the extent required by law, neither we, nor any of our respective agents, employees or advisors intend or have any duty or obligation to supplement, amend, update or revise any of the forward-looking statements contained or incorporated by reference in this document.

**PART I****Item 1.** *Identity of Directors, Senior Management and Advisors*

Not applicable.

**Item 2.** *Offer Statistics and Expected Timetable*

Not applicable.

**Item 3.** *Key Information***A.** Selected Financial Data

The selected consolidated and combined financial data set forth below at December 31, 2006, 2005, 2004, 2003 and 2002 and for the years then ended have been derived from our audited financial statements prepared in accordance with U.S. GAAP. The selected consolidated and combined financial data should be read in conjunction with our Consolidated Financial Statements as of December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005, and 2004 included under Item 18. Financial Statements and Item 5. Operating and Financial Review and Prospects.

|  | For the years ended December 31, |               |            |            |            |
|--|----------------------------------|---------------|------------|------------|------------|
|  | 2006                             | 2005          | 2004       | 2003       | 2002       |
| <b>Statement of Operations Data:</b>                           |                                  |               |            |            |            |
| Sales  | 1,762,127                        | 1,394,590 (1) | 1,183,986  | 938,459    | 824,734    |
| Cost of sales  | (1,194,159 )                     | (999,006 )    | (858,767 ) | (665,104 ) | (579,707 ) |
| Gross profit   | 567,968                          | 395,584       | 325,219    | 273,355    | 245,027    |
| Selling and distribution expenses                              | (246,054 )                       | (191,990 )    | (173,433 ) | (140,746 ) | (109,527 ) |
| General and administrative expenses                            | (134,481 )                       | (109,642 )    | (92,816 )  | (75,973 )  | (62,955 )  |
| Other operating expenses                                       | (31,812 )                        | (6,457 )      | (6,047 )   | (7,481 )   | (6,497 )   |
| Operating income   | 155,621                          | 87,495        | 52,923     | 49,155     | 66,048     |
| Financial income and expenses, net                             | (15,480 )                        | (22,868 )     | (14,618 )  | (15,273 )  | (14,131 )  |
| Income before provision for income taxes and minority interest | 140,141                          | 64,627        | 38,305     | 33,882     | 51,917     |
| Provision for income taxes(2)                                  | (41,560 )                        | (30,712 )     | (12,170 )  | (10,717 )  | (14,249 )  |
| Minority interest  | (3,197 )                         | (3,649 )      | (3,161 )   | (2,012 )   | (1,922 )   |
| Net income   | 95,384                           | 30,266        | 22,974     | 21,153     | 35,746     |
| Earnings per share basic and diluted:                          |                                  |               |            |            |            |
| Income from continuing operations                              | 2.17                             | 0.69          | 0.52       | 0.48       | 0.83       |
| Income from discontinued operations                            |                                  |               |            |            |            |
| Net income   | 2.17                             | 0.69          | 0.52       | 0.48       | 0.83       |
| Dividends per share(3)   | 0.55                             |               |            |            |            |
| Weighted average number of shares outstanding                  | 44,000,000                       | 44,000,000    | 44,000,000 | 44,000,000 | 43,063,014 |
| <b>Other Data:</b>   |                                  |               |            |            |            |
| Capital expenditures   | 129,963                          | 75,110        | 72,639     | 107,186    | 136,100    |
| Cash provided by (used in) operating activities                | 167,252                          | 113,937       | 71,720     | 29,940     | (6,863 )   |
| Cash used in investing activities                              | (228,158 )                       | (125,157 )    | (73,808 )  | (95,142 )  | (122,677 ) |
| Cash (used in) provided by financing activities                | 1,359                            | 82,619        | (16,159 )  | 73,399     | 152,600    |

(1) Where necessary, corresponding figures have been adjusted to conform with changes in the presentation of the current period. Previously, we classified as sales revenue amounts from sales of



non-milk inventory and services; related expenses were included in the cost of sales. Commencing 2006, we began classifying such items in other operating expenses. Prior net sales and cost of sales have been reclassified accordingly for comparative periods presented in the accompanying financial statements. This change in classification has no effect on previously reported net income.

(2) Provision for income taxes includes the tax benefit in our juice business relating to the small enterprise tax legislation.

(3) Dividends paid in 2006 are attributable as follows: \$0.17 per share for years 2002-2004, \$0.08 per share for three months ended March 31, 2006, \$0.30 per share for nine months ended September 30, 2006.

|   | At December 31,<br>2006 | 2005    | 2004    | 2003    | 2002    |
|---|-------------------------|---------|---------|---------|---------|
| <b>Balance Sheet Data:</b>                |                         |         |         |         |         |
| Total assets                              | 1,175,936               | 920,557 | 796,088 | 743,885 | 589,093 |
| Total net assets                          | 497,494                 | 387,043 | 370,916 | 324,618 | 282,884 |
| Total debt(1)                             | 442,999                 | 371,646 | 283,168 | 283,442 | 186,039 |
| Total liabilities                         | 659,465                 | 508,895 | 407,845 | 398,099 | 284,660 |
| Total liabilities and shareholders equity | 1,175,936               | 920,557 | 796,088 | 743,885 | 589,093 |

(1) Total debt represents long-term and short-term loans, including the current portion of long-term loans, notes payable and vendor financing obligations.

#### Exchange Rates and Inflation

The following tables show, for the periods indicated, certain information regarding the exchange rate between the ruble and the U.S. dollar, based on data published by the Central Bank of Russia. These rates may differ from the actual rates used in the preparation of our financial statements and other financial information appearing herein.

| Year ended December 31, | Rubles per U.S. dollar |       |            | Period<br>End |
|-------------------------|------------------------|-------|------------|---------------|
|                         | High                   | Low   | Average(1) |               |
| 2006                    | 28.48                  | 26.18 | 27.09      | 26.33         |
| 2005                    | 29.00                  | 27.46 | 28.31      | 28.78         |
| 2004                    | 29.45                  | 27.75 | 28.73      | 27.75         |
| 2003                    | 31.88                  | 29.25 | 30.61      | 29.45         |
| 2002                    | 31.86                  | 30.14 | 31.39      | 31.78         |

(1) The average of the exchange rates on the last business day of each full month during the relevant period.

|               | Rubles per U.S. dollar |       |
|---------------|------------------------|-------|
|               | High                   | Low   |
| May 2007      | 25.92                  | 25.69 |
| April 2007    | 26.01                  | 25.69 |
| March 2007    | 26.24                  | 25.97 |
| February 2007 | 26.55                  | 26.16 |
| January 2007  | 26.58                  | 26.45 |
| December 2006 | 26.39                  | 26.18 |

On June 5, 2007, the exchange rate between the ruble and the U.S. dollar was 25.89 rubles per \$1.00.

The following table shows the rates of inflation in Russia for the years indicated:

| <b>Year ended December 31,</b> | <b>Inflation<br/>rate</b> |
|--------------------------------|---------------------------|
| 2006                           | 9.7 %                     |
| 2005                           | 10.9 %                    |
| 2004                           | 11.7 %                    |
| 2003                           | 12.0 %                    |
| 2002                           | 15.1 %                    |

Source: Central Bank of Russia.

Effective from January 1, 2003, Russia no longer met the criteria for a highly inflationary economy. Inflation continued to slow down in Russia in the period from January 1, 2004 till now days. Inflation dynamics were affected by several factors resulting both to international energy and oil market prices and to administrative decisions and controlling factors of Bank of Russia.

Our results of operations are affected by the relationship between the rate of inflation and the nominal rate of devaluation/appreciation of the ruble against the U.S. dollar (*i.e.*, by the real appreciation or depreciation of the ruble against the U.S. dollar). In 2006, 2005 and 2004, the ruble appreciated in real terms against the U.S. dollar.

|  | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|--|-------------|-------------|-------------|
| Inflation(1)   | 9.7 %       | 10.9 %      | 11.7 %      |
| Nominal appreciation/(depreciation) of the ruble relative to the U.S. dollar(1)(2) | 4.0 %       | 1.9 %       | 6.5 %       |
| Real appreciation of the ruble relative to the U.S. dollar(2)                      | 10.7 %      | 10.8 %      | 15.1 %      |

(1) Source: Central Bank of Russia.

(2) For purposes of calculating the interest rate of our U.S. dollar-denominated notes, we used the Russian ruble/U.S. dollar exchange rates at December 31, 2006, 2005 and 2004, which appreciated/(depreciated) at the rates of 8.5%, (3.7)% and 6.1%, respectively.

#### **B. Capitalization and Indebtedness**

Not applicable.

#### **C. Reasons for the Offer and Use of Proceeds**

Not applicable.

#### **D. Risk Factors**

*An investment in our shares and ADSs involves a high degree of risk. You should carefully consider the following information about these risks, together with the information contained in this document, before you decide to buy our shares or ADSs. If any of the following risks actually occurs, our business, financial condition, results of operations or prospects could be materially adversely affected. In that case, the value of our shares and ADSs could also decline and you could lose all or part of your investment.*

*We have described the risks and uncertainties that our management believes are material, but these risks and uncertainties may not be the only ones we face. Additional risks and uncertainties, including those we*





*currently are not aware of or deem immaterial, may also result in decreased operating revenues, increased operating expenses or other events that could result in a decline in the value of our ADSs.*

#### **Risks Relating to Business Operations in Emerging Markets**

*Emerging markets such as the Russian Federation are subject to greater risks than more developed markets, including significant legal, economic and political risks.*

Investors in emerging markets such as the Russian Federation should be aware that these markets are subject to greater risks than more developed markets, including in some cases significant legal, economic and political risks. Investors should also note that emerging economies, such as the economy of the Russian Federation, are subject to rapid change and that the information set out herein may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment is appropriate. Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved and investors are urged to consult their own legal and financial advisors before making an investment in our securities.

#### **Risks Relating to Our Business and Industry**

*Economic downturns could hurt our turnover and materially adversely affect our strategy to increase our sales of premium brands.*

Demand for dairy and certain beverage products depends primarily on demographic factors and consumer preferences, as well as factors relating to discretionary consumer spending, including the general condition of the economy and general levels of consumer confidence. The willingness of consumers to purchase branded food and beverage products depends, in part, on local economic conditions. In periods of economic uncertainty, consumers tend to purchase more economy brands and, to the extent that our business strategy depends on the expansion of the sales of premium brands and value-added products, our results of operations could suffer. Reduced consumption of our products in any of our key markets could reduce our turnover and profitability.

*The failure of our geographic expansion strategy could hamper our continued growth and profitability.*

Our expansion strategy depends, in part, on funding growth in additional markets, on our ability to identify attractive opportunities in markets that will grow and on our ability to manage the operations of acquired or newly established businesses. Should growth decline in our existing markets, not increase as anticipated in markets in which we have recently acquired or established businesses, or not increase in markets into which we subsequently expand, our geographic expansion strategy may not be successful and our business and profitability may suffer.

In addition, we currently have production facilities in Ukraine, Kyrgyzstan and Uzbekistan and trade operations in Kazakhstan, and our strategy contemplates the acquisition of additional operations in the countries of the Commonwealth of Independent States, or the CIS. As with Russia, these countries are emerging markets subject to greater political, economic, social and legal risks than more developed markets. In many respects, the risks inherent in transacting business in these countries are similar to those in Russia, especially those risks set out below in Risks Relating to the Russian Federation.

Moreover, these countries represent new operating environments for us, which are located, in many instances, a great distance from our Russian operations and across multiple international borders. We thus expect to have less control over their activities. In addition, we may face more uncertainties with respect to the operational and financial needs of these businesses. These factors may hurt the profitability of our current and future operations in these countries.

***Our growth strategy relies on acquisitions and establishing new businesses, and our future growth, results of operations and market share would be adversely affected if we fail to identify suitable targets, outbid competing bidders or finance acquisitions on acceptable terms.***

Our strategy depends on us being a large manufacturer in the dairy and juice sectors so that we can benefit from economies of scale, better satisfy customer needs and compete effectively against other producers. Our growth will suffer if we are unable to implement our acquisition strategy, whether because we fail to identify suitable targets, outbid competing bidders or finance acquisitions on acceptable terms or for any other reason. Furthermore, any acquisitions or similar arrangements may harm our business if we are unsuccessful in our integration process or fail to achieve the synergies and savings we expect.

***We cannot assure you of the successful integration of existing or newly acquired businesses. If we fail to integrate our businesses successfully, our rate of expansion could slow and our results of operations and financial condition could be materially adversely affected.***

We have grown through numerous acquisitions and are in the process of integrating and restructuring some of our businesses. We may make additional acquisitions in the future. Achieving the benefits of our acquisitions and our restructuring efforts will depend, in part, on integrating our businesses in an efficient manner. We cannot assure you that such integration will happen or that it will happen in a timely manner.

The integration of our businesses, as well as of any businesses we may acquire in the future, requires significant time and effort from our senior management, who are also responsible for managing our existing operations. The integration of new businesses may be difficult for a variety of reasons, including differing culture, management styles and systems and infrastructure and poor records or internal controls. In addition, integrating new acquisitions may require significant initial cash investments. Furthermore, even if we are successful in integrating our existing and new businesses, expected synergies and cost savings may not materialize, resulting in lower than expected profit margins. We cannot assure you that we will be successful in realizing any of the anticipated benefits of the companies that we are now in the process of integrating or that we may acquire in the future. If we do not realize these benefits, our financial condition, results of operations and prospects could be materially adversely affected.

We also may acquire or establish businesses in countries that may represent new operating environments for us and which may be located a great distance from our headquarters in Moscow. We may thus have less control over the activities of these companies and may face more uncertainties with respect to the operational and financial needs of these businesses, which may hinder our integration efforts.

***Rapid growth and expansion may cause us difficulty in obtaining adequate managerial and operational resources, restricting our ability to expand successfully our operations.***

We have experienced substantial growth and development in a relatively short period of time, and we believe that our businesses will continue to grow for the foreseeable future. The operating complexity of our business, as well as the responsibilities of management, have increased as a result of this growth, placing significant strain on our managerial and operational resources. Our future operating results depend, in significant part, upon the continued contributions of our management and technical personnel.

We will need to continue to improve our operational and financial systems and managerial controls and procedures to keep pace with our growth. We will also have to maintain close coordination among our logistical, technical, accounting, finance, marketing and sales personnel. Management of growth will require, among other things:

- the ability to integrate new acquisitions into our operations;
- continued development of financial and management controls and IT systems and their implementation in newly acquired businesses;

- increased marketing activities;
- hiring and training of new personnel; and
- the ability to adapt to changes in the markets in which we operate, including increased competition and demand for our services.

Our inability to manage our growth successfully could have a material adverse effect on our business, financial condition and results of operations.

*There are material weaknesses in our internal control over financial reporting and we may not be able to remedy these material weaknesses or prevent future material weaknesses. If we fail to do so there is a more than remote likelihood that a material misstatement of the annual or interim statements will not be prevented or detected.*

The material weaknesses in our internal control over financial reporting as identified by our management for the year ended December 31, 2006 are summarized below:

- Our financial statement closing process and the transformation of our statutory financial statements into U.S. GAAP consolidated financial statements has not reduced to an acceptably low level the risk that material errors may occur and may not be detected on a timely basis by management in the normal course of business; and
- Insufficient accounting resources and expertise in respect of the preparation of consolidated financial statements in accordance with U.S. GAAP.

Notwithstanding the steps we have taken and continue to take that are designed to remediate each material weakness identified above, we may not be successful in remediating these material weaknesses in the near or long term and we may not be able to prevent other material weaknesses in the future. Any failure to maintain or implement required new or improved internal control over financial reporting, or any difficulties we encounter in their implementation, could result in additional significant deficiencies or additional material weaknesses, failure to meet our periodic reporting obligations or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002. Management assessment has been done by WBD as of December 31, 2006, but it has not been audited by our independent registered public accounting firm, as we are subject to exemptions provided by SEC filing #33-8730A of August 9, 2006. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to miss our reporting deadlines and cause investors to lose confidence in our reported financial information, leading to a decline in the price of our ordinary Shares and ADSs. See Item 15T. Controls and procedures for additional information.

*To comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, we have incurred and will continue to incur significant costs and resources, including senior management time, from our operating businesses, which could materially adversely affect our business, results of operations and prospects.*

Section 404 of the Sarbanes-Oxley Act and the SEC's and the PCAOB's regulations thereunder require that our management evaluate the effectiveness of our internal control over financial reporting on an annual basis and disclose any material weaknesses in our internal control over financial reporting. In addition, commencing in our annual report for the fiscal year ended December 31, 2007, to be filed in 2008, our independent registered public accounting firm will be required to audit management's evaluation as well as our internal control over financial reporting. We have already incurred and will continue to incur costs and resources, including time of senior management, to design, maintain and evaluate internal control over financial reporting under these rules. Senior management time will necessarily be diverted

from running our business. These costs are especially high for us primarily due to the diversity and geographic location of our businesses. For these reasons, the costs involved in attempting to achieve Section 404 compliance could have a material adverse effect on our business, financial condition, results of operation and prospects.

We are taking steps to refine our internal control over financial reporting directed to correct the material weaknesses pursuant to Section 404 of the Sarbanes-Oxley Act, and the efficacy of the steps we have taken to date and the steps we are still in the process of completing is subject to continued management review supported by confirmation and testing by management and by our internal auditors, as well as audit committee oversight. As a result, additional changes are continued to be made to our internal control over financial reporting.

We developed a documentation of our statutory and U.S. GAAP financial statements closing process. Currently, we are in the process of improving internal guidelines and strengthening individual procedures and controls over the reporting process. We continue to improve U.S. GAAP capabilities of our professional staff engaged in the financial statements preparation process by hiring accounting personnel who are receiving or have received ACCA-qualification, with experience at other NYSE-listed Russian companies and at Big Four accounting firms. Further, we plan to continue arranging training seminars for our accounting staff, including various U.S. GAAP trainings.

In addition we have a special department established as part of internal control department, devoted to strengthening our systems of internal control over financial reporting in an effort to comply with Section 404 of the Sarbanes-Oxley Act of 2002. As of March 2007, this department was comprised of three employees developing the internal controls methodology and three employees tasked with implementing the procedures as they are developed. The department is based out of our Moscow headquarters, with additional internal controllers at regional subsidiaries.

***Increased competition among juice producers in Russia may adversely affect our results of operations.***

Although juice consumption in Russia continues to increase, our juice product sales volume decreased in 2004 and 2005 due to vigorous market competition from other domestic producers and increased activity by foreign producers. Although our juice sales increased in 2006 by 6.9% compared to 2005, continued and/or increased competition among juice producers in Russia may cause future decline in the sales volumes of our juice products, as well as affect our juice prices and profit margins and, consequently, may materially adversely affect our results of operations.

See Item 4. Information on Our Company B. Business Business Overview Beverage products and brands Market trends and competition for additional information regarding our competitors.

***Consumer preference for low-price juice products and the volatility of certain raw materials required for juice production may cause our profit margins to decline and have a material adverse affect on our results of operations.***

Consumer preference for low-price juice products, primarily in the regions outside of Moscow and St. Petersburg where per capita household incomes are generally lower, put pressure on juice prices in 2004, 2005 and 2006. In addition, raw materials required for juice production, such as juice concentrate and sugar, are international commodities and are subject to international price fluctuations, and we have experienced significant increases in the cost of these commodities in 2005 and 2006. The prices for sugar and juice concentrate, especially orange, have increased significantly and we expect them to continue to increase for the foreseeable future. A continuation of these trends may cause a decline in our juice product profit margins and, consequently, materially adversely affect our results of operations.

***Increasing tariffs and restructuring in the transport sector could have a materially adverse effect on our business.***

Railway transportation is one of our principal means of transporting supplies and juice and water products to our facilities and customers. Currently, the Russian government sets rail tariffs and may further increase these tariffs as it did in 2004, 2005 and 2006.

In 2003, legislation was enacted which sets out the framework for the reorganization of the Russian Railways Ministry into OAO Russian Railroads, a joint-stock company, to be followed by the eventual privatization of certain of its functions by 2007. It is currently unclear whether this reorganization and privatization will be completed in accordance with the timetable contemplated in the legislation or at all. If the privatization of Russian Railroads or other factors result in increased railway transport costs, thereby decreasing our profit margins, our results of operations could be materially adversely affected.

***Our inability to develop and maintain awareness of new brands, products and product categories could significantly inhibit our future growth and profitability.***

Our business strategy contemplates our entry into new product categories, development of new products and marketing new brands in existing product lines. This strategy is designed to increase our market share and revenues by increasing consumer demand in our existing markets and entering into new market segments. The success of this strategy depends, in part, on our ability to anticipate the tastes and dietary habits of consumers and to introduce and offer products that appeal to their preferences. Our failure to anticipate, identify or react to changes in consumer preferences and consequent failure to successfully develop new brands, products and product categories could negatively affect our expansion strategy and could significantly inhibit our future growth and profitability.

In addition, developing and maintaining brand awareness of our brands in a cost effective manner is critical to informing and educating the public about our current and future product offerings and is an important element in attracting new consumers. Successful promotion of our brands will depend largely on the effectiveness of our marketing efforts and on our ability to provide reliable and useful products and services at competitive prices. Brand promotion activities may not yield increased operating revenues, and even if they do, such operating revenues may not offset the operating expenses we incur in building our brands. Furthermore, our ability to attract new consumers and retain existing consumers depends, in part, on our ability to maintain what we believe to be our favorable brand image. Our failure to successfully and efficiently promote and maintain our brands may limit our ability to attract new consumers and retain our existing consumers and materially adversely affect our business, financial condition, results of operations and prospects.

***If we do not continue to be an efficient producer in a highly competitive environment, particularly in relation to purchases of our packaging and raw materials, or an effective advertiser in a highly inflationary media environment, our results of operations will suffer.***

Our success depends, in part, on our continued ability to be an efficient producer in a highly competitive industry. If we cannot continue to control costs through productivity gains or by eliminating redundant costs resulting from acquisitions, our results of operations will suffer. In particular, price increases and shortages of packaging and raw materials could have a material adverse effect on our results of operations. For example, our results of operations may be affected by the availability and pricing of packaging materials, principally cardboard and plastic containers, and raw materials, principally raw milk and juice concentrate. We are substantially dependent upon one supplier of packaging materials, Tetra Pak, which may make us more vulnerable to changes in global supply and demand and their effect on price and availability of these materials. Additionally, weather conditions and other factors beyond our control significantly influence the price and availability of our raw materials. A number of our raw materials, such as juice concentrate and sugar, are international commodities and are subject to international price

fluctuations, and we experienced significant increases in raw milk, sugar and concentrate prices during 2004, 2005 and 2006.

Our success also depends on our continued ability to be an effective advertiser in a market where media inflation on leading national television channels exceeded 30% in 2006. A substantial increase in the prices of any of the foregoing, which we may not be able to pass on to customers through price increases, or a protracted interruption in supply with respect to packaging or raw materials, could have a material adverse effect on our financial condition and results of operations. See Item 4. Information on Our Company B. Business Business Overview.

***We may be unable to continue to add products and greater production capacity in faster growing and more profitable categories.***

The food industry's growth potential is constrained by population growth and growth in personal income. Our success depends, in part, on our ability to expand our business faster than populations are growing in the markets that we serve, or notwithstanding declines in the populations in those markets. One way to achieve that growth is to enhance our portfolio by adding products and greater production capacity in faster growing and more profitable categories. In the past, we have experienced delays in the installation of new production equipment due to internal technical integration issues as well as delays by vendors and other third-party suppliers in installing and testing new production lines. Future delays in new equipment installation could inhibit our ability to add products and expand our production capacity, cause our output volume to suffer and, consequently, have a material adverse effect on our results of operations.

***Our inability to address the seasonal difference between the demand for dairy products and the supply of raw milk and the increasing prices of raw milk could result in a significant increase in our production costs, reducing our profitability.***

The demand for our dairy products is significantly higher during the winter months, when Russian raw milk production is at its lowest. Conversely, during the summer months we generally experience depressed demand for dairy products in many markets, while raw milk production is at its peak. If we are unable to mitigate this inverse relationship successfully, either through the purchase of raw milk during the winter at commercially competitive prices or through the use of powder milk, our production costs will increase significantly in the winter, reducing our profitability.

In addition, the average weighted raw milk purchase price increased for us in ruble terms by approximately 17% in 2004, 14% in 2005 and 7% in 2006. The price increases are due, in part, to the raw milk shortages caused by the ongoing decline of dairy cattle in Russia. These increases adversely affected our dairy product profit margins in 2004, 2005 and 2006, and continued increases in raw milk prices could further reduce our profitability. The shortage of high quality raw milk, coupled with the raw milk price increases, may also limit our ability to expand our production of high margin value-added dairy products. See Item 5. Operating and Financial Review and Prospects D. Trend Information for additional information.

***In the event that the Moscow City Government were to reduce significantly the prices or the amount of products it purchases from our baby food business, then our revenues and profits from this business could be reduced.***

In 2005 and 2006, baby food purchased from us by the Moscow City Government comprised approximately 36% and 33% respectively of the total sales revenue of our baby food segment. We supply these products to the Moscow City Government pursuant to a tender held on a yearly basis. In the event that we were to lose a tender, or the Moscow City Government was to reduce significantly the prices or the amount of products it purchases from our baby food business, and we were unable to find alternative purchasers, then our revenues and profits from this business could be reduced, which could have a material

adverse effect on our financial condition and results of operations. We discuss the sale and distribution of products produced at the Moscow Baby Food Plant in B. Business Business Overview.

***Our substantial reliance on independent retailers and independent distributors for the distribution of our products could lower our turnover and reduce our competitiveness.***

We sell our products either directly to retailers, including supermarkets, grocery shops and restaurants, or to independent distributors for resale to retail outlets. We expect sales to retailers and independent distributors to continue to represent a significant portion of our revenues. Our operations and distribution costs could be affected by the increasing consolidation of these entities, particularly as these customers become more sophisticated and attempt to force lower pricing and increased promotional programs. For example, in the spring of 2001, several Russian supermarket chains formed a loose alliance which publicly announced its intention not to purchase our products. Although these supermarket chains now purchase our products, they may not continue to do so, and they or other supermarket chains may attempt a similar consolidation of market power in the future. In addition, two of Russia's largest supermarket chains, Perekryostok and Pyatyorochka, merged in April 2006, which further strengthens the negotiating leverage in their dealings with us. Although we have not yet experienced any material adverse effect as a result of this merger, we cannot guarantee that we will not experience adverse consequences in the future. A number of large Western retailers, such as Turkish retailer Ramenka, German retailer Metro and French retailer Auchan, have also opened stores in our markets, which will put further pressure on prices.

We also compete with other brands for shelf space in retail stores, whilst marketing focus by our independent distributors and retailers is also split between a number of producers. Our independent distributors and retailers also offer other products, including their own brands, that compete directly with our products. In addition, retailers in Russia typically charge food and beverage producers, including us and our competitors, for shelf space. If independent distributors and retailers give higher priority to other brands, purchase less of, or even refuse to buy, our products, seek substantial discounts, charge unreasonable prices for shelf space, fail to offer sufficient shelf space, or devote inadequate promotional support to our brands, it could lower our turnover and reduce our competitiveness and profitability.

***Independent distributors may export our products to countries where such products do not meet the requirements of applicable legislation.***

In exporting our products, we attempt to meet the standards and requirements of applicable legislation governing the import of food products into the importing country. However, we do not have control over independent distributors, who have, in some cases, attempted to export our products to countries where such products did not meet the requirements of applicable legislation. Any consequent recalls of our products and the associated negative publicity may adversely affect our reputation and materially adversely affect our results of operations.

***We do not carry the types of insurance coverage customary in more economically developed countries for a business of our size and nature, and a significant event could result in substantial property loss and inability to rebuild in a timely manner or at all.***

We maintain insurance against some, but not all, potential risks and losses affecting our operations. We cannot provide assurance that our insurance will be adequate to cover all of our losses or liabilities. We also can provide no assurance that insurance will continue to be available to us on commercially reasonable terms. In the event that a significant event were to affect one of our facilities, we could experience substantial property loss and significant disruptions in production, for which we would not be compensated. Additionally, depending on the severity of the property damage, we may not be able to rebuild damaged property in a timely manner or at all. We do not maintain separate funds or otherwise set



aside reserves for these types of events. Any such loss or third party claim for damages may have a material adverse effect on our business, results of operations and financial condition.

We are also exposed to product liability claims in the event that consumption of our products results in illness, injury or death, and we cannot assure you that we will not experience any material product liability losses in the future. Although we maintain insurance coverage for product liability, such coverage may be insufficient in the event of a claim. Moreover, certain of our smaller production facilities are currently not covered by product liability insurance. In addition, if any of the products we have produced are determined to be unsuitable for consumption, we may be required to participate in a recall involving such products.

Additionally, although we have made and will continue to make capital and other expenditures to comply with environmental requirements, in 2005 and 2006 we did not incur material capital expenditures for environmental controls. For a more detailed discussion of our insurance coverage see Item 4. Information on Our Company B. Business Overview Insurance.

***If transactions of members of our group of companies and their predecessors-in-interest were to be challenged on the basis of non-compliance with applicable legal requirements, the remedies in the event of any successful challenge could include the invalidation of such transactions or the imposition of other liabilities on such group members.***

Members of our group, or their predecessors-in-interest at different times, took a variety of actions relating to share issuances, share disposals and acquisitions, mandatory buy-out offers, valuation of property, interested party transactions, major transactions, meetings of the group members governing bodies, other corporate matters and anti-monopoly issues that, if successfully challenged on the basis of non-compliance with applicable legal requirements by competent state authorities, counterparties in such transactions or shareholders of the relevant group members or their predecessors-in-interest, could result in the invalidation of such transactions and our corporate decisions, restrictions on voting control or the imposition of other liabilities. Because applicable provisions of Russian law are subject to many different interpretations, we may not be able to defend successfully any challenge brought against such transactions, and the invalidation of any such transactions or imposition of any such liability may, individually or in the aggregate, have a material adverse effect on our business, financial condition and results of operations.

***Our management information system may be inadequate to support our future growth.***

Our management information system is less developed in certain respects than those of food producers in more developed markets and may not provide our management with as much or as accurate information as those in more developed markets. In addition, we may encounter difficulties in the ongoing process of implementing and enhancing our management information system. Our inability to maintain an adequate management information system may have a material adverse effect on our business.

***Our competitive position and future prospects depend on our senior managers and other key personnel.***

Our ability to maintain our competitive position and to implement our business strategy is dependent to a large degree on the services of our senior management team and other key personnel. Moreover, competition in Russia for personnel with relevant expertise is intense due to the small number of qualified individuals and, as a result, we attempt to structure our compensation packages in a manner consistent with the evolving standards of the Russian labor market. We are not insured against the detrimental effects to our business resulting from the loss or dismissal of our key personnel. The loss or decline in the services of members of our senior management team or an inability to attract, retain and motivate qualified key personnel could have a material adverse effect on our business, financial condition and results of operations.

*We may not be able to protect our intellectual property rights adequately, resulting in material harm to our financial results and ability to develop our business.*

Given the importance of brand recognition to our business, we have invested considerable effort in protecting our portfolio of intellectual property rights, including trademark registration. However, the steps we have taken may not be sufficient and third parties may infringe or misappropriate our proprietary rights. Moreover, Russia and the other countries of the CIS in which we operate generally offer less intellectual property protection than in Western Europe or North America. If we are unable to protect our proprietary rights against infringement or misappropriation, it could materially harm our future financial results and our ability to develop our business. See Item 4. Information on Our Company B. Business Overview Current Operations Trademarks and Patents.

*Failure of several of our brand names and images, for which trademarks are currently being sought, to be awarded trademark protection could negatively affect our marketing plans, resulting in increased advertising expenses and a material adverse effect on our financial results.*

As of December 31, 2006, we had 81 pending trademark applications in Russia and 18 pending trademark applications abroad. We are also in the process of contesting the rejection for registration of a number of our trademarks in countries outside of Russia. If our pending applications are not granted trademark status, we will have limited ability to defend these brand names or images from use by others, significantly reducing the value of any advertising using these brand names or images. This will negatively affect our marketing plans for the products that utilize these brand names or images, and may require us to develop a different marketing approach for these products, resulting in increased advertising expenses and adversely affecting our financial results. See Item 4. Information on Our Company B. Business Overview Current Operations Trademarks and Patents.

*If we are unable to obtain adequate funding, we may have to limit our operations substantially, which could have a material adverse effect on our business, prospects and results of operations.*

We continue to make significant capital expenditures, particularly in connection with the expansion of our existing operations, upgrades of existing facilities, enhancing our infrastructure, including building new warehouses and acquisitions of new companies. For the fulfillment of our capital spending plans, excluding expenditures for acquisitions, we spent approximately \$72.6 million in 2004, \$75.1 million in 2005 and \$130.0 million in 2006. We spent approximately \$5.3 million in 2004, \$24.3 million in 2005 and \$137.3 million in 2006 for acquisitions. However, we may not be able to meet our planned capital spending needs in the future in the event of the following potential developments:

- a lack of external financing sources;
- changes in the terms of existing financing arrangements;
- slower than anticipated growth in demand for our products;
- slower than anticipated revenue growth;
- regulatory developments; or
- a deterioration in the Russian economy.

To meet our financing requirements, we may need to attract additional equity or debt financing. Russian companies are limited in their ability to issue shares in the form of ADSs or other depository receipts due to Russian securities regulations, which, until 2005, generally provided that no more than 40% of a Russian company's shares may be circulated abroad through depository receipt programs. This limitation was subsequently decreased to 35%. Our ADS and GDS programs together account for 40% of our outstanding shares (this amount was approved by the Russian securities regulator based on the prior

limit and is not required to be reduced to 35%). As a result, we are currently unable to raise additional equity financing through the issuance of depositary receipts. The Russian government or its agencies may also impose other restrictions on international securities offerings by Russian issuers. Any of the foregoing factors may limit the amount of capital available to meet our operating requirements. If we cannot obtain adequate funds to satisfy our capital requirements, we may need to limit our operations significantly, which could have a material adverse effect on our business, results of operations and prospects.

***We are controlled by a group of shareholders whose interests could conflict with those of the holders of our securities.***

As of June 5, 2007 to our knowledge, approximately 47.58% of our outstanding common stock was owned by our founding shareholders. This group has acted in concert since our establishment and, since 1997, pursuant to a Partnership and Cooperation Agreement, amended and restated January 16, 2002, which requires the parties to vote the same way. This group continues and will continue to be bound by this agreement to vote as a block until any member of the group elects to withdraw from the agreement. This agreement gives them control over us and the ability to elect a majority of the directors, appoint management and approve certain actions requiring the approval of a majority of our shareholders.

If not otherwise required by law, resolutions at a shareholders' meeting will be adopted by a simple majority in a meeting at which shareholders holding more than half of the issued share capital are present or represented. Accordingly, as long as the group continues to hold, directly or indirectly, the majority of our shares and act in concert pursuant to the Partnership and Cooperation Agreement, they will have the power to control the outcome of most matters to be decided by vote at a shareholders' meeting and the appointment of the majority of directors and removal of directors. The group will also be able to control or significantly influence the outcome of any vote on, among other things, any proposed amendment to our charter, reorganization proposal, proposed substantial sale of assets or other major corporate transactions. Thus, the group can take actions that may conflict with the interest of holders of our ADSs.

Members of our controlling group of shareholders also have interests in other companies, some of which conduct business with us. We are not aware of any related party transactions that are being carried out on preferential terms, but cannot exclude the possibility of related party transactions that may potentially result in the conclusion of transactions on terms less favorable than could be obtained in arm's length transactions.

According to its latest public statements and 13D filing, Groupe Danone, together with its subsidiaries, holds a 13.7% stake in Wimm-Bill-Dann Foods OJSC, which allowed Groupe Danone to nominate its candidate Jacques Vincent, Vice-President, authorized CEO, to our board of directors. The election of a director nominated by Groupe Danone may present a conflict of interest between Wimm-Bill-Dann Foods OJSC and Groupe Danone, which is one of our main competitors. All the nominees will be voted on by our shareholders at the General Meeting of Shareholders scheduled for the end of June. Groupe Danone has never had a representative on our board, although its stake enables it to secure one seat.

***Recently adopted changes in Russian law will limit the amount of advertising time permitted on television, which could increase our advertising expenses and have a material adverse effect on our sales and results of operations.***

The new Federal Law on Advertising which came into force on July 1, 2006, limits the amount of time that a broadcaster may devote to advertising to 15% of total broadcasting time per day and 20% in any given hour. From January 1, 2008, advertising will be further limited to no more than 15% in any given hour of broadcasting time.

As a result of this new law, the amount of available advertising time will decrease. In turn, the reduction in available advertising time is likely to lead to increased costs to advertisers for purchasing

advertising time due to an increased demand for available time slots and a drive by media outlets to recover their losses from the decreased volume of advertising time they are permitted to sell. We expect the greatest price increases to affect television advertising, particularly during primetime.

The new law also imposes certain restrictions on advertising that may require us to adjust some of our advertising campaigns. We are among the Russia's top advertisers. According to Gallup, we were the third largest advertiser in 2004, the ninth largest advertiser in 2005 and the twelfth largest advertiser in 2006. In 2005 and 2006, over 50% of our advertising expenditures related to television advertisements. At the same time, media inflation in Russia has been significant in recent years, exceeding 34% in 2004, 28% in 2005 and 35% in 2006. Our advertising and marketing expenses increased in 2006 by 31.5% or \$18.3 million in absolute terms, and increased by 0.2% as a percentage of sales to 4.3% in 2006 from 4.1% in 2005. The increase in expenses was due to our continued investments into major brand promotions, media inflation on Russia's leading national television channels and general increases in marketing costs. Despite this media inflation, we were able to obtain volume discounts and endeavored to manage the cost increases more effectively. Imposition of the new law, coupled with overall media inflation in Russia, is likely to increase our advertising expenses. The increased cost of advertising, along with the decreased availability of advertising time slots, may also lead to a decrease in our television advertising which, consequently, may have a material adverse effect on our sales and results of operations.

***One or more of our subsidiaries could be forced into liquidation on the basis of formal non-compliance with certain requirements of Russian law, which could materially adversely affect our business, financial condition, results of operations and prospects.***

Certain provisions of Russian law may allow a court to order liquidation of a Russian legal entity on the basis of its formal non-compliance with certain requirements during formation, reorganization or during its operation. There have been cases in the past in which formal deficiencies in the establishment process of a Russian legal entity or non-compliance with provisions of Russian law have been used by Russian courts as a basis for liquidation of a legal entity. For example, in Russian corporate law, negative net assets calculated on the basis of Russian accounting standards as at the end of the second or any subsequent year of a company's operation, can serve as a basis for a court to order the liquidation of the company, upon a claim by governmental authorities. Many Russian companies have negative net assets due to very low historical asset values reflected on their Russian accounting standards balance sheets; however, their solvency, *i.e.*, their ability to pay debts as they come due, is not otherwise adversely affected by such negative net assets.

Fourteen of our subsidiaries have negative net assets. These subsidiaries, taken together, are material to our operations. We believe that, as long as these subsidiaries continue to fulfill their obligations, the risk of their liquidation is minimal. However, we have taken and continue to take certain steps to remedy this situation and reduce the number of subsidiaries with negative net assets. We are also in the process of integrating the newly acquired businesses and restructuring our subsidiaries, which we expect will reduce the number of subsidiaries with negative net assets. While we understand that a Moscow court liquidated a company with negative net assets in 2002, we are not aware of any situation where a Russian company has been liquidated pursuant to this legislation if it has met all of its obligations, as each of these subsidiaries has. Therefore, we believe that this risk is remote and have not included it as a contingency in the notes to our financial statements which appear elsewhere in this document. However, weaknesses in the Russian legal system create an uncertain legal environment, which makes the decisions of a Russian court or a governmental authority difficult, if not impossible, to predict. If involuntary liquidation were to occur, then we may be forced to reorganize the operations we currently conduct through the affected subsidiaries. Any such liquidation could lead to additional costs, which could materially adversely affect our business, financial condition, results of operations and prospects.

***In the event that deficiencies or ambiguities in privatization legislation are successfully exploited to challenge our ownership in our privatized subsidiaries and we are unable to defeat these challenges, we risk losing our ownership interest in the subsidiaries or their assets, which could materially adversely affect our business, financial condition, results of operations and prospects.***

Our business includes a number of privatized companies in Russia and other countries of the former Soviet Union, and our acquisition strategy will likely involve the acquisition of additional privatized companies. To the extent that privatization legislation is vague, inconsistent or in conflict with other legislation, including conflicts between federal and local privatization legislation, many privatizations are vulnerable to challenge, including selective challenges. For instance, a series of presidential decrees issued in 1991 and 1992 that granted to the Moscow City Government the right to adopt its own privatization procedures were subsequently held to be invalid by the Constitutional Court of the Russian Federation, which ruled, in part, that the presidential decrees addressed issues that were the subject of federal law. While this court ruling, in theory, did not require any implementing actions, the presidential decrees were not officially annulled by another presidential decree until 2000. In the event that any title to, or our ownership stakes in, the privatized companies acquired by us, are subject to challenge as having been improperly privatized and we are unable to defeat this claim, we risk losing our ownership interest in the company or its assets, which could materially affect our business and results of operations. In particular, as we own a substantial number of our other subsidiaries through Wimm-Bill-Dann, (formerly Lianozovsky Dairy plant) and as Wimm-Bill-Dann constitutes the majority of our production capacity, its loss would materially adversely affect our prospects, business and results of operations.

In addition, under Russian law, transactions in shares may be invalidated on many grounds, including a sale of shares by a person without the right to dispose of such shares, breach of interested party and/or major transactions rules and failure to register the share transfer in the securities register. As a result, defects in earlier transactions in shares of our subsidiaries (where such shares were acquired from third parties) may cause our title to such shares to be subject to challenge. Additionally, of the 98.02% of the Lianozovsky Dairy Plant and 98.91% of the Tsaritsino Dairy Plant which we owned, 15% of each were acquired in separate investment tenders held by the Department of State and Municipal Property of the Moscow City Government. Under the legislation governing such tenders, a tender is not valid unless at least two participants submit bids. In the investment tenders for the Lianozovsky Dairy Plant and the Tsaritsino Dairy Plant, the only two participants were entities which were under common control, an arguable violation of this requirement. In the event that the Russian government authorities were successfully to maintain that these tenders were not duly held since the participants were under common control, we could lose 15% of our stakes in the Lianozovsky Dairy Plant and the Tsaritsino Dairy Plant, materially adversely affecting our results of operations.

***Possible implementation of new federal or local government policies, or selective application of existing policies, affecting the food industry could substantially and negatively affect our turnover and operating margin.***

Possible implementation of new federal or local government policies, or selective application of existing policies, affecting the food industry could have a significant impact on our business. For example, the federal and local governments have been known to implement trade barriers, subsidies and other policies favoring certain producers. Additionally, customs regulations in Russia are unclear, subject to frequent change and are applied inconsistently. The imposition of higher customs duties on products we import would increase the costs of our products and reduce our profits, while the implementation of price controls on products we produce would reduce our operating margin. For example, federal customs regulations enacted during 2001 subject juice concentrate imports to the highest level of customs duties allowed for that particular category of imports. In addition, federal customs regulations enacted during 2002 stipulate minimum declaration amounts for imported goods. As a result of such regulations, we may

be forced to declare a higher value for imported goods than the amount actually paid and, consequently, pay a higher tariff on such goods.

Another example of a government regulation that has affected us is Government Regulation No. 988, which requires food producers intending to develop and offer a new food product to the public to file an application for the product's state registration and incorporation into the State Register of Permitted Food Products. Failure to comply with Regulation No. 988 could cause delays in introducing new food and beverage products to the public, as well as the disallowance of certain tax benefits otherwise available to producers of certain food products, such as baby food. The implementation of this regulation in June 2004 has caused delays in our introduction of certain new products and has increased production costs. We may continue to experience similar delays and increased costs in connection with Regulation No. 988 in the future.

In addition, the new Sanitary Rules on Children's Food Products, which became effective on June 1, 2005, disallow certain tax benefits we formerly enjoyed in relation to some of our baby food products.

We are also subject to regional legislation and regulations. For example, in February 2007, the Moscow government enacted regulations on the voluntary labeling of foods containing genetically modified organisms, or GMO. While GMO labeling is not obligatory, it may be treated as such by the regional authorities in Moscow. In this case, we will be required to label our products as not genetically modified and incur additional expenses in relation to this requirement.

***Increased domestic production by our foreign competitors could reduce our competitive advantages against them, which would have a material adverse effect on our market share and results of operations.***

A number of our foreign competitors, such as Danone, Parmalat, Lactalis, Campina, Ehrmann, Onken and Pascuale, have been investing and continue to invest in domestic production facilities, while others, such as Coca-Cola, have acquired domestic producers. These investments and acquisitions reduce the competitive advantages that we have over foreign competitors without domestic production capability. A continuation of this trend may result in increased competition for qualified personnel and higher labor costs, and would have a material adverse effect on our business and results of operations. See Item 4. Information on Our Company B. Business Overview for a further description of the recent investments by some of our foreign competitors in Russian production facilities.

***If the Federal Antimonopoly Service were to conclude that we acquired or created a new company in contravention of antimonopoly legislation, it could impose administrative sanctions and require the unwinding of such transactions, which could have a material adverse effect on our business and results of operations.***

Our business has grown substantially through the acquisition and founding of companies, many of which required the prior approval or subsequent notification of the Federal Antimonopoly Service or its predecessor agencies. In part, relevant legislation restricts the acquisition or founding of companies by groups of companies or individuals acting in concert without this approval or notification. While we believe that we have complied with the applicable legislation for our acquisitions and founding of new companies, this legislation is sometimes vague and subject to varying interpretations. Additionally, although the common ownership by our shareholders of a number of companies which are now our subsidiaries was generally made known to the Federal Antimonopoly Service and its predecessors, the existence of the shareholders agreement among our current shareholders was not disclosed. If the Federal Antimonopoly Service were to conclude that an acquisition or creation of a new company was done in contravention of applicable legislation, it could impose administrative sanctions and require the divestiture of this company or other assets, which could have a material adverse effect on our business and results of operations.

*Further restrictions on our business which is categorized as a monopoly, or the extension of monopoly status to our other businesses, could result in the regulation of our prices and restriction of our commercial activities, materially adversely affecting our results of operations.*

Under Russian legislation, the Federal Antimonopoly Service may categorize a company as a dominant force in a market. Our baby food business is categorized as a monopoly in Moscow and the Moscow region, placing restrictions on our ability to increase our profit margins for that business. Any ruling that any of our other businesses are a monopoly could result in the regulation of our prices and restrictions on our commercial activities. The imposition of government-determined prices could, in turn, result in competitive disadvantages and a significant decline in revenues. Additionally, restrictions on expansion or government-mandated withdrawal from regions or markets would adversely affect our plans for expansion and could reduce our market share.

*In the event that our minority shareholders or minority shareholders of our subsidiaries were to challenge successfully past or future interested party transactions, or do not approve interested party transactions or other matters in the future, the invalidation of such transactions or failure to approve such matters could have a material adverse effect on our business, financial condition, results of operations or prospects or the value of the shares and ADSs.*

We own less than 100% of the equity interests in some of our subsidiaries. In addition, certain of our wholly owned subsidiaries have had other shareholders in the past. We and our subsidiaries in the past have carried out, and continue to carry out, transactions which may be considered to be interested party transactions under Russian law, requiring approval by disinterested directors, disinterested independent directors or disinterested shareholders depending on the nature of the transaction and parties involved. See Item 10. Additional Information B. Charter and Certain Requirements of Russian Legislation Interested Party Transactions. The provisions of Russian law defining which transactions must be approved as interested party transactions are subject to different interpretations. We cannot assure you that our and our subsidiaries applications of these concepts will not be subject to challenge by former and current shareholders. Any such challenges, if successful, could result in the invalidation of transactions, which could have a material adverse effect on our business, financial condition, results of operations or prospects and the value of the shares and ADSs.

In addition, Russian law requires a three-quarters majority vote of the holders of voting stock present at a shareholders meeting to approve certain transactions and other matters, including, for example, charter amendments, major transactions involving assets in excess of 50% of the assets of the company, repurchase by the company of shares and certain share issuances. In some cases, minority shareholders may not approve interested party transactions requiring their approval or other matters requiring approval of minority shareholders or supermajority approval. In the event that these minority shareholders were to challenge successfully past interested party transactions, or do not approve interested party transactions or other matters in the future, we could be limited in our operational flexibility and our business, financial condition, results of operations or prospects could be materially adversely affected.

Over the past several years, we have sought and continue to seek to acquire minority stakes in our subsidiaries with the aim of acquiring 100% interests in each of our key subsidiaries. For example, in January 2006, we acquired 20% of Moscow Baby Food Plant OJSC, a subsidiary, from minority shareholders for cash consideration of \$7.0 million increasing our beneficial ownership to 97.34%. In January 2005, we acquired a 10% stake in our subsidiary Siberian Dairy Plant from minority shareholders for a cash consideration of \$1.1 million increasing our beneficial ownership to 87.1%. In March and April 2004, we acquired a total of an additional 6.2% of our subsidiary Tsaritsino Dairy Plant from our minority shareholders for a cash consideration of \$3.4 million increasing our beneficial ownership to 97.6%. In addition, we acquired a 47.7% interest in our subsidiary Ufa Dairy Plant in September 2003

from minority shareholders for a cash consideration of \$3.1 million increasing our beneficial ownership to 96.5%.

We are in the process of consolidating our businesses and merging certain subsidiaries into Wimm-Bill-Dann (formerly Moscow-based Lianozovsky Dairy Plant). In this context, we are re-organizing our legal entities, which may trigger a legal requirement that we redeem shares on shareholders' demand. According to amendments to the Federal Law on Joint Stock Companies, which came into effect on July 1, 2006, a holder of more than 95% of shares in an open joint stock company has the right to buy out the remaining shares from the minority shareholders for a cash consideration equal to the amount determined by an independent appraiser. The new amendments also require a person purchasing 30%, 50%, 75% or more shares in an open joint stock company to offer to other shareholders of this entity to sell their shares at a price not less than the acquisition price of the respective stake. Pursuant to this requirement, in 2007 we bought a 4.66% stake in Ochakovo Dairy Plant for a cash consideration of \$3.2 million and 0.60% of ordinary shares and 1.16% of preferred shares in Nazarovo Dairy Plant for a cash consideration of approximately \$0.1 million for both stakes. While no additional demands have been made for us to buy out minority shareholders, we may face additional buy-out demands in the future.

### **Risks Relating to Our Financial Condition**

#### ***Inflation could increase our costs and decrease our operating margins.***

The Russian economy has been characterized by high rates of inflation. As we tend to experience inflation-driven increases in certain of our costs, including salaries and rents, which are sensitive to rises in the general price level in Russia, our costs in U.S. dollar terms will rise. In this situation, due to competitive pressures, we may not be able to raise the prices we charge for our products and services sufficiently to preserve operating margins. Accordingly, high rates of inflation in Russia could increase our costs and decrease our operating margins.

#### ***Servicing and refinancing our indebtedness will require a significant amount of cash. Our ability to generate cash or obtain financing depends on many factors beyond our control.***

We have a substantial amount of outstanding indebtedness, primarily consisting of the liabilities we have in connection with our \$150 million loan participation notes due 2008 and our second \$150 million loan participation notes due 2008, our ruble bonds, bank loans and obligations under equipment financing. As of December 31, 2006 our consolidated total debt was approximately \$443.0 million, of which \$61.7 million was secured by equipment or inventory.

Among other things, increased levels of indebtedness, and particularly increases in the level of secured indebtedness, could potentially: (1) limit our ability to obtain additional financing; (2) limit our flexibility in planning for, or reacting to, changes in the markets in which we compete; (3) place us at a competitive disadvantage relative to our competitors with superior financial resources; (4) lead to a partial or complete loss of control over our key subsidiaries or properties; (5) render us more vulnerable to general adverse economic and industry conditions, (6) require us to dedicate all or a substantial part of our cash flow to service our debt; and (7) limit or eliminate our ability to pay dividends.

Our ability to make payments on and to refinance our indebtedness, and to fund planned capital expenditures and research and development efforts, will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. If we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments, we may default under the terms of our indebtedness, thereby allowing the holders of our indebtedness to accelerate the maturity of such indebtedness, and potentially causing cross-defaults under and acceleration of our other indebtedness.



We may not be able to generate sufficient cash flow or access international capital markets or incur additional indebtedness to enable us to service or repay our indebtedness or to fund our other liquidity needs. We may need to refinance all or a portion of our indebtedness, including our two \$150 million loan participation notes due 2008 on or before maturity, sell assets, reduce or delay capital expenditures or seek additional capital. Refinancing or additional financing may not be available on commercially reasonable terms, and we may not be able to sell our assets or, if sold, the proceeds therefrom may not be sufficient to meet our debt service obligations. Our inability to generate sufficient cash flow to satisfy our debt service obligations, or to refinance debt on commercially reasonable terms, would have a material adverse effect on our business, financial condition, results of operations and prospects.

***Covenants in our debt agreements restrict our ability to borrow, invest and engage in various activities, which could impair our ability to expand or finance our future operations.***

Our short-term and long-term debt agreements, including the loan agreements relating to our two \$150 million loan participation notes due 2008 contain covenants that impose operating and financial restrictions on us and our subsidiaries. These restrictions significantly limit, and in some cases prohibit, among other things, our and certain of our subsidiaries' ability to incur additional debt, provide guarantees, create liens on assets or enter into business combinations. Failure to comply with these restrictions would constitute a default under our debt agreements, including the loan agreements relating to our two \$150 million loan participation notes due 2008 and any of our other senior debt containing cross-default provisions could become immediately due and payable, which would materially adversely affect our business, financial conditions and results of operations. In addition, some of our debt agreements contain provisions which permit our lenders to require us to repay our debt to them in the event of a deterioration in our financial condition.

***We may not have the ability to raise the funds necessary to finance a prepayment of certain of our outstanding indebtedness in case of a change of control event.***

The terms of the loan agreements relating to our two \$150 million loan participation notes due 2008 as well as some of our other debt agreements require that we prepay the outstanding debt upon the occurrence of certain change of control events. A change of control event will generally be triggered at such time as any person acting alone or together with other persons (excluding several of our major shareholders acting individually or as a group): (i) is or becomes interested, directly or indirectly, in the aggregate of more than 50% of our capital stock with voting power, or (ii) has or acquires the right to appoint or remove a majority of our Board of Directors, or (iii) has or acquires control of a majority of our voting rights, in each case, in circumstances where, solely as a result of any such event as specified by the relevant rating agencies, a rating decline (as further described in the loan agreements relating to our two \$150 million loan participation notes due 2008) would result.

If a change in control occurs, and we are required to prepay our debt, such event could have a material adverse effect on our business, financial condition, results of operations and business prospects. It is also possible that we will not have sufficient funds at the time of the change of control to satisfy such prepayment obligations, or to refinance the debt on commercially reasonable terms.

***Mergers of our subsidiaries may cause their indebtedness to be accelerated, and our inability to effect certain mergers within our group of companies may prevent us from optimizing our tax rate and result in increased taxes.***

As Russian tax regulations do not allow Russian companies to pay taxes on a consolidated basis, *i.e.*, to offset the losses of one subsidiary against the profits of another subsidiary, we are seeking to merge certain companies within each of our segments in an effort to optimize the tax rates applicable to us. Under Russian law, such mergers would be considered a reorganization and the merged subsidiaries would be required to notify their creditors of this reorganization. Russian law also provides that, for a period of

30 days after notice, these creditors would have a right to accelerate the merged subsidiaries' indebtedness and demand reimbursement for applicable losses. In the event that all or part of certain of our subsidiaries' indebtedness is accelerated in connection with the mergers, we and such subsidiaries may not have the ability to raise the funds necessary for repayment and our business and financial condition could be materially adversely affected. In addition, our inability or failure to consummate the mergers may prevent us from optimizing our tax rates and our effective tax rate may increase as our operations continue to expand.

***Devaluation of the ruble and other currencies we trade in against the U.S. dollar could increase our costs and reduce our operating revenues.***

A significant portion of our costs, expenditures and liabilities, including costs of packaging, juice concentrate and certain other raw materials, as well as capital expenditures and borrowings (including our two \$150 million loan participation notes due 2008, are either denominated in, or closely linked to, the U.S. dollar, while substantially all of our operating revenues are denominated in rubles. As a result, the devaluation of the ruble against the U.S. dollar can adversely affect us by increasing our costs in ruble terms. Additionally, if the ruble declines against the U.S. dollar and price increases cannot keep pace, we could have difficulty repaying or refinancing our U.S. dollar-denominated indebtedness, including our notes. The devaluation of the ruble also results in losses in the value of ruble-denominated assets, such as ruble deposits.

The decline in the value of the ruble against the U.S. dollar also reduces the U.S. dollar value of tax savings arising from the depreciation of our property, plant and equipment, since their basis for tax purposes is denominated in rubles at the time of the investment. Increased tax liability would increase total expenses.

***Our cash holdings are exposed to devaluation.***

There are only a limited number of ruble-denominated instruments in which we may invest our excess cash. Any balances maintained in rubles will give rise to losses if the ruble devalues against the U.S. dollar.

Additionally, Russian companies must repatriate 100% of offshore foreign currency earnings to Russia. In 2005, Russian companies were required to convert 10% of those earnings into rubles within seven days of receipt. This conversion requirement was abolished in April 2006.

***Russian currency control regulations could hinder our ability to conduct our business.***

In the past, Russian currency regulations imposed various restrictions on operations involving foreign currencies in an attempt to support the ruble. Effective from January 1, 2007, most of these restrictions have been removed. However, Russian companies currently must repatriate proceeds from export sales. Moreover, the foreign currency market in Russia is still developing and we may experience difficulty in converting rubles into other currencies. A majority of our major capital expenditures and payments to vendors and substantially all of our debt are denominated and payable in various foreign currencies.

Russian legislation currently permits the conversion of rubles into foreign currency. However, the market in Russia for the conversion of rubles into foreign currencies is limited and may not continue to exist. Any delay or other difficulty in converting rubles into a foreign currency to make a payment or delay in or restriction on the transfer of foreign currency could limit our ability to meet our payment and debt obligations, which could result in the loss of suppliers, acceleration of debt obligations and cross-defaults and, consequently, have a material adverse effect on our business, financial condition and results of operations.

*Some of our customers, debtors and suppliers may fail to pay us or to comply with the terms of their agreements with us which could adversely affect our results of operations.*

Russia's inexperience with a market economy relative to more developed economies poses numerous risks that could interfere with our business. For example, the failure to satisfy liabilities is widespread among Russian businesses and the government. Furthermore, it is difficult for us to gauge the creditworthiness of some of our customers, as there are no reliable mechanisms, such as reliable credit reports or credit databases, for evaluating their financial condition. Consequently, we face the risk that some of our customers or other debtors will fail to pay us or fail to comply with the terms of their agreements with us, which could adversely affect our results of operations.

In addition, we are limited in our ability to control the conduct of our raw materials and equipment suppliers, including their adherence to contract delivery terms and their compliance with applicable legislation, such as currency, customs and environmental regulations and laws relating to the use of food additives and genetically modified food products. Failure of our suppliers to adhere to the terms of our contracts with them or the law may negatively affect our reputation and our business.

*If the various initiatives we have used to reduce our tax burden are successfully challenged and/or our ability to recover VAT and take advantage of certain tax benefits are disallowed by the Russian tax authorities, we may face significant losses associated with the assessed amount of tax underpaid and related interest and penalties, which would have a material impact on our financial condition and results of operations.*

We have used various initiatives to reduce our tax burden and several of our tax initiatives have been challenged by the Russian tax authorities. There have also been press reports of instances in which the Russian tax authorities have successfully challenged structures similar to those we have used. If any of our initiatives are successfully challenged by the Russian tax authorities, we would face significant losses associated with the assessed amount of tax underpaid and related interest and penalties. These losses could have a material impact on our financial condition and results of operations.

In addition, during 2006, the tax authorities found some suppliers dealing with certain of our subsidiaries (e.g., Moscow Baby Food Plant OJSC, Trading Company Wimm-Bill-Dann CJSC, Wimm-Bill-Dann OJSC, Ochakovo Dairy Plant OJSC) to be negligent in complying with their tax obligations. Specifically, the tax authorities have claimed, among other things, that these suppliers are, in some cases, not registered as taxpayers, have not provided tax returns and/or not paid their taxes in full or at all. Although our subsidiaries perform extensive due diligence on each of their suppliers, they are not able to scrutinize thoroughly every aspect of each supplier's business, including whether the supplier is in full compliance with respect to its tax duties. As a result of these alleged breaches by certain of our suppliers, the tax authorities have refused to reimburse VAT paid by our subsidiaries in an amount totaling approximately \$1,037,652 for services rendered and goods provided by such suppliers. They also refused to discount profit tax paid by our subsidiaries to such suppliers. We filed a claim in court seeking reimbursement for the VAT paid by our subsidiary Ochakovo Dairy Plant OJSC and have won this case in the court of the first instance. Although the tax authorities have not appealed this decision we can not exclude that they will appeal it in the future. We have also filed three claims in court seeking reimbursement for the VAT paid by our subsidiaries Trading Company Wimm-Bill-Dann CJSC and Ochakovo Dairy Plant OJSC, but the court of first instance has not yet ruled on the case. Although we continue to provide the results of our due diligence of our suppliers to the relevant Russian authorities, we cannot exclude the possibility that some of these suppliers could be recognized as negligent by the tax authorities.

***The elimination of a tax privilege from which we currently benefit and/or a successful challenge by the tax authorities of our use of this tax privilege would materially adversely affect our results of operations.***

Our juice producing subsidiaries have benefited from small enterprise tax legislation. If we had not taken advantage of this benefit in 2003, 2004 and 2005, our tax expenses would have increased by \$3.0 million, \$1.2 million and \$0.3 million, respectively. This tax benefit was eliminated as of January 1, 2002. However, under the amended legislation, our small enterprises that were formed prior to January 1, 2002 were able to continue and did continue to use this benefit for two years from the date on which they were formed, and in the third and fourth years after they were formed, income tax was levied at a rate of 25% and 50% of the income tax rate, respectively. Although none of our subsidiaries currently takes advantage of the small enterprise tax benefits, we cannot guarantee that the tax authorities may not retroactively challenge previous tax benefits enjoyed by our subsidiaries pursuant to small enterprise tax legislation. Such challenges, if successful, could materially adversely affect our results of operations.

Our use of the small enterprise tax exemption has also been subject in the past to challenge by the Russian tax authorities.

In September 2004, our subsidiary, Fruit Rivers, was assessed approximately \$12.5 million (including penalties) by the local tax authorities relating to its use of the small enterprise tax exemption in calculating its profit tax liability during 2001. Fruit Rivers challenged this tax assessment with a higher tax authority, which cancelled the assessment.

While we believe that our subsidiaries have in the past complied with the rules relating to the small enterprise tax exemption, the Russian tax authorities may in the future make additional claims against our subsidiaries challenging their use of this exemption. These claims could be significantly larger than the claim described above, and the resulting losses could have a material adverse effect on our financial condition and results of operations.

***We are only able to conduct banking transactions with a limited number of creditworthy Russian banks, as the Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business, materially adversely affecting our business, financial position and results of operations.***

Russia's banking and other financial systems are not well developed or regulated, and Russian legislation relating to banks and bank accounts is subject to varying interpretations and inconsistent application. The August 1998 financial crisis resulted in the bankruptcy and liquidation of many Russian banks and almost entirely eliminated the developing market for commercial bank loans. Although the Central Bank of Russia has the mandate and authority to suspend banking licenses of insolvent banks, many insolvent banks still operate. Most Russian banks also do not meet international banking standards, and the transparency of the Russian banking sector still lags far behind internationally accepted norms. The weak banking infrastructure in Russia also exposes us to an increased risk of unauthorized transactions or charges on our accounts due to bank error or actions by computer hackers.

The serious deficiencies in the Russian banking sector, combined with the deterioration in the credit profile of the loan portfolios of Russian banks, may result in the banking sector being more susceptible to market downturns or economic slowdowns. In addition, the Central Bank of Russia has recently revoked the licenses of certain Russian banks, which resulted in market rumors about additional bank closures and many depositors withdrawing their savings. If a banking crisis were to occur, Russian companies would be subject to severe liquidity constraints due to the limited supply of domestic funding sources and the withdrawal of foreign funding sources that would occur during such a crisis. In addition, another banking crisis or the bankruptcy or insolvency of the banks from which we receive or with which we hold our funds could result in the loss of our deposits or affect our ability to complete banking transactions in Russia, which could have a material adverse effect on our business, financial conditions and results of operations.

We have also experienced problems with transmitting tax payments through certain Russian banks and, as a result, are experiencing difficulties with the Russian tax authorities. For example, in 2004 and 2005, our subsidiaries Wimm-Bill-Dann Purchaser, Ramenskoe Moloko and Tsaritsino Dairy Plant each received a tax assessment from the Russian tax authorities for tax arrears totaling approximately \$100,000, \$100,000 and \$750,000, respectively. Each of these tax assessments resulted from the failure of the subsidiaries' banks to transfer tax payments to the state budget upon receiving the relevant payment orders. We challenged these assessments and, in each instance, the assessments were declared invalid by Russian Arbitration Courts. Nevertheless, in May 2005, the tax authorities issued a new tax assessment in the amount of \$750,000 against the Tsaritsino Dairy Plant relating to the tax payment that was the subject of their prior \$750,000 assessment. The tax authorities subsequently filed a tax claim in the Moscow Arbitration Court, though they reduced the amount of the claim to \$510,000. The Moscow Arbitration Court ruled in our favor with respect to this claim, a decision which was thereafter upheld on appeal in the Ninth Arbitration Appeals Court, as well as on appeal in the Moscow District Arbitration Court. In addition, in April, May and June 2006 several of our subsidiaries received demands and assessments from the tax authorities in an aggregate amount of \$6,928,531 again for the failure of their banks to transfer tax payments to the state budget upon receiving the relevant payment orders. In response, we have filed claims seeking the invalidation of these tax demands and assessments with the Moscow Arbitration Court, in some cases, and directly with the tax authorities in others. In addition, with respect to ZAO Lianozovsky, a court of third instance upheld a prior decision invalidating the tax authorities' claim that ZAO Lianozovsky was acting in bad faith. In June 2006, Wimm-Bill-Dann received a new assessment from the Russian tax authorities in the amount of approximately \$90,000, which an appeal court has also held as invalid. However, the tax authorities may challenge this decision in a court of third instance. In October 2006, our subsidiary ZAO ProPP filed a claim seeking the invalidation of the tax authorities' demand that ZAO ProPP was acting in bad faith for the failure of its bank to transfer tax payments to the state budget. A court of third instance ruled in our favor with respect to this claim. In May 2007, our subsidiary Grande-V received tax demands in the amount of approximately \$528,300. We have filed a claim with the tax authorities, as well as in court, seeking to recognize these demands as invalid. In April 2007, our subsidiary Podmoskovnoe Moloko received an assessment from the tax authorities for approximately \$2,475 and, as a result, we filed a claim in court seeking to recognize this assessment as invalid. The court of first instance ruled in our favor; however, this decision could be appealed by the tax authorities in a court of second instance. As of May 2007, we have successfully challenged all of the tax authorities' claims, demands and assessments and have only two pending lawsuits in respect of our subsidiaries' failure to transmit tax payments through certain Russian banks (*i.e.*, Podmoskovnoe Moloko and Grande-V). Although the Russian courts, including the appeal courts, have ruled in our favor with respect to the invalidation of the tax authorities' claims and assessments for the failure of our subsidiaries' banks to transfer tax payments, it is likely that the Russian tax authorities will continue to appeal these decisions.

While the Russian Tax Code provides that a taxpayer is deemed to have paid a tax when the corresponding payment order is received by the taxpayer's bank, recent press reports indicate that the Russian tax authorities have been actively and often successfully challenging such payments if the tax payment is not in fact received due to the failure of the bank to transfer such payment. Russian courts often rule in favor of the Russian tax authorities in such cases.

Our management believes that our subsidiaries have complied with their tax payment obligations, and we intend to challenge any further appeals by the tax authorities of the foregoing assessments or any additional similar assessments in court. However, if a court was to rule in the Russian tax authorities' favor, these subsidiaries and/or other of our subsidiaries that have faced similar problems would be liable for the amount of the assessments and potentially for interest and penalties on such amounts, and could potentially be liable for significant additional amounts.

*Vaguely drafted Russian transfer pricing* rules and lack of reliable pricing information may impact our business results of operations.

Russian transfer pricing rules effective since 1999 give Russian tax authorities the right to control prices for transactions between related entities and certain other types of transactions between unrelated parties, such as foreign trade transactions or transactions with significant price fluctuations if the transaction price deviates by more than 20% from the market price. Special transfer pricing rules apply to operations with securities and derivative instruments. The Russian transfer pricing rules are vaguely drafted, and are subject of interpretation by Russian tax authorities and courts. To date, there has been no formal guidance (although some court practice is already available) as to how these rules will be applied. Nonetheless, Russian tax authorities have paid particular attention to transfer pricing rules in their recent audits of Russian companies.

Due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and make adjustments which could affect our tax position. If such tax adjustments become effective, our results of operations could be materially adversely affected. In addition, we could face significant losses associated with the assessed amount of underpaid prior tax and related interest and penalties.

In addition, a number of draft amendments to the transfer pricing law have recently been introduced which, if implemented, would considerably toughen the existing law. The proposed changes, among other things, may shift the burden of proving market prices from the tax authorities to the taxpayer, cancel the existing permitted deviation threshold and introduce specific documentation requirements for proving market prices. Moreover, in the event that a transfer pricing adjustment is assessed by Russian tax authorities, the Russian transfer pricing rules do not provide for an offsetting adjustment to the related counterparty in the transaction that is subject to adjustment.

#### **Risks Relating to our Shares and ADSs and the Trading Market**

*Because the depositary may be considered the beneficial holder of the shares underlying the ADSs, these shares may be arrested or seized in legal proceedings in Russia against the depositary.*

Because Russian law may not recognize ADS holders as beneficial owners of the underlying shares, it is possible that ADS holders could lose all their rights to those shares if the depositary's assets in Russia are seized or arrested. In that case, ADS holders would lose all the money they have invested.

Russian law might treat the depositary as the beneficial owner of the shares underlying the ADSs. This is different from the way other jurisdictions treat ADSs. In the United States, although shares may be held in the depositary's name or to its order, making it a legal owner of the shares, the ADS holders are the beneficial, or real owners. In U.S. courts, an action against the depositary, the legal owner of the shares, would not result in the beneficial owners losing their shares. Russian law may not make the same distinction between legal and beneficial ownership, and it may only recognize the rights of the depositary in whose name the shares are held, not the rights of ADS holders, to the underlying shares.

Thus, in proceedings brought against a depositary, whether or not related to shares underlying ADSs, Russian courts may treat those underlying shares as the assets of the depositary, open to seizure or arrest. In the past, a lawsuit has been filed against a depositary bank, other than our depositary, seeking the seizure of various Russian companies' shares represented by ADSs issued by that depositary. In the event that this type of suit were to be successful in the future, and the shares were to be seized or arrested, the ADS holders involved would lose their rights to the underlying shares.

***Voting rights with respect to the shares represented by our ADSs are limited by the terms of the deposit agreement for the ADSs and relevant requirements of Russian law.***

ADS holders will have no direct voting rights with respect to the shares represented by the ADSs. They will be able to exercise voting rights with respect to the shares represented by ADSs only in accordance with the provisions of the deposit agreement relating to the ADSs and relevant requirements of Russian law. Therefore, there are practical limitations upon the ability of ADS holders to exercise their voting rights due to the additional procedural steps involved in communicating with them. For example, the Federal Law on Joint Stock Companies and our charter require us to notify shareholders no less than 30 days prior to the date of any meeting and at least 50 days prior to the date of an extraordinary meeting to elect our Board of Directors. Our ordinary shareholders will receive notice directly from us and will be able to exercise their voting rights by either attending the meeting in person or voting by power of attorney.

An ADS holder, by comparison, will not receive notice directly from us. Rather, in accordance with the deposit agreement, we will provide the notice to the depository. The depository has undertaken in turn, as soon as practicable thereafter, to mail to the ADS holders the notice of such meeting, voting instruction forms and a statement as to the manner in which instructions may be given by holders. To exercise its voting rights, the ADS holder must then instruct the depository how to vote its shares. Because of this extra procedural step involving the depository, the process for exercising voting rights may take longer for an ADS holder than for holders of shares. ADSs for which the depository does not receive timely voting instructions will not be voted at any meeting.

In addition, although securities regulations expressly permit the depository to split the votes with respect to the shares underlying the ADSs in accordance with instructions from ADS holders, there is little court or regulatory guidance on the application of such regulations, and the depository may choose to refrain from voting at all unless it receives instructions from all ADS holders to vote the shares in the same manner. ADS holders may thus have significant difficulty in exercising voting rights with respect to the shares underlying the ADSs. There can be no assurance that holders and beneficial owners of ADSs will (i) receive notice of shareholder meetings to enable the timely return of voting instructions to the depository, (ii) receive notice to enable the timely cancellation of ADSs in respect of shareholder actions or (iii) be given the benefit of dissenting or minority shareholders' rights in respect of an event or action in which the holder or beneficial owner has voted against, abstained from voting or not given voting instructions.

***The price of our shares and ADSs may be highly volatile.***

The liquidity of a securities market is often a function of the volume of the underlying shares that are publicly held by unrelated parties. Although our ADS holders are entitled to withdraw the equity shares underlying the ADSs from the depository at any time, there is a limited public market for our shares. This, in turn, may affect the liquidity of our ADSs and their trading price. The trading prices of the shares and ADSs may also be subject to wide fluctuations in response to many factors, including:

- variations in our operating results and other food and beverage companies;
- variations in national and industry growth rates;
- actual or anticipated announcements of technical innovations or new products or services by us or our competitors;
- changes in governmental legislation or regulation;
- general economic conditions within our business sector or in Russia; or
- extreme price and volume fluctuations on the Russian stock market.

In addition, no more than 35% of a Russian company's shares may be circulated abroad through depositary receipt programs, such as ADS and GDSs. Our ADS and GDS programs, however, together account for 40% of our outstanding shares (this amount was approved by the Russian securities regulator based on the prior limit and is not required to be reduced to 35%). As a result, we are currently unable to raise additional equity financing through the issuance of depositary receipts. This restriction may also limit the liquidity of our ADSs and their trading price.

***You may be unable to repatriate your earnings from our ADSs.***

We anticipate that any dividends we may pay in the future on the shares represented by the ADSs will be declared and paid to the depositary in rubles and will be converted into U.S. dollars by the depositary and distributed to holders of ADSs, net of the depositary's fees and expenses. The ability to convert rubles into U.S. dollars is subject to the availability of U.S. dollars in Russia's currency markets. Although there is an existing, albeit limited, market within Russia for the conversion of rubles into U.S. dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of Russia and no viable market in which to hedge ruble and ruble-denominated investments.

***ADS holders may not be able to benefit from the United States-Russia income tax treaty.***

Under Russian law, dividends paid to a non-resident holder of shares generally will be subject to Russian withholding tax at a rate of 15% for legal entities and organizations and at a rate of 30% for individuals. Russian tax rules applicable to ADS holders are characterized by significant uncertainties and, until recently, by an absence of interpretive guidance. In 2005 and 2006, the Ministry of Finance of the Russian Federation expressed its opinion in private rulings that holders of global depositary receipts should be treated as the beneficial owners of the dividends paid on underlying shares for the purposes of double tax treaty provisions applicable to taxation of dividend income from the underlying shares, provided that the tax treaty residence of the holders of the global depositary receipts is duly confirmed. However, the Russian tax authorities have not provided official, generally applicable guidance addressing how an ADS holder should demonstrate its beneficial ownership in underlying shares. In the absence of any specific provisions in Russian tax legislation with respect to the concept of beneficial ownership and taxation of income of beneficial owners, it is unclear how the Russian tax authorities will ultimately treat the ADS holders in this regard.

Until the Russian tax authorities clarify whether it is permitted under Russian law to withhold Russian withholding tax in respect of dividends a company pays to the depositary at a lower rate than the domestic rate applicable to such payments (currently 15%), we intend to withhold Russian withholding tax at the domestic rate applicable to such dividends, regardless of whether the Depositary (the legal owner of the shares) or an ADS holder would be entitled to reduced rates of Russian withholding tax under the relevant income tax treaty if it were the beneficial owner of the dividends for purposes of that treaty. Although non-resident ADS holders may apply for a refund of a portion of the amount so withheld by us under the relevant income tax treaty, no assurance can be made that the Russian tax authorities will grant any refunds. See Item 10. Additional Information E. Taxation Russian Income and Withholding Tax Considerations for additional information.

***Capital gains from the sale of ADSs may be subject to Russian income tax.***

Under Russian tax legislation, gains realized by non-resident legal entities or organizations from the disposition of Russian shares and securities, as well as financial instruments derived from such shares, such as the ADSs, may be subject to Russian profits tax or withholding income tax if immovable property located in Russia constitutes more than 50% of our assets. However, no procedural mechanism currently



exists to withhold and remit this tax with respect to sales made to persons other than Russian companies and foreign companies with a registered permanent establishment in Russia. Gains arising from the disposition at foreign stock exchanges of the foregoing types of securities listed on these exchanges by foreign holders who are legal entities or organizations are not subject to taxation in Russia.

Gains arising from the disposition of the foregoing types of securities and derivatives outside of Russia by U.S. holders who are individuals not resident in Russia for tax purposes will not be considered Russian source income and will not be taxable in Russia. Gains arising from disposition of the foregoing types of securities and derivatives in Russia by U.S. holders who are individuals not resident in Russia for tax purposes may be subject to tax either at the source in Russia or based on an annual tax return, which they may be required to submit with the Russian tax authorities.

***Future sales of common stock or ADSs may affect the market price of our common stock and ADSs.***

Sales, or the possibility of sales, of substantial numbers of shares of our common stock or ADSs in the public market, including the Russian stock market, could have an adverse effect on the market trading prices of the ADSs.

***Foreign judgments may not be enforceable against us.***

Our presence outside the United States may limit your legal recourse against us. We are incorporated under the laws of the Russian Federation. Substantially all of our directors and executive officers named in this document reside outside the United States, principally in Russia. All or a substantial portion of our assets and the assets of our officers and directors are located outside the United States. As a result, you may not be able to effect service of process within the United States on us or on our officers and directors. Similarly, you may not be able to obtain or enforce U.S. court judgments against us, our officers and directors, including actions based on the civil liability provisions of the federal securities laws of the United States. In addition, it may be difficult for you to enforce, in original actions brought in courts in jurisdictions outside the United States, liabilities predicated upon U.S. securities laws.

There is no treaty between the United States and the Russian Federation providing for reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters. These limitations may deprive you of effective legal recourse for claims related to your investment in the ADSs. The deposit agreement provides for actions brought by any party thereto against us to be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, provided that any action under the U.S. federal securities laws or the rules or regulations promulgated thereunder may, but need not, be submitted to arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, but it may be difficult to enforce arbitral awards in the Russian Federation due to a number of factors, including the inexperience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors and Russian courts' inability to enforce such orders and corruption.

***The lack of a central and rigorously regulated share registration system in Russia may result in improper record ownership of our shares, including the shares underlying the ADSs.***

Ownership of Russian joint stock company shares (or, if the shares are held through a nominee or custodian, then the holding of such nominee or custodian) is determined by entries in a share register and is evidenced by extracts from that register. Currently, there is no central registration system in Russia. Share registers are maintained by the companies themselves or, if a company has more than 50 shareholders or so elects, by licensed registrars located throughout Russia. Regulations have been issued regarding the licensing conditions for such registrars, as well as the procedures to be followed by

both companies maintaining their own registers and licensed registrars when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced, and registrars generally have relatively low levels of capitalization and inadequate insurance coverage. Moreover, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company's shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence, official and unofficial governmental actions or oversight by registrars incapable of compensating shareholders for their misconduct. This creates risks of loss not normally associated with investments in other securities markets.

In March 2007, the Federal Service for the Financial Markets, or the FSFM, terminated the license of three top managers of our registrar, the Central Moscow Depository. Managers of Russian depositories and registrars are required by law to be licensed by the FSFM, and their failure to do so can result in the depository or registrar's own license being terminated. While the FSFM reversed its decision to terminate the Central Moscow Depository managers' licenses in April 2007, it is possible that the FSFM may take similar action seeking to terminate the managers' or our registrar's licenses in the future.

***Russian thin capitalization rules could affect our ability to deduct interest on certain borrowings.***

Russian thin capitalization rules limit the amount of interest that can be deducted by a Russian company on debt payable to non-resident shareholders. Until January 1, 2006, these rules applied only to loans issued to a Russian company by a foreign company owning directly or indirectly more than 20% of the share capital of the Russian company. However, thin capitalization rules that came into effect on January 1, 2006 extend the rules' application to debt issued to a Russian company by another Russian company that is affiliated with such foreign company, as well as to debt issued to a Russian company which is secured by such foreign company or such affiliated Russian company. It is not yet fully clear how these new rules will be applied in practice by the Russian tax authorities.

**Risks Relating to the Russian Federation**

**Economic Risks**

***The Russian economy is less stable than those of most Western countries and could adversely affect our business and the value of the shares and ADSs.***

Since the dissolution of the Soviet Union in the early 1990s, the Russian economy has experienced at various times:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high government budget deficit and government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to domestic enterprises;
- high levels of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- widespread tax evasion;
- growth of a black and gray market economy;



- pervasive capital flight;
- high levels of corruption and the penetration of organized crime into the economy;
- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the population.

Although Russia has benefited recently from the increase in global commodity prices, providing an increase in disposable income and an increase in consumer spending, the Russian economy has been subject to abrupt downturns in the past. In particular, on August 17, 1998, in the face of a rapidly deteriorating economic situation, the Russian government defaulted on its ruble-denominated securities, the Central Bank of Russia stopped its support of the ruble and a temporary moratorium was imposed on certain foreign currency payments. These actions resulted in an immediate and severe devaluation of the ruble and a sharp increase in the rate of inflation; a substantial decline in the prices of Russian debt and equity securities; and an inability of Russian issuers to raise funds in the international capital markets. These problems were aggravated by a major banking crisis in the Russian banking sector after the events of August 17, 1998, as evidenced by the termination of the banking licenses of a number of major Russian banks. This further impaired the ability of the banking sector to act as a consistent source of liquidity to Russian companies and resulted in the losses of bank deposits in some cases.

Recently, the Russian economy has been showing positive trends, such as the increase in the gross domestic product, a stable ruble, strong domestic demand, rising real wages and a reduced rate of inflation; however, these trends may not continue or may be abruptly reversed.

***The infrastructure in Russia is inadequate, which could disrupt normal business activity.***

The infrastructure in Russia largely dates back to Soviet times and has not been adequately funded and maintained over the past decade. Particularly affected are the rail and road networks, power generation and transmission systems, communication systems and building stock. In May 2005, a fire and explosion in one of the Moscow power substations built in 1963 caused a major power outage in a large section of Moscow and some surrounding regions. The blackout disrupted the ground electric transport, including the metro system, led to road traffic accidents and massive traffic congestion, disrupted electricity and water supply in office and residential buildings and affected mobile communications. The trading on exchanges and the operation of many banks, stores and markets were also halted.

The deterioration of the infrastructure in Russia harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business and can interrupt business operations. The Russian government is actively considering plans to reorganize the nation's rail, electricity and communications systems. Any such reorganization may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems. These factors could have a material adverse effect on our business and results of operations.

***Fluctuations in the global economy could materially adversely affect the Russian economy and the value of the shares and ADSs.***

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and Russian businesses could face severe liquidity constraints, further materially adversely affecting the Russian economy. Additionally, because Russia produces and exports large amounts of oil, the Russian economy is especially vulnerable to the price of oil on the world market and a decline in the price of oil could slow or disrupt the Russian economy or undermine the value of the ruble against foreign currencies. Recent military conflicts and international terrorist activity have also significantly impacted oil and gas prices, and pose additional risks

to the Russian economy. Russia is also a major producer and exporter of metal products and its economy is vulnerable to fluctuations in world commodity prices and the imposition of tariffs and/or antidumping measures by the United States, the European Union or by other principal export markets.

#### **Political and Social Risks**

*Political and governmental instability could materially adversely affect our business, financial condition, results of operations and prospects and the value of the shares and ADSs.*

Since 1991, Russia has sought to transform itself from a one-party state with a centrally-planned economy to a democracy with a market economy. As a result of the sweeping nature of the reforms, and the failure of some of them, the Russian political system remains vulnerable to popular dissatisfaction, including dissatisfaction with the results of privatizations in the 1990s, as well as to demands for autonomy from particular regional and ethnic groups.

Current and future changes in the government, major policy shifts or lack of consensus between various branches of the government and powerful economic groups could disrupt or reverse economic and regulatory reforms. In addition, the Russian presidential elections scheduled for 2008 could bring more volatility to the market. Any disruption or reversal of reform policies could lead to political or governmental instability or the occurrence of conflicts among powerful economic groups, which could have a material adverse effect on our business, financial condition, results of operations and prospects and the value of the shares and ADSs.

*Conflict between central and regional authorities and other conflicts could create an uncertain operating environment, hindering our long-term planning ability.*

The Russian Federation is a federation of 86 sub-federal political units, consisting of republics, territories, regions, cities of federal importance and autonomous regions and districts. The delineation of authority and jurisdiction among the members of the Russian Federation and the federal government is, in many instances, unclear and remains contested. Lack of consensus between the federal government and local or regional authorities often results in the enactment of conflicting legislation at various levels and may lead to further political instability. In particular, conflicting laws have been enacted in the areas of privatization, land legislation and licensing. Some of these laws and governmental and administrative decisions implementing them, as well as certain transactions consummated pursuant to them, have in the past been challenged in the courts, and such challenges may occur in the future. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from effectively and efficiently implementing our business strategy.

Additionally, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict, such as the continuing conflict in Chechnya, which has brought normal economic activity within Chechnya to a halt and disrupted the economies of neighboring regions. Various armed groups in Chechnya have regularly engaged in guerrilla attacks in that area. Violence and attacks relating to this conflict have spread to other parts of Russia, and several terrorist attacks have been carried out by Chechen terrorists in other parts of Russia, including in Moscow. The further intensification of violence, including terrorist attacks and suicide bombings, or its spread to other parts of Russia, could have significant political consequences, including the imposition of a state of emergency in some or all of Russia. Moreover, any terrorist attacks and the resulting heightened security measures are likely to cause disruptions to domestic commerce and exports from Russia. These factors could materially adversely affect our business and the value of the shares and ADSs.

***Crime and corruption could disrupt our ability to conduct our business.***

The political and economic changes in Russia in recent years have resulted in a significant dislocation of authority. The local and international press have reported that significant organized criminal activity has arisen, particularly in large metropolitan centers. Property crime in large cities has increased substantially. In addition, the local press and international press have reported high levels of corruption, including the bribing of officials for the purpose of initiating investigations by government agencies. Press reports have also described instances in which government officials engaged in selective investigations and prosecutions to further the commercial interests of government officials or certain individuals. Additionally, some members of the Russian media regularly publish disparaging articles in return for payment. The depredations of organized or other crime, demands of corrupt officials or claims that we have been involved in official corruption could result in negative publicity, could disrupt our ability to conduct our business effectively and could thus materially adversely affect our financial condition and results of operations and the value of the shares and ADSs.

***Social instability could increase support for renewed centralized authority, nationalism or violence and thus materially adversely affect our business, financial condition, results of operations and prospects.***

The failure of the government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living have led in the past, and could lead in the future, to labor and social unrest. Labor and social unrest may have political, social and economic consequences, such as increased support for a renewal of centralized authority, increased nationalism, including restrictions on foreign involvement in the economy of Russia, and increased violence. An occurrence of any of the foregoing events could restrict our operations and lead to the loss of operating revenues, materially adversely affecting our business, financial condition, results of operations and prospects.

**Legal Risks**

***Weaknesses relating to the legal system and legislation create an uncertain environment for investment and for business activity in Russia.***

Russia is still developing the legal framework required to support a market economy. The following risks relating to the Russian legal system create uncertainties with respect to the legal and business decisions that we make, many of which do not exist in countries with more developed market economies:

- inconsistencies between and among, the Constitution, federal and regional laws, presidential decrees and governmental, ministerial and local orders, decisions, resolutions and other acts;
- conflicting local, regional and federal rules and regulations;
- the lack of judicial and administrative guidance on interpreting legislation;
- the relative inexperience of judges and courts in interpreting legislation;
- lack of independent judiciary;
- a high degree of discretion on the part of governmental authorities, which could result in arbitrary actions such as suspension or termination of our licenses; and
- poorly developed bankruptcy procedures that are subject to abuse.

The recent nature of much of Russian legislation, the lack of consensus about the scope, content and pace of economic and political reform and the rapid evolution of the Russian legal system in ways that may not always coincide with market developments place the enforceability and underlying constitutionality of laws in doubt and results in ambiguities, inconsistencies and anomalies. In addition, Russian legislation



often contemplates implementing regulations that have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. All of these weaknesses could affect our ability to enforce our rights under our permits and contracts, or to defend ourselves against claims by others. We cannot assure you that regulators, judicial authorities or third parties will not challenge our internal procedures and by-laws or our compliance with applicable laws, decrees and regulations.

***Failure to comply with existing laws and regulations or the findings of government inspections, or increased governmental regulation of our operations, could result in substantial additional compliance costs or various sanctions which could materially adversely affect our business, financial condition, results of operations and prospects.***

Our operations and properties are subject to regulation by various government entities and agencies, as well as to ongoing compliance with existing laws, regulations and standards. As a producer of food products, our operations are subject to quality, health and safety, production, packaging, labeling and distribution standards. The operations of our production and distribution facilities are also subject to various environmental laws and workplace regulations. Regulatory authorities exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and standards, the issuance and renewal of permits and in monitoring compliance with the terms thereof. Russian authorities have the right to, and frequently do, conduct periodic inspections of operations and properties of our group of companies throughout the year. Any such future inspections may conclude that we or our subsidiaries have violated laws, decrees or regulations, and we may be unable to refute such conclusions or remedy the violations. Our failure to comply with existing laws and regulations or the findings of government inspections or to obtain all approvals, authorizations and permits required for our operations may result in the imposition of fines or penalties or more severe sanctions including the suspension, amendment or termination of our permits, or in requirements that we cease certain of our business activities, or in criminal and administrative penalties applicable to our officers. Any such decisions, requirements or sanctions, or any increase in governmental regulation of our operations, could increase our costs and materially adversely affect our business, financial condition, results of operations and prospects.

We believe that our current legal and environmental compliance programs adequately address these concerns and that we are in substantial compliance with applicable laws and regulations. However, as the regulations that apply to our business are constantly changing, we are sometimes unable to immediately comply with new regulations upon their implementation. Compliance with, or any violation of, current and future laws or regulations could require material expenditures by us or otherwise have a material adverse effect on our business or financial results. See Item 4. Information on Our Company B. Business Overview Regulation .

Additionally, under relevant Russian legislation, Russian regulatory agencies can impose various sanctions for violations of environmental standards. These sanctions may include civil and administrative penalties applicable to a company and criminal and administrative penalties applicable to its officers. Also, in the course, or as a result, of an environmental investigation, regulatory authorities can issue an order halting part or all of the production at a plant which has violated environmental standards. We have been, at various times, subject to administrative sanctions for failure to comply with environmental regulations relating to effluent discharge and to minor administrative sanctions for violations relating to waste disposal. In the event that production at one of our facilities was partially or wholly prevented due to this type of sanction, our production capability would suffer significantly and our operating results would suffer.



***Lack of developed corporate and securities laws and regulations in Russia may limit our ability to attract future investment.***

The regulation and supervision of the securities market, financial intermediaries and issuers are considerably less developed in Russia than, for example, in the United States and Western Europe. Securities laws, including those relating to corporate governance, disclosure and reporting requirements, have only recently been adopted, whereas laws relating to anti-fraud safeguards, insider trading restrictions and fiduciary duties are rudimentary. In addition, the Russian securities market is regulated by several different authorities, which are often in competition with each other. These include:

- the FSFM;
- the Ministry of Finance;
- the Federal Antimonopoly Service;
- the Central Bank of Russia; and
- various professional self-regulatory organizations.

The regulations of these various authorities are not always coordinated and may be contradictory.

In addition, Russian corporate and securities rules and regulations can change rapidly, which may materially adversely affect our ability to conduct securities-related transactions. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. It is often unclear whether or how regulations, decisions and letters issued by the various regulatory authorities apply to our company. The FSFM has recently introduced a number of regulations relating to offerings of shares in and outside of Russia, including combined offerings involving closed subscription for new shares and the sale of existing shares, which remain largely untested and subject to varying interpretations. Any challenges of such regulations or transactions consummated pursuant to them could have an adverse effect on our ability to effect equity offerings in the future. As a result, we may be subject to fines and/or other enforcement measures despite our best efforts at compliance, which could have a material adverse effect on our business, financial condition and results of operations.

***The judiciary's lack of independence, its relative inexperience and occasional abuse of discretion and the difficulty in enforcing court decisions could prevent us or you from obtaining effective redress in a court proceeding.***

The independence of the judicial system and its immunity from economic, political and nationalistic influences in Russia can not be guaranteed. The court system is underfunded. Judges and courts are generally inexperienced in the area of business and corporate law. Judicial precedents generally have no binding effect on subsequent decisions. Not all Russian legislation and court decisions are readily available to the public or organized in a manner that facilitates understanding. In addition the Russian judicial system can be slow or unjustifiably swift. Enforcement of court orders can in practice be very difficult in Russia. Additionally, court claims are often used in furtherance of political and commercial aims or infighting. We may be subject to such claims and may not be able to receive a fair hearing. Additionally, court orders are not always enforced or followed by law enforcement agencies. Moreover, judicial decisions in Russia can be unpredictable and may not provide effective redress.

These uncertainties also extend to property rights. During Russia's transformation from a centrally planned economy to a market economy, legislation has been enacted to protect private property against expropriation and nationalization. However, these protections may not be enforced in the event of an attempted expropriation or nationalization. Expropriation or nationalization of any of our entities, their assets or portions thereof, potentially without adequate compensation, would have a material adverse effect on our business, financial condition, results of operations and prospects.

***Selective or arbitrary government action could have a material adverse effect on our business, financial condition, results of operations and prospects and the value of the shares and ADSs.***

Governmental authorities in Russia have a high degree of discretion and, at times, act selectively or arbitrarily, without hearing or prior notice, and sometimes in a manner that is inconsistent with legislation or influenced by political or commercial considerations. Selective or arbitrary governmental actions have reportedly included the denial or withdrawal of licenses, sudden and unexpected tax audits and claims, criminal prosecutions and civil actions. Federal and local government entities have also used ordinary defects in matters surrounding share issuances and registration as pretexts for court claims and other demands to invalidate such issuances and registrations or to void transactions. Moreover, the government also has the power in certain circumstances, by regulation or government act, to interfere with the performance of, nullify or terminate contracts. Standard & Poor's, has expressed concerns that Russian companies and their investors can be subjected to government pressure through selective implementation of regulations and legislation that is either politically motivated or triggered by competing business groups. In this environment, our competitors may receive preferential treatment from the government, potentially giving them a competitive advantage over us.

In addition, recently, the Russian tax authorities have brought tax evasion claims aggressively on the basis of certain Russian companies' use of tax-optimization schemes, and press reports have speculated that these enforcement actions have been selective and politically motivated. Selective or arbitrary government action, if directed at us, could have a material adverse effect on our business, financial condition, results of operations and prospects, and the value of the shares and ADSs.

***Shareholder liability under Russian legislation could cause us to become liable for the obligations of our subsidiaries.***

The Civil Code of the Russian Federation and the Federal Law on Joint Stock Companies generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one company is capable of determining decisions made by another company. The company capable of determining such decisions is deemed an effective parent. The company whose decisions are capable of being so determined is deemed an effective subsidiary. Under the Federal Law on Joint Stock Companies, an effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between the companies; and
- the effective parent gives obligatory directions to the effective subsidiary.

In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt resulting from the action or inaction of an effective parent. This is the case no matter how the effective parent's ability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent which caused the effective subsidiary to take action or fail to take action knowing that such action or failure to take action would result in losses. Accordingly, we could be liable in some cases for the debts of our consolidated subsidiaries. This liability could have a material adverse effect on our business, results of operations and financial condition.

*Shareholder rights provisions under Russian law* impose significant additional obligations on us.

Russian law provides that shareholders that vote against or abstain from voting on certain matters have the right to sell their shares to us at market value in accordance with Russian law. The decisions that trigger this right to sell shares include:

- a reorganization;
- the approval by shareholders of a major transaction, which, in general terms, is a transaction involving property worth more than 50% of the gross book value of our assets calculated according to the Russian accounting standards, regardless of whether the transaction is actually consummated; and
- the amendment of our charter in a manner that limits shareholder rights.

Our obligation to purchase shares in these circumstances, which is limited to 10% of our net assets calculated according to Russian accounting standards, at the time the matter at issue is voted upon, could have a material adverse effect on our business, financial condition, results of operations and prospects.

***Because there is little minority shareholder protection in Russia, your ability to bring, or recover in, an action against us will be limited.***

In general, minority shareholder protection under Russian law derives from supermajority shareholder approval requirements for certain corporate actions, as well as from the ability of a shareholder to demand that the company purchase the shares held by that shareholder if that shareholder voted against or did not participate in voting on certain types of actions. Companies are also required by Russian law to obtain the approval of disinterested shareholders for certain transactions with interested parties.

The supermajority shareholder approval requirement is met by a vote of 75% of all voting shares that are present at a shareholders' meeting. Thus, controlling shareholders owning slightly less than 75% of outstanding shares of a company may have a 75% or more voting power if certain minority shareholders are not present at the meeting. In situations where controlling shareholders effectively have 75% or more of the voting power at a shareholders' meeting, they are in a position to approve amendments to the charter of the company or significant transactions including asset transfers, which could be prejudicial to the interests of minority shareholders. It is possible that our controlling shareholders in the future may not act in the best interests of minority shareholders, and this could materially and adversely affect the value of the shares and ADSs.

While the Federal Law on Joint Stock Companies provides that shareholders owning not less than 1% of the company's stock may bring an action for damages on behalf of the company, Russian courts to date do not have much experience with such lawsuits. Russian law does not contemplate class action litigation. Accordingly, your ability to pursue legal redress against us may be limited, reducing the protections available to you as a holder of our shares and ADSs.

***Characteristics of and changes in the Russian tax system could materially adversely affect our business, financial condition, results of operations and prospects and the value of the shares and ADSs.***

The tax environment in Russia historically has been complicated by the often contradictory tax legislation. This uncertainty potentially exposes us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could result in a greater than expected tax burden and the suspension or termination of our licenses. Generally, taxes payable by Russian companies are substantial and numerous. These taxes include, among others:

- income taxes;

- VAT;
- unified social tax; and
- property tax.

There have recently been significant changes to the Russian taxation system, including a number of changes to various chapters of the Tax Code. Among the most recent changes are significant amendments to the chapters on VAT and on the profit tax effective as of January 1, 2006, as well as the changes to Part One of the Tax Code (tax administration provisions) effective as of January 1, 2007.

Since tax legislation is subject to frequent change, some sections and regulations enacted under the Tax Code are comparatively new, and interpretation of these regulations is often unclear or nonexistent. Taxpayers and the Russian tax authorities often interpret tax laws differently whilst the Russian tax authorities' interpretation of tax laws rarely favors taxpayers. In some instances, the Russian tax authorities have applied new interpretations of tax laws retroactively. There is no established precedent or consistent court practice in respect of these issues. Taxpayers often have to resort to court proceedings to defend their positions against the tax authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretations of the legislation and assessments.

In addition, differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Generally, in an audit taxpayers are subject to inspection with respect to the three calendar years which immediately preceded the year in which the audit is carried out. Previous audits do not completely exclude subsequent claims relating to the audited period because Russian tax law authorizes upper-level tax inspectorates to review the results of tax audits conducted by subordinate tax inspectorates. In addition, in July 2005, the Russian Constitutional Court issued a decision that allows the statute of limitations for tax liabilities to be extended beyond the three-year term set forth in the tax laws if a court determines that a taxpayer has obstructed or hindered a tax audit. Because none of the relevant terms is defined, tax authorities may have broad discretion to argue that a taxpayer has obstructed or hindered an audit and ultimately seek penalties beyond the three-year term.

In October 2006, the Supreme Arbitration Court of the Russian Federation introduced a new concept of unjustified tax benefit which is defined mainly by reference to specific examples of such tax benefits (*e.g.* absence of business purpose) and which may lead to disallowance thereof for tax purposes. There is currently no practice or guidance from the tax authorities or courts for interpreting this new concept; however, it is likely that the tax authorities will actively seek to apply this concept when challenging in courts tax positions taken by taxpayers. Although the intent of the court when introducing the concept of unjustified tax benefit was to combat abuse of tax law, in practice, there is no assurance that the tax authorities will not seek to apply this concept in a broader sense than may have been intended by the court. In addition, a recent pronouncement by a Russian court in December 2006 indicates a trend within the judicial system to broaden the application of criminal responsibility for tax violations.

Also there is no concept of a tax group in Russia, nor can a consolidated filing be made by Russian companies for tax purposes. Therefore, Russian companies and each of their Russian subsidiaries pay their own Russian taxes and may not surrender profits or losses to other group companies for tax purposes. In addition, payments of dividends between two Russian companies are currently subject to a withholding income tax of 9% at the time they are paid out of profits, although the effective rate of this tax may be lower than 9% if the company paying the dividends has received, in the same or a preceding tax period, dividends from other Russian companies. This may give rise to additional tax liabilities and inefficiencies.

The foregoing conditions create tax risks in Russia that are more significant than those typically found in jurisdictions with more developed tax systems and complicate tax planning and related business decisions. They also impose additional burdens and costs on our operations, including management resources. In addition to our substantial tax burden, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines and penalties and enforcement measures despite our best efforts at compliance. Our exposure to additional tax liabilities could have a material adverse effect on our business, financial condition, results of operations and prospects. See also [Risks Relating to the Russian Federation](#) [Legal Risks and Uncertainties](#) Selective or arbitrary government action could have a material adverse effect on our business, financial condition, results of operations and prospects and the value of the shares and ADSs.

#### **Other Risks**

*We have not independently verified information we have sourced from third parties.*

We have sourced certain information contained in this document from third parties, including private companies and Russian government agencies, and we have relied on the accuracy of this information without independent verification. The official data published by Russian federal, regional and local governments may be substantially less complete or researched than those of Western countries. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia in this document must, therefore, be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

#### **Item 4. Information on Our Company**

##### **A. History and Development**

We trace our history back to 1992, when a group of individuals formed an enterprise which began leasing a production line at the Lianozovsky Dairy Plant and purchasing juice concentrates and packaging materials. On November 25, 1992, we produced the first carton of juice carrying the Wimm-Bill-Dann brand name. We selected this brand name to attract consumers who preferred products with foreign-sounding names due to perceived higher quality and novelty and, since its introduction, the Wimm-Bill-Dann name has become a brand name recognized in a substantial percentage of Russian households.

To take advantage of the opportunities arising from the privatization of Russian state-owned assets, our current shareholders then began acquiring shares in the Lianozovsky Dairy Plant in Moscow, and continued to expand their juice product enterprises. Following their acquisition of a majority stake in the Lianozovsky Dairy Plant in 1995, they added dairy products to their portfolio, thus becoming a dairy and juice producer. Our growth has been accomplished, in part, through significant acquisitions, including the following:

- In 1995, we acquired majority control of the Lianozovsky Dairy Plant (renamed into Wimm-Bill-Dann in 2006);
- In 1996 and 1997, we acquired majority stakes in the Moscow Baby Food Plant, the Tsaritsino Dairy Plant and the Ramenskiy Plant (renamed into Wimm-Bill-Dann Beverages in 2007);
- In 1998 and 1999, we began to expand into regions outside Moscow, acquiring dairy plants in Novosibirsk, Nizhny Novgorod and Vladivostok;
- In 2000, 2001 and 2002, we acquired majority stakes in dairy plants in Ufa, Bashkortostan and the Krasnodar region in Russia, as well as dairy plants in Kiev, Ukraine and Bishkek, Kyrgyzstan;
- In 2001, we acquired 100% interests in dairy plants in the Altaisky and Voronezh regions of Russia;

- In 2002, we acquired control of three dairy plants in the Krasnodar, Belgorod and Samara regions of Russia;
- In 2002, we acquired control of a dairy plant in Kharkov, Ukraine;
- In 2002, we acquired a 100% interest in the Roska Dairy Plant (renamed Baltic Milk in 2004) in St. Petersburg;
- In 2002, we acquired control of Depsona (since renamed Fruktopak) in Tula and a large warehouse complex in the Moscow region;
- In 2002, we acquired control of a dried milk plant in Buryl, Ukraine;
- In January 2003, we acquired a 100% interest in Siberian Cheese, a refrigeration and warehousing facility in Novosibirsk adjacent to our principal Siberian dairy production facility;
- In August 2003, we acquired underground wells in the Essentuki area of Russia and a water processing and bottling factory which produces Essentuki brand mineral water through our purchase of 100% interests in the companies Healing Springs and Geiser;
- In December 2004, we acquired Atamanskoe farm, a raw milk production company;
- In April, July and September 2005, we acquired three raw milk production companies, Plemzavod Za Mir i Trud, Zavety Ilyicha and Trud Farms;
- In July 2005, we acquired 66.3% control of the Obninsk Dairy Plant in the Kaluga region;
- In July 2005, we acquired a 100% interest in the Kursk Baby Food Plant in the Kursk region;
- In October 2005, we acquired a 100% interest in the Essentuki Mineral Water Plant at CMW (Caucasian Mineral Waters) in the town of Essentuki in the Stavropol region;
- In December 2005, we acquired a controlling stake in Nazarovskoe Milk in the Krasnoyarsk region;
- In December 2005, we acquired a 100% interest in the Pervouralsk City Dairy Plant in the Sverdlovsk region;
- In January 2006, we increased our aggregate ownership in the Moscow Baby Food Plant to 97.3%;
- In September 2006, we acquired a 100% interest in the Surgut City Dairy Plant in Western Siberia;
- In November 2006, we acquired 93.74% control of the Moscow-based dairy producer Ochakovo;
- In December 2006, we acquired 100% control of the Omsk-based dairy producer Manros-M; and
- In December 2006, we acquired 83.36% control of Angarsky Dairy Plant (MOLKA), one of the largest dairy enterprises in Irkutsk region.

Our operations are currently organized into three separately reported segments: dairy products, beverages, baby food, all operating under the umbrella of our holding company, Wimm-Bill-Dann Foods OJSC, which was incorporated on May 31, 2001. In addition, at the end of 2004, we created a separately managed non-core business unit called Agro for the purpose of buying and managing a select number of dairy farms in certain Russian regions. Agro is currently reported as part of our dairy division.

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In order to improve our corporate structure and management, as well as to reduce our expenses, we commenced the reorganization of our subsidiaries in April and May 2007 with the merger of 14 of our subsidiaries (Tsaritsyno Dairy Plant, Ufa Dairy Plant, Siberian Milk Dairy Plant, Rubtsovsk Dairy Plant, Siberian Cheese Plant, Nizhny Novgorod Dairy Plant, Baltic Milk Dairy Plant, Nazarovo Dairy Plant, PAG Rodnik, Pervouralsk Dairy Plant, Kursk Baby Food Plant, Moscow Baby Food Plant, Timashevsk Dairy Plant and Vladivostok Dairy Plant) into Wimm-Bill-Dann (formerly Lianozovsky Dairy Plant). We are planning to merge some other of our subsidiaries into Wimm-Bill-Dann during 2007.

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We completed our initial public offering on February 14, 2002 and listed our shares of common stock, represented by American Depositary Shares, or ADSs, on the New York Stock Exchange under the symbol WBD. Each ADS represents one underlying share of our common stock.

According to Standard & Poor's global scale, our corporate credit rating is B+, and Moody's Investors Service ranks our Corporate Credit rating as B1. In March 2007, Moody's Investors Service upgraded our Eurobond Debt rating from B2 to B1 with a positive outlook. In May 2006, Standard & Poor's Governance Services announced the upgrade of our Corporate Governance Score (CGS) from 7 to 7+, which makes our score the highest in Russia.

Our legal name is Wimm-Bill-Dann Foods OJSC, and we are incorporated as an open joint stock company under the laws of the Russian Federation and registered with the Moscow Inter-District Inspectorate No. 39 of the Russian Ministry of Taxes and Duties under the state registration number 1037700236738. We operate in the Russian Federation and the CIS under a number of different trademarks and brand names, as more fully described below in **B. Business Overview** Current Operations. Our products and brands. Our business objectives, set forth in Article 4 of our charter, include the production and sale of food products, including milk and sour milk products, mineral water, fruit and vegetable juices and beverages and children's food. Our head office is located at 16 Yauzsky Boulevard, Moscow 109028, Russian Federation, and our telephone number is +7 495-105-5805. We maintain a website at <http://www.wbd.com>. The information on our website is not a part of this report. We have appointed CT Corporation System, 111 Eighth Avenue, New York, New York 10011, as our authorized agent for service of process for any suit or proceeding arising out of or relating to our shares, ADSs, or the deposit agreement.

## **B. Business Overview**

We are one of the Russia's largest manufacturers of food products. Our reportable business segments in 2006 were dairy, beverage and baby food products. In 2006, the dairy segment accounted for 75.0% of our sales, the beverages segment, which includes juice and bottled mineral water, accounted for 18.4% of our sales and the baby food segment accounted for 6.6% of our sales.

Since our founding in 1992, we have become the market leader in Russia in the dairy market and one of the market leaders in the juice market. In the dairy market, according to an AC Nielsen study of 24 major cities located throughout Russia, including Moscow and St. Petersburg, we were the market leader at the end of 2006 with a 34% market share in terms of value. In the Russian juice market, according to a Business Analytica survey of all of Russia, we had a 19% market share in terms of value at the end of 2006.

We currently have 36 manufacturing facilities in Russia, Ukraine, Kyrgyzstan, and Uzbekistan, as well as distribution centers in 24 cities throughout Russia and the CIS. As of March 2007 we employed 19,582 people.

We offer our consumers a full range of quality branded dairy, juice, water and baby food products, using carefully selected raw materials, modern production technology and strict quality control. All of our products are made according to our own recipes and reflect our understanding of consumer demand.

Our principal dairy products include:

- Traditional products, such as sterilized and pasteurized milk, butter and cream, as well as traditional sour-milk products such as kefir, cottage cheese, soft cottage cheese and sour cream;
- Yogurts and dairy desserts, such as traditional and drinking yogurt, mousse, fruit-flavored milk and kefir, puddings and flavored cottage cheese;
- Cheese products, including hard yellow and processed cheese.



Our principal beverage products include:

- Juice and nectars produced from juice concentrate;
- Enriched juice-based drinks;
- A traditional berry-juice-based drink made from natural berries;
- Bottled natural mineral water.

Our baby food products include:

- Liquid dairy products for infants under the age of three;
- Juices for infants under the age of three;
- Meat, fish, poultry, fruit, vegetable and dairy purees for infants under the age of three; and
- Products for pregnant women and nursing mothers.

#### **Business Strategy**

Our strategy is driven by clearly defined business architecture. In March 2007, our senior management, after extensive consultation, approved a concise strategic approach for the company aimed at meeting our qualitative and quantitative goals over monthly, quarterly, annual and multi-year time horizons. This approach does not mark a departure from our longer term strategic vision, rather it lends greater clarity and defines the steps to be taken following the important restructuring work implemented during 2006. The vision is that by 2010 we should be Russia's leading fast-moving consumer goods (FMCG) company with leading key profit ratios for the industry.

Our strategy reflects our mission and is driven by a vision of where the company should be in the future. The mission, as articulated during 2006, is to help the entire family live healthier by enjoying our nutritious and delicious food and beverage products every day throughout their lives.

#### **Business Goals**

Our business goals for 2010 represent the key individual elements needed to achieve this vision. By this date, our goal is to be recognized by both consumers and all key Russian regulators as the leading food company in terms of health and nutrition and for our top ten brands by revenue to be among the top-50 FMCG brands in Russia. At the same time, we intend to undertake an accelerated process of innovation with the aim of increasing revenues by 2010.

In addition, we will seek to further strengthen our corporate image and to become one of the most desired employers of choice in Russia. Finally, by 2010, we will aim to achieve better route-to-market execution, with greater control over how products are sold at the outlet level.

#### **Business Strategies**

In order to meet these goals, our strategy is focused on key elements that are relevant across all of our business units as well as departments serving the group as a whole, including Marketing, Human Resources, Research and Development and Corporate Communications. These key elements are as follows:

- **Investing in marketing to build brand equity.** We intend to increase our marketing activities and focus sponsorship on sports and active lifestyle to promote the health and wellness values of our brands.



- **Investing in the sales team and route-to-market (RTM) control.** We will seek to increase our sales force, with consolidated key account teams focusing on large and growing retail chain customers and an increased focus on training. We have defined our merchandizing standards and are starting to implement them in the markets where we are present. **Driving margin improvements through optimal brand, pack and price mix.** We will study changing consumer price elasticity in order to adapt the right approach to brand, packaging type and size as well as price. New, higher margin packaging will be introduced with investment focused on higher margin brands.
- **Driving lowest appropriate cost and protecting quality.** We will regularly audit retailers to ensure quality and provide detailed quality specifications for each stock-keeping unit (SKU). We will seek to continue to improve plant efficiency and reduce logistics costs. We also intend to continue to buy out minority shareholdings and consolidate legal entities to create a more efficient and streamlined company.
- **Accelerating innovation, new category entry and acquisitions.** We will seek to continue to enter new and innovative categories and segments offering profitable growth consistent with our mission . We also intend to continue our policy of acquiring successful dairy companies across Russia and the CIS and we will carefully study opportunities for selective acquisitions of other food companies. Finally, we will continually assess the attractiveness and potential for entry into new geographic areas.
- **Strengthening human resource capability.** We operate in both maturing markets, such as Moscow and St Petersburg, and emerging markets, such as Russia's regions and the CIS. We will strive to develop our human resource capability at all levels to attract and retain talented executives with experience in developed and emerging markets worldwide. At the same time, we are dedicated to developing our considerable human resource capacity within the company. This entails promoting talented people within the organization and providing them with experience in other parts of the business and other regions. We seek to provide ongoing opportunities for our employees to learn new skills through training and continued education in our Corporate University. A yearly appraisal process allows managers to understand what is expected from them, provides a forum for dialogue and an opportunity to discuss career planning. Improved corporate communications is also helping central management communicate the company's plans and goals to employees across the business and build a more unified corporate culture. We understand that motivated and well-informed employees are directly responsible for our success.

## Current Operations

### Dairy industry

**Consumption.** Russian dairy consumption is relatively low compared to most European countries and is characterized by two primary trends—the comparatively solid development of the market for traditional dairy products, and a more rapidly developing market for yogurts and desserts.

We estimate, based on combined data from Comcon, AC Nielsen and Goskomstat, that per capita consumption of packaged dairy products in Russia was 60.8, 65.9 and 70.3 liters per year in 2004, 2005 and 2006, respectively, levels that are relatively low compared to the majority of European countries. The demand for dairy products remained relatively stable in the aftermath of the 1998 Russian financial crisis and the ensuing decline in per capita income, as dairy products are generally considered to be staple consumer goods. Additionally, increasing per capita income following 1998 has positively affected dairy consumption, particularly of higher-priced products such as yogurt and dessert dairy products. We estimate that per capita consumption of traditional packaged dairy products in Russia increased 6% to 56.9 kg in 2006 from 53.7 kg in 2005. We believe that packaged dairy product consumption levels will continue to increase at a solid pace in Russia as the consumption of bulk liquid milk decreases due to increasing per capita incomes, the growing desire and demand for sterilized milk and the greater convenience of



packaged products. Although consumption of bulk liquid milk, which generally consists of unpackaged milk sold in markets to consumers who bring their own packaging, has been decreasing in Russia, it is still relatively common.

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Source: Company

Since its first widespread commercial appearance in Russia in the early 1990s, yogurt's popularity has increased. For instance, the consumption of such products as drinkable yogurt, functional foods/drinks and flavored milk is relatively high among certain groups of consumers and comparable with milk consumption levels. However, the per capita consumption of the above products remains relatively low, although we believe that this segment of the dairy market has a high growth potential as incomes in Russia grow.

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Source: R-TGI Comcon, as of the second quarter of 2006



According to our estimates, annual per capita consumption of yogurt and dairy desserts in Russia increased to about 8.4 kilograms in 2006 from 7.5 kilograms in 2005, reflecting an increase of 11%.

According to our estimates, annual cheese consumption (yellow, white and processed) in Russia increased by 8.7% to 5.0 kilograms per capita in 2006 from 4.6 kilograms per capita in 2005. We believe that cheese consumption levels will continue to grow due to increasing per capita incomes and the greater variety of cheese products available to Russian consumers.

**Production.** Milk production and processing in Russia declined dramatically during the 1990s due to the general state of the Russian economy, a lack of raw materials due, in part, to the slaughter of dairy cows necessitated by a shortage of feed, and a sharp increase in energy prices. Additionally, the majority of Russian milk producers, comprising individual farmers and collective agricultural enterprises, operate with inefficient and outdated facilities and equipment, and function under outdated management practices.

The result of this decline was a drop in processing volumes and an increased reliance upon imported dairy products. While the financial crisis of 1998 aided Russian producers to some extent, as it pushed imported foods out of the Russian market, it also caused difficulties for Russian companies that depended on imported materials for production. In general, producers that were able to limit their exposure to fluctuations in the value of the ruble and to establish links with Russian suppliers survived the crisis and took leading positions in the marketplace. The milk processing sector, however, still remains fragmented, and currently includes over 1,500 large, medium and small enterprises, according to IKAR (the Institute of the Agricultural Market). There is evidence, though, that the process of consolidation is continuing, with the less efficient producers going out of business or being acquired by larger companies. For example, our competitor Unimilk acquired various dairy plants in the course of 2005-2006 throughout Russia, including Tommas, Rosa, Cheboksarsky M.K., Solti, Permmoloko.

Additionally, foreign, particularly European, producers have recognized the potential for growth in the demand in Russia for milk, yogurt and dairy desserts and are investing in the Russian market. A number of European producers, such as Danone, Parmalat, Campina, Lactalis and Ehrmann, produce dairy products in Russia, principally in the Moscow region, and comprise our principal competition in the yogurt and dairy dessert segment of the dairy market. The dessert market is growing at higher rates than the traditional dairy market. It is also developing to cater to changing consumer tastes with more attention being paid to fresh health and wellness products.

We have made significant investments in the development of our own farms and also establishing long-term relationships with third party raw milk suppliers. These steps help us to address the problem of raw milk deficits and increase the quality of the raw milk we purchase. The government has also started a large scale program aimed at the revival of the agricultural sector in Russia, which we see as an important development.

#### **Juice and Mineral Water industries**

**Consumption.** Before the early 1990s, consumption of juice products in Russia was limited. Juice products manufactured in the Soviet Union included only vegetable juices and fruit juices made of locally grown fruit such as apples and pears. Most Russian households tried orange, pineapple, grapefruit and other exotic fruit juices for the first time in 1991 and 1992, following the dissolution of the Soviet Union. Russian juice consumption grew each year until 1998, when it fell following the 1998 financial crisis, which led to a reduction in Russian incomes and a significant increase in the cost of juice products due to the increase in the ruble cost of imported juice packaging and ingredients. While Russian juice consumption has recovered from the effects of the 1998 financial crisis, it is still relatively low compared to most European countries.

The following table shows annual per capita juice product consumption in liters in Russia and selected European countries in 2006:

| Country    | 2006 |
|------------|------|
| Hungary    | 48   |
| Germany    | 41   |
| Netherland | 38   |
| UK         | 36   |
| Poland     | 35   |
| France     | 24   |
| Bulgaria   | 20   |
| Russia     | 18   |
| Italy      | 14   |

Source: Euromonitor, 2006

We estimate annual per capita juice product consumption in Russia in 2006, 2005 and 2004 to be approximately 18 liters, 16 liters and 14 liters, respectively.

Consumption of bottled water in Russia is now on par with juice consumption. According to Business Analytica, per capita consumption of bottled water in Russia in 2006 was 21 liters per year. This figure is significantly lower than consumption levels elsewhere in Europe. For example, according to Euromonitor, current per capita consumption of bottled water in the United Kingdom is close to 30 liters per year, and over 140 liters per year in Italy and France.

**Production.** Following the dissolution of the Soviet Union and the economic reforms that liberalized import procedures, foreign producers were able to capture a significant share of the Russian juice market by importing their products. However, the 1998 financial crisis caused a majority of the foreign companies to leave the market, and also forced a majority of Russian producers to decrease or discontinue juice production.

The juice product market began recovering in 1999, and since then, has experienced significant increases in sales volume, stimulated by rising Russian incomes and an increased interest in health issues, as well as by the advertising efforts of juice producing companies.

Additionally, a number of Russian producers that survived the 1998 financial crisis managed to restructure their production facilities using Western technologies and to strengthen their market positions. In 2006, according to a Business Analytica survey of Total Urban Russia (cities with the population of over 100,000 people), the four largest Russian producers had an 84% share of the juice market. Russian producers often use cheaper domestic inputs and modern packaging technologies, and they increasingly promote their brands on a national scale. The industry is now experiencing consolidation, as demonstrated by the increase in acquisition activity. According to the Business Analytica survey, during 2006, there were more than 100 brands of juice products in the Russian juice market, though 10 of them accounted for 78% of the market. The bottled water market in Russia is characterized by a large number of brands, including local brands that are strong in the regions where they are produced. In addition, the leading brands in Moscow differ from those with leading market shares in many of the regions outside of Moscow. According to Business Analytica, in 2006, the top ten bottled water producers in Russia had jointly a 73% market share in Moscow and a 68% market share in the ten largest cities of Russia in terms of value. This difference is largely due to the prominence of local or regional producers in certain regions outside of Moscow whose water products are less expensive than those of national brands. The joint Moscow market share of the two largest international bottled water providers, Pepsi and Coca-Cola, decreased from 29.2% in 2005 to 28.5% in 2006 in terms of value, according to Business Analytica. Coca-Cola became the market



leader in terms of market share in Moscow in 2006 followed by Pepsi and domestic producer Shishkin Forest.

### **Baby Food industry**

*Consumption.* The baby food market in Russia is comprised of four main segments:

- powdered formula and cereals;
- liquid dairy products (milk, kefir, cottage cheese and curd desserts, yogurts, liquid formula);
- supplemental infant food products (early solid foods, including juices, purees);
- other products (baby water, puddings, soups, biscuits, tea).

According to our estimates, approximately 75 - 80% of the dairy products consumed by children aged 0 - 3 years in Russia are adult food products, with specialized baby foods comprising only 20 - 25% of the dairy products consumed in this age group.

From 2003 to 2006, the baby food market in Russia grew by 56% in terms of volume, according to our estimates. Three regions of Russia currently account for over 70% of nationwide baby food product sales, including the Central region (including Moscow), the Northwest region (including St. Petersburg) and the Volga region, according to our estimates.

In 2006, the Russian government launched a nationwide program aimed at improving the health of the nation and increasing the birth rate, which we believe could have a positive impact on the baby food market over the next five years. Within the framework of the program, mothers get additional compensation for the birth of their second child. More and more Russian women go back to work shortly after giving birth. Many of them rely on ready-to-eat baby food.

*Production.* The baby food market emerged in Russia in the early 1990s with a government plan to build approximately 110 production sites throughout the country to develop baby food products such as meat, fruit, vegetable, grain and fish purees and various dairy products. Although only a small number of these government-sponsored production sites have since been built, domestic and foreign producers of baby food started to acquire production facilities in Russia in the second half of the 1990s. Since 2000, the baby food market has grown substantially with additional types of products being introduced and increased consumption due to the increasing birth rate in Russia.

Today, both Russian and foreign producers are present in the market, with foreign producers generally operating in each of the four main product categories and Russian producers generally operating in individual categories.

In the individual product categories, foreign producers currently dominate the powdered formula and cereals market, while domestic producers hold leading positions in the liquid dairy products and supplemental infant food market.

**Our products and brands**

Our dairy, beverage and baby food products accounted for 75.0%, 18.4% and 6.6% of our net sales in 2006, respectively. Our principal geographic market is Russia, with Moscow being the most significant one. The following table sets forth our annual consolidated net sales, the proportion of consolidated net sales accounted for by our main business lines, our reported annual production volumes and their growth rates:

|   | 2006         | 2005(1)      | 2004         |
|---|--------------|--------------|--------------|
| <b>Dairy products</b>                   |              |              |              |
| Sales (in million USD)                  | 1,321        | 1,004        | 818          |
| Annual sales growth (% year on year)    | 31.6 %       | 22.6 %       | 33.5 %       |
| Percent of total sales                  | 75.0 %       | 72.0 %       | 69.1 %       |
| Sales volume (in th. tons)              | 1,354        | 1,195        | 1,099        |
| Annual volume growth (% year on year)   | 13.2 %       | 8.7 %        | 14.4 %       |
| <b>Beverage products</b>                |              |              |              |
| Sales (in million USD)                  | 324          | 303          | 301          |
| Annual sales growth (% year on year)    | 6.9 %        | 0.7 %        | 9.3 %        |
| Percent of total sales                  | 18.4 %       | 21.7 %       | 25.4 %       |
| Sales volume (in million liters)        | 447          | 436          | 463          |
| Annual volume growth (% year on year)   | 2.5 %        | (5.7 )%      | (3.3 )%      |
| <b>Baby food products</b>               |              |              |              |
| Sales (in million USD)                  | 117          | 88           | 65           |
| Annual sales growth (% year on year)    | 33.5 %       | 35.9 %       | 40.7 %       |
| Percent of total sales                  | 6.6 %        | 6.3 %        | 5.5 %        |
| Sales volume (in th. tons)              | 66           | 58           | 50           |
| Annual volume growth (% year on year)   | 14.7 %       | 15.5 %       | 8.9 %        |
| <b>Total net sales (in million USD)</b> | <b>1,762</b> | <b>1,395</b> | <b>1,184</b> |

(1) Previously, the Company classified as sales revenue amounts from sales of non-milk inventory and services; related expenses were included in the cost of sales. Commencing 2006, the Company began classifying such items in other operating expenses. Prior net sales and cost of sales have been reclassified accordingly for comparative periods presented in the accompanying financial statements. This change in classification has no effect on previously reported net income.

**Dairy products and brands**

Our principal dairy product lines, types of products, principal brands, and their approximate percentage of our total dairy revenue in 2006, 2005 and 2004 are as follows:

| <b>Product line</b>        | <b>Types of products</b>  | <b>Main brands</b>  | <b>Approximate percentage of total dairy revenue in 2006</b> | <b>Approximate percentage of total dairy revenue in 2005</b> | <b>Approximate percentage of total dairy revenue in 2004</b> |
|----------------------------|---|---|--|--|--|
| Traditional products       | Sterilized and pasteurized milk, concentrated milk, butter, cream, traditional sour-milk products such as kefir, cottage cheese, soft cottage cheese, sour cream, milk porridge | Little House in the Village , Happy Milkman , M , Kuban Cow , Bio-Max | 58.2%  | 57.4%  | 56.0%  |
| Yogurts and dairy desserts | Traditional and drinking yogurt and dairy desserts, including mousse, fruit-flavored milk and kefir, puddings and flavored cottage cheese                                       | Neo , Chudo ,   | 36.3%  | 36.9%  | 39.5%  |
| Cheese                     | Traditional cheese products   | Lamber , Happy Milkman  | 5.5%   | 5.7%   | 4.5%   |

The Russian market for packaged dairy products has several defined market segments. It can also be divided into non-branded and branded products, although non-branded products generally cover only the low segment of the market. Our branding policy is designed to ensure we reach customers in most of the segments with the right mix of brands, brand images, products and packaging formats. We support strong national brands, as well as local brands which are well established in their respective regions. The following chart illustrates our estimates of the current market segment positioning for our major brands, as well as a general description of the purchasers which each market segment covers:

| Segment                 | Purchaser material well-being scale  | Traditional products                                       | Yogurts and dairy desserts | Health-oriented enriched products | Cheese Products |
|-------------------------|--|--|----------------------------|-----------------------------------|-----------------|
| Premium                 | Enough money to buy major household appliances, monthly income above \$500 per family member | NEO  |                            |                                   |                 |
| Upper-middle and middle | Enough money to buy major household appliances   | Little House in the Village ,<br>33 Cows ,<br>Na Zdorovye  | Chudo                      | Bio-Max                           | Lamber          |
| Middle and lower-middle | Enough money to buy food and clothing, but not enough to buy major household appliances      | Happy Milkman,<br>Slavyanochka,<br>Kubanskaya Cow<br>and M | Frugurt, Lada              | Our Doctor                        | Happy Milkman   |
| Econom                  | Enough money for food only   | Zavetny Bidonchik ,<br>Pastushok                           |                            |                                   |                 |

In general, we seek to maintain at least one brand within most dairy market segments, and we intend to develop new brands to expand our coverage of attractive segments. In 2003 we launched the premium NEO brand and the mass-market Zavetny Bidonchik . We expanded our NEO brand in 2004 and 2005 to offer a broader selection of products in this attractive premium segment. In 2006, we entered a totally new category of fresh chocolate , distributed through cold chain and sold on the cold shelf, with a premium brand Morand .

**Market trends and competition.** The Russian dairy market has been growing in the last three years. According to our estimates, the total market for packaged dairy products in Russia was 8.7 billion liters in 2004, 9.4 billion liters in 2005 and 10.1 billion liters in 2006. We believe that consumption may continue to increase at a more moderate pace, as rising household incomes in Russia may tend to bring about higher protein consumption and preferences for yogurt and dessert products. In particular, Russian households have proven receptive to yogurt, enriched dairy products and dessert dairy products. Given the existing low per capita consumption, we see this market segment as providing an opportunity for growth. We also expect continued growth in the consumption of products with long shelf lives, including sterilized milk.

Though some measure of consolidation is occurring in the Russian dairy industry, the milk processing sector in Russia remains fragmented and currently includes over 1,500 large, medium and small enterprises, according to Institute for Agricultural Market Studies (IKAR). Due to the high degree of

fragmentation, the market is very price competitive. From 2000 to the present, we have expanded our distribution service, reduced our sales to wholesalers, increased our sales to retailers and increased advertising. We also remain committed to our regional expansion strategy and are constantly widening our regional product offerings as consumer spending is growing steadily in the regions. Cutting costs and improving the quality of our products remain our main focus areas. We believe that these strategies have increased public awareness of our products and helped us expand our market share. We have also increased our production of value-added products available in attractive and convenient packaging.

In the dairy market, according to an AC Nielsen study of 24 major cities, including Moscow and St. Petersburg, we were the market leader at the end of 2006 with a 34% market share in value terms. In the traditional dairy market, we lead the market with a 33% market share in value terms. In the enriched dairy market, our share was approximately 29% in value terms at the end of 2006. In yogurts and desserts, we were the market leader with almost 44% in value terms.

In traditional dairy, we compete primarily with local producers, such as Unimilk, Voronezhsky M.K. (Molvest), as well as with a number of smaller regional producers. In enriched dairy, we compete primarily with Groupe Danone. In yogurts and desserts and, to some extent, in products for children, we compete with foreign producers such as Danone, Campina and Ehrmann who continue to invest in their businesses in Russia. We view the following producers as our primary competitors:

- *Groupe Danone*, a French company which is the most active foreign producer in Russia and aggressively promotes its products. It has a dairy plant in the Volga region where it produces yogurts, as well as a dairy plant in the Moscow region. Its domestically produced and imported products are sold under the Danone brand name across Russia through its own distribution network. According to the AC Nielsen study of 24 cities, in 2006, Danone had a 21% market share in yogurts and desserts and a 15% overall share of the Russian dairy market in value terms.
- *Unimilk*, the second largest dairy holding company in Russia. Unimilk has over 20 dairy production facilities in Russia and two in Ukraine. Its largest production facility, the St. Petersburg-based Petmol, produces a wide range of dairy products. According to the AC Nielsen study of 24 cities, in 2006, Unimilk had a 13% market share in traditional dairy, a 5% market share in yogurts and desserts and an 11% overall share of the Russian dairy market in value terms.
- *Ehrmann*, a German company producing yogurts at its plant located in the Moscow region. Its brand names Ehrmigurt, Yoghurtovich, Fruktovich and Uslada were developed specifically for Russian consumers. According to the AC Nielsen study of 24 cities, Ehrmann had a 7% market share in yogurts and desserts in 2006 in value terms.
- *Voronezhsky M.K.*, a Russian company producing a wide range of dairy products. Its main brand names are Vkusnoteevo and Ivan Poddubniy. According to the AC Nielsen study of 24 cities, Voronezhsky M.K had a 3% market share in traditional dairy and a 2% overall share of the Russian dairy market in value terms.
- *Campina* is an international co-operative dairy company that specializes in production of milk, yogurt and desserts. Its main brand names are Campina, Fruttis, Nezhniy, Stupinskoe and Yogho!. According to the AC Nielsen study of 24 cities, Campina had a 9% market share in yogurts and desserts in 2006 and a 2% overall share of the Russian dairy market in value terms.

Recent trends also indicate that industry consolidation may lead to the emergence of larger domestic producers, which could become our significant competitors.

Foreign dairy manufacturers generally have large promotional budgets and advanced production know-how, allowing them to offer quality and innovative products, and strong distribution networks. While foreign manufacturers generally tended in the past to focus on niche markets, usually in the premium

segment, they are now increasingly offering products to an average Russian consumer with an average income. For example, Danone owns two plants in Russia and has introduced several of its yogurt brands into the Russian market, some of which were developed specifically for Russian consumers. In April 2005, Danone announced the opening of new production lines at its factory near Chekov in the Moscow region, which increased the factory's capacity to 250,000 metric tons. Dutch company Campina also owns a dairy plant in Russia that produces fresh yogurts and yogurts with a long shelf life, and announced plans in 2005 to expand its production of dairy beverages in the Moscow region, increasing Campina's total investments in Russia to over \$100 million. In addition, the German companies Ehrmann and Onken produce yogurt at Russian plants, and Onken launched its own dairy production factory in Russia in 2003. Foreign cheese producers also launched production facilities in 2003, including French company Lactalis and German company Hochland. In 2004, Lactalis acquired Foodmaster International, a company owning seven dairy factories in Kazakhstan, Moldova and Ukraine that produce milk, kefir, sour cream, yogurt and cheese. In Russia, Lactalis owns Lactalis Istra, a factory located near Moscow with capacity to produce up to 6,000 metric tons of cheese annually, and in Ukraine it owns a dairy plant in Nikolaev that produces various dairy products. Due to their increased domestic production of yogurt and dairy desserts, foreign producers have become our main competitors in these sectors, whereas we mainly compete with domestic producers in the traditional milk products sector.

We believe that we have several important competitive advantages that will allow us to maintain a leading position in the Russian dairy market: strong and diversified brands, stable access to raw milk, a broad distribution network, new product development focus, modern production assets and technology, access to external capital and a strong management team. We also benefit from our strong regional production base, while our foreign competitors must generally transport their yogurts and premium segment desserts from Moscow to the regions, which is costly and logistically complex.

We intend to take advantage of these strengths through our strategy of promoting brand awareness and loyalty with an emphasis on product quality, as well as by continuing our efforts to focus on developing new products equal to or better in quality than those offered by Western producers.

#### **Beverage products and brands**

Our beverage products consist of juice and bottled mineral water products. In 2006, juice products made up 96% of beverages sales with bottled mineral water accounting for 4%.

Our juices are produced primarily at the Ramenskiy Plant in Moscow (renamed to Wimm-Bill-Dann Beverages in 2007) and at Fruktopak in Tula, and we have also installed juice lines at our dairy production facilities in Vladivostok, Novosibirsk and at the Tsaritsino Dairy Plant in Moscow. Our mineral water is produced at our two plants in the Essentuki area.

Our principal beverage product lines and types of products and brands are as follows:

| Product Line                                      | Brands and Types of Products  |
|---|---|
| Juice and nectars produced from juice concentrate | <ul style="list-style-type: none"> <li>• J-7, covering 13 kinds of fruit and berry juices and nectars</li> <li>• 100% Gold, covering 9 kinds of fruit and berry juices and nectars</li> <li>• Lovely Garden, covering 17 kinds of fruit and berry juices and nectars, 5 kinds of juices and nectars enriched with vitamins and 3 kinds of traditional Russian berry drinks</li> </ul> |
| Enriched juice-based drinks                       | <ul style="list-style-type: none"> <li>• J-7 Exotic, an exotic fruit juice and nectar range</li> </ul>  |
| Traditional berry-juice-based drinks              | <ul style="list-style-type: none"> <li>• Wonder Berry, covering 7 kinds of berry-juice based drinks and 3 kinds of berry compote</li> </ul>   |
| Mineral water                                     | <ul style="list-style-type: none"> <li>• Essentuki, covering 3 kinds of therapeutic mineral water (Essentuki #4, #17 and #20)</li> <li>• Novoessentukskaya, covering 1 kind of therapeutic mineral table water</li> </ul>   |

Products in the juice market tend to be branded and, as with the dairy market, there are several defined segments. However, the market segmentation tends to fall along different lines than in the dairy market, primarily due to the tendency for dairy products to be considered food staples. We have positioned our portfolio of juice and nectar brands so that we have at least one of our brands in each of the four juice market segments, with two or three brands in particularly competitive segments. The following chart illustrates our estimates of the current market segment positioning for our major brands, as well as a general description of the purchasers which each market segment covers:

| Segment      | General Purchaser Characteristics   | Juice and nectars produced from juice concentrate | Traditional berry-juice-based drinks | Other juice-based drinks | Mineral water     |
|--------------|---|---|--------------------------------------|--------------------------|-------------------|
| Upper-middle | <ul style="list-style-type: none"> <li>• Aged 20-45</li> <li>• Men and women in the middle to upper-middle income bracket</li> <li>• Active, optimistic and open-minded</li> </ul>                              | J-7   | Wonder Berry                         | J7 Exotic                | Essentuki         |
| Middle       | <ul style="list-style-type: none"> <li>• Aged 25-45</li> <li>• Primarily married men and women with children in the middle income bracket</li> <li>• Self-confident, rational, but not trend setters</li> </ul> | 100% Gold   |                                      |                          |                   |
| Lower-middle | <ul style="list-style-type: none"> <li>• Aged 25-45</li> <li>• Men and women typically with children and below average incomes; family oriented</li> </ul>  | Lovely Garden                                     | Lovely Garden                        |                          | Novoessentukskaya |

In 2004, we introduced new packaging and marketing approaches for J-7 brand products, including a change from Tetra Brik and Tetra Slim to Tetra Prizma and the launch of PET packaging. When launched, the new products with PET bottle packaging were unique for the Russian market. We also launched a new product under our Lovely Garden brand in 2004 called Lovely Garden 10 Vitamins. In 2005, we released J-7 Bio, a probiotic drink sold in PET bottles. We also began selling berry compotes under the Wonder Berry brand at the end of 2005, and began producing 3 types of mors, a traditional Russian berry drink, under the Lovely Garden brand. We also began producing J7 and 100% Gold juices and nectars in 1.5 liter formats, and Lovely Garden juices and nectars in 2.0 liter containers. In





2006, we added a new 0.425 liter container to the Lovely Garden range, and began selling certain juices and nectars in PET bottles. We also began producing 100% Gold juices and nectars in 0.5 liter formats.

Our main water brand is produced at factories from underground wells in the Essentuki area of Russia. Our mineral water products are positioned in the upper-middle segment of the market and cater to consumers who prefer bottled natural mineral water to purified or ordinary tap water. In 2005, we merged our water and juice businesses into a single beverages business unit to further reduce costs and benefit from natural synergies.

In August 2003, we acquired underground wells and a factory that produces Essentuki mineral water and acquired an additional Essentuki mineral water plant in October 2005. Essentuki brand water is mineral water from the Essentuki area of Russia, which is known for its mineral waters and spas. Essentuki was a famous Soviet brand, and is still one of Russia's best known mineral water brands. It is produced and bottled by several manufacturers in the Essentuki area in recognizable 0.54 liter dark green bottles long associated with the brand. We also produce Essentuki in 1.5 liter plastic bottles. We remain committed to expanding our Essentuki production capacity.

Although there is no significant history of consumption of non-aerated bottled drinking water in Russia, the situation is changing due to environmental factors. There is a rising interest in bottled drinking water in Russia, especially in large cities such as Moscow. The mineral water market is expanding not only in terms of production volumes, but also in terms of the number of brands. Moreover, the number of Russian premium brands is growing, while the share of imported brands is declining.

Our aim in entering the bottled water sector is to satisfy the growing demand among Russian consumers for quality mineral water using ecologically pure Russian sources. We believe that consumers will eventually distinguish and value the superior quality spring and natural water that we offer them as opposed to purified water.

We believe that our primary competitors in this area are Pepsi's Aqua Minerale and Coca-Cola's BonAqua, as well as Borzhomi, Narzan and Saint Springs, all of which are produced in the CIS. We have positioned our brand in a more up-to-date style, accentuating the fact that it is naturally produced mineral water, and offer both still and carbonated waters in a variety of bottle sizes, giving consumers a wider selection.

**Market trends and competition.** The Russian juice market grew steadily from the time of the dissolution of the Soviet Union until the 1998 financial crisis, following which there was a significant decrease in consumption from which the market had substantially recovered by 2000. The total market for juice products, defined as the total consumption of domestically produced and imported products, increased to 2,515 million liters in 2006, according to Business Analytica, from 2,191 million liters in 2005. We believe that rising household incomes in Russia and the increasing preference for juice over fresh fruit, which generally accompanies increased incomes, will encourage the consumption of vitamin-rich, value-added products with different tastes and nutritional characteristics. For example, according to Business Analytica, in Moscow, which enjoys higher average per capita incomes than most other parts of Russia, the average consumption of juice in 2006 was approximately 44 liters per capita, as opposed to national per capita consumption of approximately 19 liters per capita. The most dynamic growth in recent years has been in the lower-middle price bracket, which we expect will continue to drive market growth in the foreseeable future.

The markets for juice products in Moscow, the Moscow region and St. Petersburg are relatively mature compared to other regions of Russia, and are expected to exhibit relatively modest growth rates in the future, with particular growth expected in the upper-middle product segment. We believe that significant growth opportunities lie in the regions of Russia. In many of them juice is still a novelty and we believe that with rising household incomes there will be a growing demand for lower-middle juice

offerings. The operating environment has been challenging since the 1998 financial crisis. Competitive pressures have intensified because of the low purchasing power of households outside of Moscow and St. Petersburg and the rising number of domestic producers. We initially responded to this competitive challenge by introducing two new brands, one targeted at the middle-market price segment and the other at the mass-market price segment. In addition, we have been revising our juice distribution network, reducing the number of distributors we work with and maintaining relationships with distributors having direct distribution capabilities. We believe that, together with the launch of new products, the increased share of higher-priced products in our product mix, increased advertising, new packaging and increased production capacity, these strategies will increase public awareness of our products and our sales, which will allow us to expand our market share at acceptable prices.

In the Russian juice market, according to a Business Analytica survey of all of Russia, we had a 19% market share in value terms at the end of 2006.

Our principal competitors in the Russian juice market include the following companies:

- *Multon* is based in St. Petersburg and, according to Business Analytica, had a 21.1% market share in Russia at the end of 2006. Its Rich, Kind and Niko brands entered the Moscow market in 1998 and since then have gained significant market shares primarily through aggressive pricing policies and advertising. Multon was purchased by Coca-Cola in 2005.
- *Lebedyansky* is based in the Lipetsk region and, according to Business Analytica, had a 28% market share in Russia at the end of 2006. Its Tone, I, Fruit Garden and other brands have become well-known among Russian consumers. Lebedyansky recently acquired a majority stake in Progress, a juice concentrate producer. Lebedyansky raised over \$150 million in its initial public offering in Russia in 2005.
- *Nidan* is a Novosibirsk-based Russian company that, according to Business Analytica, had a 15.6% market share in Russia during 2006.

The market for mineral water is characterized by rising consumption, as well as many local brands that are strong in their respective home regions. According to Business Analytica, the total market for bottled water in Russia increased to 2,970 million liters in 2006 from 2,380 million liters in 2005. Russian bottled water producers dominated the market, with a 67% market share in terms of value, while the share of the two market leaders, PepsiCo and Coca-Cola, accounted for 33%, according to a Business Analytica survey of Russia's 10 largest cities in 2006. According to the same survey, we were among the top ten water producers in Russia, with a 2.7% market share by value. The market growth in recent years has been driven mainly by the increased consumption of bottled water sold in large packaging, which is consumed for drinking, as well as cooking purposes. We believe that this market will continue to expand in the coming years due to the growing per capita income in Russia and increasing concern among the population over food and water quality.

#### **Baby food products and brands**

Our baby food products, sold under the Agusha brand, include liquid dairy baby food, juice, purees and products for pregnant and nursing women. These products are mainly produced at the Moscow Dairy Baby Food Plant and at the Kursk Baby Food Plant as of late spring 2007. In 2006, baby food products comprised 6.6% of our total sales.

In 2005, we created a separate baby food segment. Prior to 2005, baby food was part of our dairy segment.

We are currently developing our baby food division by focusing on regional expansion and increased production. We also plan to launch new products, as well as expand the range of the existing ones.

To further our development strategy, we acquired the Kursk Baby Food Plant in July 2005 and have overhauled it throughout 2006 and early 2007. The plant sources certain of its raw materials from its own fruit orchards, and our acquisition of the plant will allow us to expand our baby food product range to include fruit and vegetable purees.

**Market trends and competition.** The baby food market in Russia has been experiencing dynamic growth in recent years, supported by improved market conditions, including rising average incomes, more stringent government regulation of baby food production and the introduction of various state-supported social programs aimed at improving domestic birth rates and providing maternity assistance. As a result of these improved conditions and increased consumer demand, domestic production of baby food products has increased over the last few years, with certain of Russia's major juice and dairy producers increasing their production capacity and introducing new baby food brands. Foreign producers are also active in the market and, similar to the dairy and juice markets, several such producers have begun to focus on establishing local production capacity in Russia. We believe that market consolidation is likely over the next several years, with the largest foreign and domestic baby food producers acquiring smaller regional producers in order to increase their production capacity. In addition, we believe continued market growth will lead to the emergence of product price segments similar to those in the juice and dairy markets. Given the existing low per capita consumption of products specifically produced for babies and the fact that spending on such products increases as family incomes grow, we see this market segment as providing an opportunity for growth. Another factor driving the growth of the Russian baby food market is the increase in the number of infants aged four and under by 3.5% in 2005 and by 2.5% in 2006.

We were the market leader in dairy products for kids and infants in Russia in 2006, with 63% value share, followed by Petmol (part of Unimilk, Tyoma brand) with 25% value share. Nestlé and Nutricia were the market leaders for powdered formula and cereals, with 46% and 34% value shares in powdered formula and 19% and 28% value shares in cereals, respectively. The preceding market share data is in value terms and based on MEMRB Retail Tracking Services' latest research. Local producers of baby food products are also active in regional markets, the largest of which are the Zelenodolsk Baby Food Dairy Plant, Ekaterinburg Dairy No. 1, Novosibirsk Dairy and Ratmir Tver Dairy.

Among the leading producers of baby food products in Russia are foreign producers such as Nestlé, Nutricia, Heinz and Hipp, which generally operate in all of the main baby food categories, as well as domestic producers such as us, Nutritek, Azov KDP, MK Tikhoretsky and Lebedyansky, which generally operate in select baby food product categories. According to MEMRB, the foregoing producers held an approximately 78% market share in the Russian baby food market during 2004 in terms of value. According to our estimates, the market share of foreign producers declined in 2005 and 2006, while the market share of domestic producers increased. However, sales of baby food products in Russia increased during this period for both foreign and domestic producers due to the overall growth in the market.

In addition to our Agusha brand, other brands competing in the infant liquid dairy products market include baby food brands Rastishka Tema, Prince, Nasten`ka and others. In the supplemental infant foods category, we compete with brands including Azov, Vinni and FrutoNyanya. In the cereals category, our main competitors consist of brands from foreign producers, including Nutricia, Kolinska, Podravka and Heinz. The main producer of baby drinking water is Zelnogradsky Istochnik, producing under the Malyshka brand.

#### **New Product Development**

For a leading consumer goods company operating in an ever more competitive marketplace, we rely on the process of innovation in order to strengthen our market position and win market share in other segments. A high technology research and development capability is a crucial competitive advantage for us and a key to our long-term profitability growth.

Our Research and Development (R&D) base, employing more than 40 people, is located at Lianozovsky Dairy Plant in Moscow, the company's flagship enterprise and one of the largest and one of the best technically equipped dairy production facilities in Europe. R&D creates and tests new products for the company's Dairy, Beverages and Baby Food Units, working closely with production across the company. Since 2006, with the creation of the new post of Head of Marketing and Innovation, R&D is working even more closely with Marketing to combine intelligence and research about changing consumer habits and patterns to develop new products across all three main business units.

Innovations can include enriched versions of existing products, new formats and packaging for popular products changing how they are consumed and wholly new products for the Russian market. New packaging technology can turn a product into a convenient snack or meal, such as Happy Milkman kasha with a spoon. All of these innovations are aimed at providing higher margin goods for the company and nutritious, convenient and tasty foods for the consumer.

Looking forward, new product development is being conducted in line with the company's mission to provide healthy, high-quality and safe foods for the entire family. Functional foods, products aimed at women and convenience products for busy lifestyles are key areas of focus. The department is working to develop new, enriched products that deliver added nutrition through the use of biologically active ingredients that help deliver essential nutrients. In Baby Food, R&D is focused on the development of new lines of meat and vegetable containing foods, as we look to expand our strong market position in this still developing market segment.

Much of our new product development effort over the past three years has focused on higher-margin, value-added yogurt and dessert products to help ensure that we can offer products that match the quality and variety offered by our main foreign competitors in Russia. At present, we are focused on the development of value-added dairy products oriented towards Russian consumers, taking into consideration the general deficit of micro- and macro-nutrients in the diets of the average Russian consumer.

An example of a value-added innovation is our new line of chilled truffles, Morand, launched in October 2006. It is the first line of fresh chocolate launched in Russia and contains fresh cream. Aimed at the premium end of the confectionary market, the truffles are sold in the chilled section of supermarkets.

We also continued to actively develop our cheese products and enriched dairy products during 2005 and 2006. We also expanded our cheese production, introducing new brands and varieties. For example, we introduced a wide selection of processed cheese products under our Happy Milkman brand, as well as hard cheese products sold under the new Lamber brand, including a creamy hard yellow cheese product. In addition, in 2005, we launched a new line of 5 Grain yogurts and cottage cheese products, a low lactose milk under the Bio-Max brand, a fruit smoothie drink La Fruit and a new yogurt product sold with a plastic spoon to enable easy consumption anywhere both under the Chudo brand.

In 2006, we launched a new kefir called Effective under the Bio-Max brand. In addition, in 2006, we launched rice pudding under the Happy Milkman brand.

In the beverages segment, we launched a new product under our Lovely Garden brand called Lovely Garden 10 Vitamins during 2005. In the same year, we introduced new PET bottle packaging for this brand.

In 2006 we launched a new production line at the Kursk Baby Food Plant for juices and fruit purees. In the first quarter of 2007 we launched new Agusha product ranges, including meat and fish purees containing essential vitamins and minerals and made from GM-free ingredients.

## Advertising and Marketing

Brand building and marketing have always been at the core of our business. Since the early 1990s, we have built brands into household names in Russia and the CIS, from the J7 brand of juice to one of Russia's first yogurts under the Chudo brand to Agusha, a popular baby food brand.

Our marketing strategy is aimed at turning our leading portfolio of brands into even stronger competitive advantage. We will aim to accelerate product innovation based on a deeper understanding of consumers and faster reaction to new trends in the marketplace. As the cost of advertising on Russian television continues to rise, we will concentrate on larger and more efficient campaigns to reach target consumer audiences.

Investment in some 10 power brands in 2007 is aimed at increasing their average selling price and market share, while achieving the right product mix. We believe that even our most successful brands still have considerable untapped potential.

In juice, the J-7 brand has seen radical changes in 2007, with a new, targeted advertising campaign, new packaging and new pricing structure.

Instead of viewing products within the context of a single market niche, all of our power brands are today being positioned on the basis of health and wellness, reflecting our mission and the emerging trend toward healthier lifestyles visible today in Russia. We see each brand as a reflection of our broader corporate identity, with our label on every product aimed at conveying a consistent message of quality, tastiness and health.

In addition, the scientific potential of the Research and Development (R&D) division and consumer knowledge have been brought together, with R&D reporting to marketing. The innovation process has been accelerated with a focus on value-added, functional foods.

Our advertising and marketing expenditures of \$54.3 million in 2004, \$57.9 million in 2005 and \$76.2 million in 2006 constituted 4.6%, 4.1% and 4.3% of net sales, respectively. Though we are, in some instances, able to obtain volume discounts, we expect these expenditures, as a percent of net sales, to increase significantly due to market competition and annual media inflation. According to Gallup, in Russia, we were the third largest advertiser in 2004 and the ninth largest advertiser in 2005, and the twelfth largest advertiser in 2006.

We plan to continue to allocate the bulk of our advertising budget to a limited group of strategic brands which are highly ranked in their respective markets. We also plan to continue our aggressive advertising and marketing of selected new products.

We have also built brand awareness through charitable work and sponsored events. For example, in 2004, 2005 and 2006, we sponsored the Tefi National Television Awards program. For several years, we have sponsored International Charity Foundation events benefiting orphans through its Hope Around the World program. We also support several other charitable organizations and serve as a trustee of the Charity Foundation for Special Grants, which was headed by the late Mstislav Rostropovich, a prominent Russian musician.

## Sales and Distribution

In 2006, we made substantial investments in our Sales and Distribution (S&D) function as part of a long-term commitment to improve our route-to-market and enhance the management of our supply chain.

Today, Russia's retail landscape is in the midst of a transformation. International and domestic food retail chains, the familiar retail model in Western countries, have expanded, replacing more traditional

outlets such as open markets and kiosks. According to a Business Analytica retail audit in Russian cities with 100,000 plus population, at the end of 2006, modern format food retailers, including supermarkets, hypermarkets and discounters, accounted for around 25% of all retail food and beverage spending. By 2010, modern formats are expected to account for nearly 35% of all retail food spending in Russia.

In Moscow, the country's largest single market, this ratio is considerably higher and in the last few years, foreign and domestic retail chains have focused on expanding in large regional cities, in particular targeting fast-growing but under-served regions such as the Urals and Siberia. At the same time, the absolute size of the retail market continues to grow every year, with Russia's regional markets seeing the fastest growth. According to Russia's federal Rosstat statistics agency, total retail sales grew by around 13% year-on-year in 2006 for Russia as a whole.

We attempt to meet the changing and increasing demands of our customers by planning appropriate stock levels and reasonable delivery times consistent with achieving the optimal economics of distribution. In order to achieve these objectives, we have developed a network of distribution centers and trade offices throughout Russia and other countries of the CIS. Specifically, we had 14 dairy distribution centers by the end of 2006. This number had reached 20 by the end of March 2007. We also had 15 beverage trade affiliates that provide us with a broad national presence and facilitate the sale of our products in populous regions and in certain regions where we do not own production facilities. These distribution centers function as distribution points in their respective regions, and also coordinate certain local trade marketing. We also sell our products directly from our production facilities.

A key part of our strategy is to enhance control over the "route-to-market" and collaborate successfully with retailers to ensure key brands are well positioned in retail outlets, priced correctly and maintained at the same high quality as when they left the factory. Investment in our own fleet of cold-chain delivery vehicles represents a substantial upfront cost, but ensures better control and flexibility over deliveries of perishable dairy products. Across the company, improvements are being made to the supply chain to reduce costs, maintain quality and tightly track products from the factory to the consumer.

During 2006, we increased the number of sales representatives and focused on the development and training of Key Account Management teams to service key retail customers and take advantage of new opportunities for merchandizing. We are also developing our merchandising standards and setting up showrooms for our sales personnel and distributors to showcase our brands and provide a template for merchandizing strategies.

### **Distribution**

Due to different consumption patterns and product characteristics, our dairy, baby food and beverages businesses require different distribution strategies. We have therefore built two distribution systems: one for our dairy and baby food, and the other one for beverage products, although we use the same marketing approach in each business and take advantage of synergies between the systems to the extent possible.

Given the limited shelf life of dairy products, their distribution tends to focus on local customers near the production facilities. Typically, key dairy sales personnel are located at the production plant and are responsible for regional sales activities mainly aimed at large retail outlets, including facilitating orders, coordinating deliveries to chains and retail outlets, customer account management, marketing analysis and reporting to headquarters.

Our infant dairy products produced by the Moscow Baby Food Plant are also purchased by the Moscow City Government, which, in turn, distributes them through specialized milk kitchens located around Moscow and the Moscow region. In 2005 and 2006, the Moscow City Government purchased 36% and 33% respectively of our total baby food sales. The baby food product sales volume distributed through

the milk kitchens has been decreasing while, at the same time, the volume of commercial sales has increased. For a description of the risk relating to our reliance on the Moscow City Government to purchase our infant dairy products, see Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry In the event that the Moscow City Government were to reduce significantly the prices or the amount of products it purchases from our baby food business, then our revenues and profits from this business could be reduced.

Our beverage products have longer shelf lives than dairy products, which allows us to distribute these products to customers across the country. We have established a broad distribution network, with distribution centers in all key Russian cities with populations of more than one million and representative offices and sales agents in smaller regions. Typically, a distribution center includes sales and marketing personnel dedicated to serving each customer group separately, and accounting and logistics personnel.

#### **Customer base and pricing**

Reflecting the many sales channels present in Russia's regional markets, we rely on a variety of them, including independent distributors and wholesalers, supermarket chains, small- and medium-sized grocery stores, open air markets, pavilions and restaurants. However, as the share of chain retailers grows, our strategy has been to increase the share of our own direct distribution to retail clients, while maintaining long-standing, often exclusive relationships with independent distributors in specific market segments and geographic areas.

*Independent distributors.* As a percentage of our total sales during 2006, in terms of product value, we sold 63% of our dairy products, 79% of our beverage products and 46% of our baby food products through large networks of independent distributors. The process is controlled by our sales personnel.

- All of our dairy distributors in Moscow are exclusive to us and do not distribute the dairy products of our competitors. We also implemented a segmentation program among the Moscow distributors whereby each distributor controls the distribution of a particular segment or segments of the dairy product market and distributes in accordance with our unified pricing scheme. In St. Petersburg and the surrounding areas, we also have large independent distributors who purchase products from us in accordance with the segmentation program. We believe that this strategy increases the quality and efficiency of distribution while allowing distributors a larger financial stake and incentive to operate high-quality distribution channels.
- As of December 31, 2006, our beverage product distribution network consisted of 15 affiliate offices throughout Russia. We have reduced the number of distributors we work with and broadened the scope of sales made through the distributors to include sales to sub-distributors, wholesalers and small retailers. In Moscow, our independent distributors act principally as logistical coordinators, as our sales representatives work directly with retail outlets and other customers in making sales but rely on the distributors to execute the orders through delivery and payment collection. Outside of Moscow, we rely more heavily on our independent distributors to make sales in addition to coordinating payment and delivery logistics. Some of our beverage distributors have teams devoted exclusively to the sale and distribution of our products, with such teams compensated by us and the relevant distributor.
- A number of independent distributors with whom we work purchase both dairy, beverage and baby food products from us. We offer our independent distributors certain discounts off our base prices. A long-term tariff plan is developed with each independent distributor that provides the terms of the discount and deferred payment plans. The terms of these tariff plans may be adjusted from time to time based on the performance of a distributor.



- Independent distributors purchase directly from us and then resell our products through their own distribution centers. Given the importance of these customers, we process orders from independent distributors relatively quickly. The Lianozovsky Dairy Plant computer center launched its Internet order system in January 2000, and all orders by our dairy product distributors in Moscow and the Moscow region are now placed through the Internet. In 2001, we started to use an automated order system with all of our independent distributors who purchase our products in large volumes, and in 2002, we began using this automated order system with our smaller independent distributors as well.
- During 2004, we worked and invested with our independent distributors in Moscow to establish warehouses and transportation capable of supporting a cold supply chain in order to maintain our products integrity, freshness and nutritional value.

*Supermarket chains.* As a percentage of total sales in 2006, in terms of product value, we sold 29% of our dairy products, 14% of our beverage products and 21% of our baby food products to supermarket chains in Russia. We believe that the importance of these customers will continue to grow in the coming years. Our approach to supermarket chains is to increase our share in this sector by becoming the supplier of choice to the major retailers by developing key supplier relationships and improving customer service standards. We also sell our products to wholesaler Metro, whose customers are mainly small- and medium-sized businesses that purchase our products in bulk for resale or everyday business use.

While relationships with supermarket chains are currently beneficial for us, we expect that the growth of certain chains and consolidation of market power may increase the bargaining power of some of these customers. For example, some Russian supermarket chains have, from time to time, created informal alliances in an attempt to obtain greater price discounts from manufacturers. We do not intend to seek or sustain inefficient sales volumes and may withdraw from unprofitable business relationships. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry Our substantial reliance on independent retailers and independent distributors for the distribution of our products could lower our turnover and reduce our competitiveness.

*Other sales.* We sell our juice products directly to certain airlines, restaurants, schools, hotels and other establishments, while our baby food products are sold to milk kitchens in Moscow pursuant to the terms of a Moscow City Government tender. As a percentage of total sales in 2006, in terms of product value, we sold 5.3% of our dairy products, 5.2% of our beverage products and 33% of our baby food products to these other customers.

#### **Transportation**

We sell from our plant warehouses, distribution centers or through direct delivery. We deliver our products to customers directly using third-party truck and railway delivery services and our own truck fleet. We do not charge our customers a delivery fee for the shipment of products to our regional distribution centers, though a delivery fee may be assessed for the delivery to a customer from such distribution centers.

#### **Export program**

We began exporting our juice products, in particular our Wonder Berry traditional berry-juice drinks, to Western markets in 1999, mainly focusing on Russian communities abroad. We selected this product because of its distinctiveness and the opportunity it presented to take advantage of the expansion of the red-berry juice market in Europe.

We currently export our juice products to the United States, Canada, Australia, Germany, France, Israel, Latvia, Estonia and Lithuania. Our juice products are distributed in these countries through independent distributors and are sold in various national and multinational retail chains. Our products are

also exported and sold through various sales channels in CIS countries such as Georgia, Armenia and Moldova, and we further developed our distribution channels, marketing efforts and sales in Belarus during 2006. We also export our Essentuki mineral water, principally to the United States, Canada and Moldova. Our beverages export sales totaled \$2.6 million in 2004, \$3.0 million in 2005, and \$3.3 million in 2006.

We export dairy products to Belarus, Azerbaijan, Georgia, Moldova, Turkmenistan and Armenia. Our dairy products are distributed in these countries through independent distributors, and our dairy export sales totaled \$2.5 million in 2004, \$4.2 million in 2005 and \$8.6 million in 2006.

At the end of 2005, the Tsaritsino Dairy Plant received a license to export dairy products to the EU. During the licensing process, all of the plant's equipment and production, technological and control processes were inspected to ensure compliance with international norms and standards. The Lianozovsky Dairy Plant received a similar license in 2004 and currently exports dairy products to the Baltic States and Germany.

We routinely participate in trade shows in foreign countries and work with foreign distributors on promotional campaigns and product tastings. We also engage in market tests and market research in, as well as one-off deliveries to, foreign countries in order to determine future potential markets. We are a three time recipient, most recently in 2005, of The Best Industry Sector Exporter award from the Trade and Economic Council of the Russian Ministry of Economic Development.

In exporting our products to a country, we attempt to meet the applicable legislation governing the import of food products into the country. Independent distributors have, in some cases, attempted to export products to other countries that did not meet applicable legislation.

#### **Production and raw materials**

#### **Production efficiency and quality**

Our Quality System (QS) is a clearly defined set of procedures that work together to ensure quality process control and quality assurance.

Our QS undertakes Supplier Assessment audits to ensure suppliers provide materials that meet our exacting quality standards. This includes raw materials for making our products, packaging and equipment. Our experts work with existing and prospective suppliers to ensure their goods can demonstrate compliance with our quality, safety and performance standards. Suppliers are graded and assigned Key Production Indicators (KPIs) based on the criteria of product quality, delivery, cost and responsiveness. This work not only ensures suppliers meet our standards but helps make them more efficient, lowering our input costs.

The QS plays a critical role in ongoing technological integration across all of our factories and trading groups. In the Dairy Business Unit, where we have invested substantially since 2003 in modernizing acquired production facilities, quality control experts have led the Unification Project, aimed at establishing tight coordination of the manufacturing process at many of our geographically distant plants. Consistent manufacturing procedures and technology mean plants operating thousands of kilometers apart can make products with consistently high and uniform taste and quality.

We have our own certified research laboratory with a team of scientists and experts. Samples of all our primary ingredients and samples of our final products undergo microbiological analysis and in-depth testing. In addition, we have laboratories at all of our plants that perform quality checks on our products at all stages, including quality checks on the raw milk supplied by dairies to us, the materials at our production facilities and the finished products in our warehouses.

The Trade QS measures the quality of the product and packaging in the marketplace itself. Under a system being launched in 2007, trade sampling and laboratory analysis match products against our specifications and provide a Quality Index calculation determining whether a product meets the high standards set by us for our consumers.

In developing new types of products, we cooperate closely with the Institute of Nutrition of the Russian Academy of Medical Sciences, Moscow State University of Food Production, Moscow State University of Applied Biotechnology, All-Russian Institute of Dairy Industry and the GFL-Laboratory in Berlin, Germany. This cooperation has provided our employees with scientific advice, solutions to technical problems and on-site training. We also work closely with several multinational raw material and additive suppliers in order to benefit from their collective technical expertise in relation to our new product development and evolving quality standards.

In addition, our researchers and quality control experts work closely with Russian federal bodies and their regional and local departments, such as the Sanitary and Epidemiological Inspectorate and the country's main consumer safety agency, known as Rospotrebnadzor. We work actively with lawmakers and government experts to develop new regulations and procedures for the food industry aimed at making sure rules are clear for all participants.

In addition to compliance with the relevant Russian quality standards, we attempt to ensure that our products conform to the quality standards of organizations such as the World Health Organization, l Association Francaise de Normalisation and the Food and Agricultural Organization, as well as the regulations of the European Union. We are also a member of the International Federation of Fruit Juice Producers, the Russian Union of Juice Manufacturers and the Russian Dairy Union. Additionally, we assist relevant Russian government agencies in initiating and developing corresponding regulations for the Russian market.

To improve the feedback and receive queries from the customers a nation-wide toll-free hot-line was developed and implemented. The number is printed on our packaging for all of our products.

We have been upgrading and expanding our facilities with advanced technological engineering. Our significant investments in manufacturing have helped enable our products to compete with those of leading domestic and international manufacturers. For example, at the Lianozovsky and Tsaritsino Dairy Plants, we installed new equipment improving the quality of raw milk used in production; at the Timashevsk Dairy Plant, we installed an automatic system controlling production processes; and at the Vladivostok Dairy Plant, we modernized the water purification system. Additionally, the reconstruction of the Moscow Baby Food Plant and installation of new production lines there have allowed us to improve the quality of the products produced at this plant. All the lines at the Moscow Baby Food Plant are now equipped with aseptic technology. The method of ultrafiltration we use at this plant also allows us to produce a children's cheese paste which retains its most beneficial nutrient, serum protein, giving it a higher nutritional value than similar products manufactured at other dairy plants.

During 2005, we continued to modernize the Lianozovsky and Tsaritsino Dairy Plants by upgrading acceptance workshops, broadened our cheese production capacity at the Rubtsovsk Dairy Plant in order to satisfy the growing demand for our hard cheese products and added a new production line for porridges and processed cheese at the Timashevsk Dairy Plant. At the Tsaritsino Dairy Plant, we installed new production lines for yogurt in unique packaging with a spoon attached and a new production line for a smoothie beverage sold under our new La Fruit brand. At the Vladivostok Dairy Plant, we installed three juice production lines to produce Lovely Garden and J-7 juice products.

During 2006, we installed a new innovative line of fruit preparation that allows us to improve the quality of jams used in our products. A unique technology for aseptic dairy-based sauce production was developed and implemented at Lianozovsky Dairy Plant. A new filling line with tunnel autoclave was

installed at the Kursk Baby Food Plant. New technologies for purification of raw juice were implemented at Rameskoye.

We are currently starting the installation of new production lines and upgrading of the existing ones at our newly acquired plants, Ochakovskiy Dairy Plant, Manros and Angarsky Dairy Plant (MOLKA). These renovations are expected to be completed by the end of 2007

#### **Food raw materials**

The main raw materials we use in our production include the following:

- raw milk, which we generally obtain from domestic farmers;
- powder milk, which we generally obtain from our own production, domestic producers or import;
- bacteria cultures, which we generally import;
- flavorings, which we generally import;
- sugar, which we generally import;
- juice concentrate and juice puree, which we primarily import, but also purchase domestically; and
- other ingredients such as frozen fruits, aromas and stabilizers.

The prices of each of the foregoing raw materials are generally volatile.

Our purchasing policy is to build long-term strategic relationships with the suppliers-partners. We have focused on developing partnerships with established leaders in the field of local and global food production, including the leading Russian and international sugar, fruit concentrates and purees, powder milk, frozen fruits and ingredients producers.

We purchase almost all of our raw materials from the producers and do not engage in a significant amount of barter transactions. We purchase certain raw materials such as bacteria cultures, juice concentrates and flavors from foreign manufacturers when products of appropriate quality are not available locally.

With the aim of ensuring a stable supply of raw milk at reasonable and forecasted prices, ensuring consistent quality of milk and balancing out seasonality, we are moving towards long-term milk supply contracts, leasing milking and refrigeration equipment to local producers, providing selected local milk producers with working capital loans or guarantees, assisting with long-term subsidized bank financing arrangements, contracting directly with farmers and avoiding middlemen and working with the state authorities that regulate this sector. We also created a separate Agro business unit in 2004 for the purpose of buying and managing a select number of dairy farms in certain Russian regions with the aim of developing a guaranteed supply of raw milk at stable prices for use by our dairy division.

***Milk Rivers program.*** We have strengthened our position in the dairy market by developing our own network of raw material suppliers, in significant part through investments that support agricultural producers. Our investment in these programs totaled \$1.9 million in 2005 and \$1.3 million in 2006.

In the summer of 1999, we merged and formalized these programs under our Milk Rivers program, through which we provide local dairies with trade loans, feed, and leased combines and milking and refrigeration equipment. In selecting farms to participate in this program, we choose only those that seek to increase the quality of their products and raise the productivity of their herds. We also look for producers that can help balance out the seasonality in raw milk production volumes.

Under the Milk Rivers program, we have rented advanced milking, feed production, feed-chopping and refrigeration equipment for periods from three to eight years for agricultural enterprises located in the



Moscow and other regions, including Voronezh, Nizhny Novgorod, Ufa, Novosibirsk, Krasnodar and Altai. The lease receivables are offset with milk supplies based on a predetermined schedule during the lease term. The lease receivables are denominated in U.S. dollars and Russian rubles. Equipment leased out to farms includes milking and refrigeration equipment for accelerated milk cooling and the temporary storage of milk at farms and other technical devices that increase the productivity of farms. The type of equipment provided depends on the needs of each particular farm. We have also set up a service center to assist the participants in keeping the leased equipment in good repair.

Under the Milk Rivers program, we also provide loans to Milk Rivers dairy producers for the purchase of dairy cattle. We have also offered seminars and lectures to our Milk Rivers program participants to help them improve the quality of the milk they produce.

We plan to eventually expand the scope of this program to other regions of Russia.

*Other initiatives.* A key factor for enhancing milk productivity of a herd and increasing milk quality is the availability of a good feed base. This particular problem has been one of the most important in recent years and arose because of harvesting problems deriving from a lack of modern harvesting machinery. For this reason, the second stage of the Milk Rivers program has entailed providing a number of the participating agricultural enterprises with new fodder-harvesting machines. German company Doppstadt, through its joint-venture in St. Petersburg, has become our partner in this project.

We believe that providing dairies with wholesome, well-balanced compound animal fodder is essential for increasing the productivity of dairy herds, especially in the winter. We have been working with select farms and fodder producers since 1999. As with the Milk Rivers program, payment for the fodder is made with milk supplies. The offset milk price is in a range which approximates average cash prices for milk.

#### **Seasonality**

The demand for our dairy products is significantly higher during the winter months, when Russian raw milk production is at its lowest. Conversely, during the summer months, we generally experience depressed demand for dairy products, while raw milk production is at its peak. To address these seasonal demands, we have commenced and expanded the production of powder milk at some of our dairy production facilities for use in production during the winter months, and currently produce powder milk at five of our plants: Buryin Powder Milk Plant, Karasuk Dairy Plant, Annino Dairy Plant, Veidelevka Dairy Plant and Tuimazy Dairy Plant.

The demand for our juice products traditionally peaks during April through May and in December. We believe that the high demand during April through May is related to the public's heightened desire for vitamin-rich food and drink products during the transition from winter to spring, and the high demand in December is related to increased juice consumption during the holidays.

The demand for both dairy and juice products in southern Russia rises in the summer due to an increase in the number of tourists.

Sales of certain baby food products are affected by seasonal factors. In particular, sales of juice and purees for babies are typically 10-15% higher during the summer months, while sales of liquid dairy baby products are typically 5-8% lower in the summer due, in part, to the fact that many Russians travel to the countryside for vacations in the summer and are unable to transport such products, which have short shelf lives.

## Packaging

Our principal packaging raw materials include materials needed for packaging our dairy and juice products, consisting mainly of five groups:

- aseptic paper
- nonaseptic paper
- plastics (PP, PE, Polysterene and others)
- foils
- corrugated board

Our main supplier of composed material for the production of milk and juice carton containers is Tetra Pak, the world leader in manufacturing equipment and materials for aseptic packaging of liquid food products.

Tetra Pak supplied approximately 60% of our total packaging materials in 2006 (including carton, plastic, foil and other materials), and we are substantially dependent upon this packaging supplier to meet our requirements.

As a major Russian consumer of Tetra Pak products, we have annual contracts with Tetra Pak, which supplies us from its Russian plants as well as from its other European plants. See Note 27 to our Consolidated Financial Statements included under Item 18. Financial Statements.

We have established similar relationships with companies such as SIG Combibloc (aseptic paper for juice and milk) and Elopak (nonaseptic paper).

As part of our strategy to increase locally produced raw materials, we are developing relationships with Russian manufacturers of packaging materials, in particular with companies such as Gofra, Polimer, Formoline, Formaplast, Eximpack, Lukoil-Neftekhim and Planet Thermoforming.

We focus on two main areas building our procurement strategy:

- standardization of specifications for raw materials and packaging allowing group purchasing
- strategic relationships with key group-wide suppliers

These two factors are aimed at allowing us to benefit from economies of scale, which we believe will lead to enhanced effectiveness and cost optimization.

## Trademarks and Patents

We have registered brand names and trademarks throughout Russia and in other countries. We keep track of our intellectual property and monitor the protection of our brand names and instances of copyright infringement in Russia and the CIS. The extent to which we seek protection of our trademarks outside of Russia and the CIS depends on the significance of the brand and jurisdiction concerned. The brand names listed above under Our products and brands Dairy products and brands and Our products and brands Beverage products and brands, which we have registered in Russia, are material to us. We also own several licenses, patents and proprietary recipes, know-how and technologies related to our products and processes. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry We may not be able to protect our intellectual property rights adequately, resulting in material harm to our financial results and ability to develop our business for a description of the risks related to the protection of our trademarks.

## Insurance

We maintain property insurance coverage for our 19 major Russian facilities, including Wimm-Bill-Dann Foods, Wimm-Bill-Dann, Tsaritsino Dairy Plant, Moscow Baby Food Plant, Ochakovo Dairy Plant, Ramenskiy Plant, Timashevsk Dairy Plant, Obninsk Dairy Plant, Annino Dairy Plant, Ufa Dairy Plant, Siberian Dairy Plant, Vladivostok Dairy Plant, Nizhny Novgorod Dairy Plant, Rubtsovsk Dairy Plant, Pervouralsk Dairy Plant, Healing Springs, Valdai Springs Water Plant, Baltic Milk, Kiev Dairy Plant, Kharkov Dairy Plant, Buryan Dairy Plant, Bishkeksut, Toshkent Dairy Plant and our warehousing facility Roselectrocenter. Insurance coverage is on All Risks basis covering buildings of 15 plants and Roselectrocenter warehouse, equipment at 18 facilities for the total sum of \$485.2 million. We have insurance for business interruption at 14 major manufacturing facilities with the total coverage of \$421.7 million

We have product liability insurance with \$1 million liability coverage per insurance case within the territory of Russia and the CIS countries, \$2.5 million liability coverage per insurance case worldwide except for the territory of Russia and the CIS countries with the cumulative coverage of \$5 million for 26 facilities in Russia.

See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry We do not carry the types of insurance coverage customary in other more economically developed countries for a business of our size and nature, and a significant event could result in substantial property loss and inability to rebuild in a timely manner or at all. See Note 29 to our Consolidated Financial Statements included under Item 18. Financial Statements.

## Environmental and Product Liability

We are subject to the requirements of environmental laws and regulations. While we devote resources designed to maintain compliance with these requirements, we cannot assure you that we operate at all times in complete compliance with all such requirements. We could be subject to potentially significant fines and penalties for any noncompliance that may occur. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry Failure to comply with existing laws and regulations or the findings of government inspections, or increased governmental regulation of our operations, could result in substantial additional compliance costs or various sanctions which could materially adversely affect our business, financial condition, results of operations and prospects.

We also face an inherent business risk of exposure to product liability claims in the event that consumption of our products results in personal illness or death, and we cannot assure you that we will not experience any material product liability losses in the future. In addition, if any of the products we have produced are determined to be unsuitable for consumption, we may be required to participate in a recall involving such products. We have not had any significant historical experience of such claims and are unaware of any potential unasserted claims. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry Failure to comply with existing laws and regulations or the findings of government inspections, or increased governmental regulation of our operations, could result in substantial additional compliance costs or various sanctions which could materially adversely affect our business, financial condition, results of operations and prospects and Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry Independent distributors may export our products to countries where such products do not meet the requirements of applicable legislation. The consequent recalls of our products and the associated negative publicity may adversely affect our reputation in the Russian Federation, the CIS and abroad, and adversely affect our results of operations.



## **Regulation**

Production, sale and distribution of food and beverages in the Russian Federation are regulated by general civil legislation and by special legislation that includes quality standards and various safety and sanitary rules.

## **Government Entities Involved**

Aside from federal executive bodies and their structural subdivisions that have authority over general issues, such as defense, internal affairs, security, border service, justice, tax enforcement and rail transport, there are a large number of government agencies directly involved in regulating and supervising the quality and safety of food in the Russian Federation.

*The Ministry of Health Protection and Social Development.* This Ministry is authorized to issue regulations in various areas, including with respect to sanitary and epidemiological safety and consumer rights protection. The Ministry supervises and coordinates its subordinate bodies, including, among others, the Federal Service for Supervision in the Area of Protection of Consumer Rights and Human Welfare.

*The Federal Service for Supervision in the Area of Protection of Consumer Rights and Human Welfare.* This Service is the principal federal body authorized to supervise sanitary and epidemiological issues in the Russian Federation. The Service enforces sanitary-epidemiological rules (which include sanitary rules, sanitary standards and hygienic requirements), monitors the sanitary conditions of production sites and equipment, fulfillment of sanitary standards for raw material and finished product storage at manufacturing plants, compliance with sanitary standards for the storage and sale of food products, their quality and safety at wholesale and retail outlets and businesses catering to the public. The Service also carries out inspections of sellers' premises.

*The Federal Agency for Technical Regulation and Metrology.* This Agency manages government property in the sphere of technical regulation and metrology. On a temporary basis, until such functions are transferred to other federal authorities, the Agency oversees compliance with obligatory general and industrial standards. This Agency is subordinated to the Ministry of Industry and Energy.

*The Federal Service for Veterinary and Fito-Sanitary Supervision.* This Service supervises the sanitary safety of raw food materials used in the production of food products and beverages where such raw food materials are derived from animals. This Service is subordinated to the Ministry of Agriculture.

## **Applicable Food and Health Legislation**

Russian legislation regulating quality and safety of food and beverages includes the following acts:

*The Federal Law on Quality and Safety of Food Products* establishes a general framework for ensuring that food products and materials used in their production conform to certain quality, safety and sanitary requirements and provides for the state registration and certification of food products once they so conform. It also establishes general requirements for the manufacturing, packaging, storage, transportation and sale of food products and beverages, and for the destruction of poor-quality and unsafe products.

*The Federal Law on the Sanitary Epidemiological Well Being of People* requires food products and beverages, and the raw materials used in their production, to meet certain sanitary standards and health requirements and to have no harmful effects. Products that do not conform to sanitary rules and health requirements and represent a danger to consumers must be withdrawn immediately from production or sale. As a result, the fulfillment of sanitary standards and health requirements is an obligatory condition for the production, import and sale of food and beverage products in the Russian Federation.

*The Federal Law on Technical Regulation* provides for the development, enactment, application and enforcement of obligatory technical requirements and the development of voluntarily standards relating to

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manufacturing processes, operations, storage, transportation, selling and utilization. Amendments to this law, dated May 1, 2007, provide for the adoption of obligatory technical requirements on the safety of food products by January 1, 2010. Until such technical requirements are developed and adopted, the existing standards are mandatory to the extent they are necessary to secure the protection of safety and health, environmental protection and consumers' rights.

*The Governmental Regulation on Monitoring of Quality and Safety of Food Products and Health of People establishes a procedure for supervising and monitoring the quality and safety of food products.*

*The Government Regulation on State Registration of New Food Products, Materials and Goods* provides for the obligatory state registration of certain food products, including mineral water, baby food and dairy products enriched with vitamins and/or other microelements. Food producers intending to develop and offer a new food product to the public are required to file an application for the product's state registration and incorporation into the State Register of Permitted Food Products. Such applications are reviewed by the Federal Service for Supervision in the Area of Protection of Consumer Rights and Human Welfare (together with the Federal Service for Veterinary and Fito-Sanitary Supervision with respect to products derived from animals) within 40 days of their filing.

*The Regulation for the Conduct of Sanitary-Epidemiological Examinations of Products* establishes procedures for the sanitary-epidemiological examination of products. Government bodies that monitor sanitary and health issues conduct sanitary-epidemiological examinations of samples of each product and issue a conclusion as to whether such product satisfies the prescribed requirements. Products that have not undergone a hygienic evaluation may not be produced, shipped, used, sold or certified.

A number of other regulations also apply to food products, including baby food products. For example, requirements for the storage, production, labeling, transportation and sale of food and beverages are established by state standards, sanitary rules, hygienic requirements and other regulations.

In addition, food products may be subject to regulation by regional authorities. For instance, the Moscow Government approved a series of regulations relating to the use of GMO in food products aimed at informing customers about such use and providing preferences to manufacturers who do not use GMO. In particular, in February 2007, the Moscow Government issued a decree recommending that manufacturers refrain from marketing GMO products in Moscow and establishing a voluntary GMO labeling system.

### **Registration Requirements**

Certain food and beverage products (such as children's products, dietary foods, milk products enriched by vitamins and/or other microelements, additives to food and food products manufactured using technologies that have never been applied in the Russian Federation) must be registered with the Russian government if they are either manufactured in Russia or imported into Russia for the first time. The regulation makes it illegal to manufacture, import or circulate products that are subject to state registration but have not been registered.

The product registration process includes:

- An examination of documents provided by the manufacturer or supplier of the product describing the product, its safety and evidencing its conformity with applicable rules;
- Toxicological, hygienic, veterinary and other types of tests of products and, with respect to products manufactured in Russia, an examination of the manufacturing conditions of such products;
- Registration of the product, its manufacturer and supplier with the State Register of Food Products maintained by the Federal Agency for Health Protection and Social Development; and



- Issuance of a certificate of state registration permitting the product to be manufactured, imported or distributed in the Russian Federation.

The state registration of products is carried out by the Federal Service for Supervision in the Area of Protection of Consumer Rights and Human Welfare (together with the Federal Service for Veterinary and Fito- Sanitary Supervision with respect to products derived from animals).

#### **Certification**

The certification of products and services is currently regulated by the Federal Law on Technical Regulation. Product certification is a procedure whereby an agency authorized by the government confirms that a product complies with technical regulations, standards and requirements. Milk products, juice, certain water products and other beverages are subject to mandatory certification. Conformity symbols evidencing that the manufacturer has undergone certification procedures are required to be printed on a product's packaging. Failure to mark a product with a required conformity symbol carries possible administrative sanctions.

#### **Bulk Purchase of Raw Milk**

A supplier of raw milk must provide a certificate stating that the farm from which it originated has passed a health inspection. Milk bought in bulk must also conform to requirements with respect to temperature, color, sedimentation, content of neutralizers, heavy metals, density, protein content, fat content, alcohol content and other characteristics.

#### **Production and Transportation**

Laboratory employees and technical specialists must verify that the condition of equipment, implements, raw materials and packaging conform to sanitary requirements. For example, in the course of manufacturing, microbiological tests must be conducted of samples of raw materials, packaging and products. Products are tested for their content of chemical pollutants, toxins, medicinal and hormonal preparations, radionuclides and pathogenic microorganisms. They are also tested to identify bacteria, yeast and mold content, and to determine their sterility and the effectiveness of the pasteurization process. Products are also examined to determine the amounts of certain nutrients they contain, including protein, fat, vitamins and carbohydrates. In addition, the cleanliness of the factory, storage conditions and employees must be monitored.

Food products and beverages must be transported in specially equipped vehicles, for which sanitary registration documents must have been issued.

#### **Packaging Material and Labeling Requirements**

Manufacturers and suppliers of all types of packaging materials used in the production of dairy and juice products must provide certificates of conformity and sanitary-epidemiological certificates for packaging materials showing that the packaging materials are permitted and safe for contact with the food products.

The Law on the Protection of Consumers' Rights and the Law on Quality and Safety of Food Products determine the scope and format of the information that should be made available to consumers. According to these laws and other applicable national standards, the packaging of finished products must contain the following information: the name of the product, information regarding its certification, conditions of use (if necessary), contraindications (if any), preservatives and food additives, net mass or volume, ingredients, nutritional value, conditions of storage, shelf life, name and address of the manufacturer and other information. The law also authorizes a wide range of government and public agencies to monitor

producers compliance with the requirements of the law and imposes sanctions and penalties if such requirements are not met.

### **Special Requirements for Children's Dairy Products**

The Law on the Quality and Safety of Food Products defines children's food products as food products specially designed for children under 14 that meet certain nutritional requirements. Such products are subject to more stringent sanitary-epidemiological standards. For example, certain ingredients and components are prohibited for use in children's food products, and the procedures for monitoring raw materials and ingredients used in manufacturing, technological processes and sanitary conditions of production are stricter for children's dairy products than for other dairy products. Laboratory analyses and tests must be conducted for a broader list of microbiological indicators. Packaging materials for children's dairy products must be certified for use with children's products. Children's dairy products are also subject to special labeling requirements. For example, packaging of children's dairy products must bear information on the purpose and conditions of use of such products.

Under the Sanitary Rules on Children's Food Products, which became effective on June 1, 2005, the volume of liquid food product packaging for children under three years old cannot exceed 0.35 liter. In addition, such products may be produced only by separate specialized factories or manufacturing lines that are subject to special certification.

### **Competition and Pricing**

The Federal Antimonopoly Service is the governmental agency that regulates the prevention and limitation of monopolistic activity and the support of competition in the market. The Federal Law on the Protection of Competition prohibits the abuse of a dominant position to limit competition. Our subsidiary, the Moscow Baby Food Plant, has been included in the register of entities holding a significant share of the market. Inclusion in this register does not impose additional reporting or other requirements on us; however, because of our significant position, the Federal Antimonopoly Service monitors our activities and we are required to notify the Federal Antimonopoly Service and/or apply for its prior approval for the acquisition of other companies.

### C. Organizational Structure

The following table sets out our primary production subsidiaries, their countries of incorporation and our aggregate beneficial ownership interest and voting interest in each subsidiary as of June 5, 2007.

| <b>Plant</b>   | <b>Beneficial Ownership</b> | <b>Voting Interest</b> | <b>Country of Incorporation</b> |
|--|-----------------------------|------------------------|---------------------------------|
| Wimm-Bill-Dann Plant(1)  | 97.93 %                     | 97.93 %                | Russian Federation              |
| Annino Dairy Plant   | 100 %                       | 100 %                  | Russian Federation              |
| Karasuk Dairy Plant  | 93.80 %                     | 93.80 %                | Russian Federation              |
| Wimm-Bill-Dann Ukraine(2)  | 98.50 %                     | 98.50 %                | Ukraine                         |
| Moloko Veidelevki  | 100 %                       | 100 %                  | Russian Federation              |
| Buryl Powder Milk Plant  | 76.00 %                     | 76.00 %                | Ukraine                         |
| Tuymazinskiy Dairy Plant   | 85.00 %                     | 85.00 %                | Russian Federation              |
| Bishkek Dairy Plant  | 96.10 %                     | 96.10 %                | Kyrgyz Republic                 |
| Gulkevichy Dairy Plant   | 52.27 %                     | 52.27 %                | Russian Federation              |
| Kharkov Dairy Plant  | 99.94 %                     | 99.94 %                | Ukraine                         |
| WBD Toshkent   | 100 %                       | 100 %                  | Republic of Uzbekistan          |
| Obninsk Dairy Plant  | 96.45 %                     | 96.45 %                | Russian Federation              |
| Ochakovo Dairy Plant   | 98.40 %                     | 98.40 %                | Russian Federation              |
| Surgut City Dairy Plant  | 100 %                       | 100 %                  | Russian Federation              |
| Angarsky Dairy Plant (MOLKA)                                       | 83.36 %                     | 83.36 %                | Russian Federation              |
| Krutinsky Creamery Plant   | 100 %                       | 100 %                  | Russian Federation              |
| Manros-M   | 100 %                       | 100 %                  | Russian Federation              |
| Bolsherechensk Dairy Plant   | 79.78 %                     | 79.78 %                | Russian Federation              |
| Pavlogradsky Dairy Plant   | 56.78 %                     | 56.78 %                | Russian Federation              |
| <b>Beverage plants</b>   |                             |                        |                                 |
| Wimm-Bill-Dann Beverages(3)  | 96.68 %                     | 96.68 %                | Russian Federation              |
| Valdai Springs Water Plant   | 100 %                       | 100 %                  | Russian Federation              |
| Essentuki Mineral Water Plant at CMW (Caucasian Mineral Waters)(4) | 100 %                       | 100 %                  | Russian Federation              |
| <b>Farms</b>   |                             |                        |                                 |
| Trud   | 93.26 %                     | 93.26 %                | Russian Federation              |
| Atamanskoe Farm  | 99.53 %                     | 99.53 %                | Russian Federation              |
| Plemzavod Za Mir and Trud  | 100 %                       | 100.00 %               | Russian Federation              |
| Zavety Ilyicha   | 99.59 %                     | 99.59 %                | Russian Federation              |

(1) Formerly Lianozovsky Dairy Plant. In April and May 2007, the following subsidiaries were merged into Wimm-Bill-Dann: Tsaritsyno Dairy Plant, Ufa Dairy Plant, Siberian Milk Dairy Plant, Rubtsovsk Dairy Plant, Siberian Cheese Plant, Nizhny Novgorod Dairy Plant, Baltic Milk Dairy Plant, Nazarovo Dairy Plant, PAG Rodnik, Pervouralsk Dairy Plant, Kursk Baby Food Plant, Moscow Baby Food Plant, Timashevsk Dairy Plant and Vladivostok Dairy Plant. On March 5, 2007, we sold Novokuibyshevskmoloko our Samara region-based subsidiary. See Note 34 to our Consolidated Financial Statements.

(2) Formerly Kiev Dairy Plant 3

(3) Formerly Ramensky Dairy Plant

(4) Our subsidiary Healing Springs was merged into Essentuki Mineral Water Plant at CMW

**D. Property, Plants and Equipment Production facilities**

We currently manufacture our products at 36 production facilities, including 29 plants that principally produce dairy products, two baby food plants, two plants that produce exclusively juice products and three water production plants. We have made substantial investments to maintain and enhance quality, lower costs and increase productivity. Over 2004, 2005 and 2006, we invested approximately \$277.7 million in the modernization of our existing production facilities and \$151.7 million in the acquisitions of new production assets. Our main production plants are capable of managing the production of a diverse and evolving product range, enabling us to adapt quickly to changes in consumer demand on a seasonal basis or otherwise. We have completed the main phase of our extensive modernization program and have begun cost cutting programs at all of our plants.

We also review our production headcount with the aim of enhancing productivity. Sales per production employee, calculated on the basis of our total headcount (excluding newly acquired dairy plants Surgut, Manros-M, Ochakovo, and Angarsky Dairy Plant (MOLKA)), which is a common measure of productivity used in the food industry, was \$138,300 per employee in 2004, \$142,815 per employee in 2005 and \$162,994 per employee in 2006.

In 2006 we started working with an international management consulting firm on a training and business-process optimization program at the Lianozovsky Dairy Plant and Moscow Baby Food Plant in an effort to increase asset utilization, to cut costs, and to raise labor productivity. As a result, we were able to reduce our employee headcount during 2006, excluding the plants we acquired during the second half of 2006, where the reduction of headcount is still in process.

The following table contains data regarding our main production facilities.

|   | Year of<br>Acquisition(1) | Year of<br>Building | Number of<br>Production<br>Lines |
|---|---------------------------|---------------------|----------------------------------|
| <b>Moscow and Moscow region</b>                                     |                           |                     |                                  |
| Wimm-Bill-Dann(2)   | 1995                      | 1989                | 186                              |
| Wimm-Bill-Dann Beverages(3)   | 1997                      | 1982                | 14                               |
| Obninsk Dairy Plant OJSC  | 2005                      | 1982                | 9                                |
| Ochakovskiy Dairy Plant   | 2006                      | 1962                | 18                               |
| <b>Central Russia (excluding Moscow)</b>                            |                           |                     |                                  |
| Annino Dairy Plant  | 2001                      | 1978                | 5                                |
| Tuimazy Dairy Plant   | 2002                      | 1958                | 9                                |
| Essentuki Mineral water Plant at the CMW (Caucasian Mineral Waters) | 2005                      | 2001                | 3                                |
| <b>Siberia and Far East Russia</b>                                  |                           |                     |                                  |
| Karasuk Dairy Plant   | 1999                      | 1952                | 5                                |
| Angarsky Dairy Plant (MOLKA)  | 2006                      | 1956                | 8                                |
| Surgut Dairy Plant  | 2006                      | 1974                | 5                                |
| Manros-M  | 2006                      | 1970                | 8                                |
| <b>Other CIS countries</b>  |                           |                     |                                  |
| Wimm-Bill-Dann Ukraine(4)   | 2001                      | 1973                | 21                               |
| Kharkov Dairy Plant   | 2002                      | 1974                | 16                               |
| Buryl Powder Milk Plant   | 2002                      | 1974                | 4                                |
| Bishkek Dairy Plant   | 2000                      | 1990                | 14                               |

(1) Acquisition means the purchase of more than 50% of the issued share capital. Only plants acquired by us as of December 31, 2006 are included in this table.



(2) Formerly Lianozovsky Dairy Plant. In April and May 2007, the following subsidiaries were merged into Wimm-Bill-Dann: Tsaritsyno Dairy Plant, Ufa Dairy Plant, Siberian Milk Dairy Plant, Rubtsovsk Dairy Plant, Siberian Cheese Plant, Nizhny Novgorod Dairy Plant, Baltic Milk Dairy Plant, Nazarovo Dairy Plant, PAG Rodnik, Pervouralsk Dairy Plant, Kursk Baby Food Plant, Moscow Baby Food Plant, Timashevsk Dairy Plant and Vladivostok Dairy Plant. On March 5, 2007, we sold Novokuibyshevskmoloko our Samara region-based subsidiary. See Note 34 to our Consolidated Financial Statements.

(3) Formerly Ramensky Dairy Plant

(4) Formerly Kiev Dairy Plant № 3

As of December 31, 2006 and 2005 the assets that served as collateral consisted of the following:

- Inventory in the amounts of \$12.1 million and \$3.4 million, respectively;
- Property, plant and equipment with a net book value of \$34.8 million and \$9.4 million, respectively;
- Further, property, plant and equipment amounting to \$33.1 million and \$47.7 million, respectively, served as collateral under the vendor financing agreements.

**Item 4A.** *Unresolved Staff Comments*

None.

**Item 5.** *Operating and Financial Review and Prospects*

*The following discussion of our financial condition and results of operations should be read in conjunction with our Consolidated Financial Statements and the related notes included under Item 18. Financial Statements and other information in this document. This Item 5 contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors, including the risks described in Item 3. Key Information D. Risk Factors and under the caption Cautionary Statement Regarding Forward-Looking Statements. Our Consolidated Financial Statements are expressed in U.S. dollars and prepared in accordance with accounting principles generally accepted in the United States ( U.S. GAAP ).*

**A.** **Operating Results**

**Overview**

We are one of the largest Russian manufacturers of dairy and juice products, with sales of \$1,762.1 million, \$1,394.6 million and \$1,184.0 million in 2006, 2005 and 2004, respectively. Our reportable business segments in 2006 were dairy products, beverage products and baby food products. In 2006, the dairy segment accounted for 75.0% of our sales, the beverages segment, which includes juice and bottled mineral water products, accounted for 18.4% of our sales and the baby food segment accounted for 6.6% of our sales. In 2005, the dairy segment accounted for 72.0% of our sales, the beverages segment accounted for 21.7% of our sales and the baby food segment accounted for 6.3% of our sales. Our principal geographic market is Russia, which approximately accounted for 93%, 92% and 94% of our sales in 2006, 2005 and 2004, respectively. However, we also have production facilities in Ukraine, Kyrgyzstan and Uzbekistan.

In 2006, our net income increased to \$95.4 million from \$30.3 million in 2005, an increase of 215.2%, and sales increased by 26.4%, including sales increases of 31.6%, 6.9% and 33.4% in the dairy, beverages and baby food segments, respectively. By volume, dairy segment sales were higher by 13.2%, beverages segment sales increased by 2.5% and baby food sales increased by 14.7%.



In the dairy segment, our gross margin in 2006 improved primarily due to higher average selling prices due to general price increases, a more favorable product mix, ruble appreciation and a moderate increase in the cost of raw milk compared to prior years. Gross margin decreased in the beverages segment primarily due to certain changes in the structure of our sales which lead to a faster increase of cost of sales than the average price increase. Gross margin was higher in the baby food segment. This was driven primarily by volume growth, as Russia's baby food market continues to grow rapidly in both value terms and geographic reach and also due to a moderate increase in the cost of raw milk compared to prior years, higher average selling prices as a result of general price increases and a shift in our product mix to include more value-added products. Our selling and distribution expenses increased in 2006 as compared to 2005 in absolute terms and also as a percentage of sales, from 13.8% to 14.0%. In particular, our transportation, personnel and advertising costs were higher in 2006 as a result of our regional expansion program.

Over the past three years, we have been constructing new capacity, modernizing existing capacity and making strategic acquisitions. Our capital expenditures (excluding acquisitions) in 2006, 2005 and 2004 were \$130.0 million, \$75.1 million and \$72.6 million, respectively. Expenditures for acquisitions of subsidiaries in 2006, 2005 and 2004 totaled \$137.3 million (exclusive of advances made in 2006 for acquisitions completed in 2007), \$24.3 million (exclusive of advances made in 2005 for acquisitions completed in 2006 but including advances made in 2004 for acquisitions made in 2005) and \$5.3 million (exclusive of advances made in 2004 for acquisitions completed in 2005), respectively.

As of December 31, 2006, we had a total of \$443.0 million in outstanding debt (consisting of notes, vendor financing for property, plant and equipment and loans). Of our total indebtedness as of December 31, 2006, 43.5% was denominated in U.S. dollars and euros and 56.6% was denominated in rubles.

### Operational Highlights for 2006

Below is a summary of our operational highlights for 2006 and beginning of 2007:

2006

|           |  |
|-----------|--|
| April     | Tony Maher was appointed Chief Executive Officer and Chairman of the Management Board. He replaced Sergei Plastinin, one of Wimm-Bill-Dann's founders and CEO of the company since 1992. Mr. Maher brings more than 30 years of experience at Coca-Cola companies to his new position. |
| May       | Standard & Poor's Governance Services announced the upgrade of our Corporate Governance Score (CGS) from 7 to 7+ (from 7.3 to 7.7 accordingly on the Russian national scale). The upgrade makes the company's rating the highest in Russia.  |
| May       | Board recommended the payment of dividends for the financial years 2002-2004 in the amount of RUR4.60 (approximately US\$0.17) per share, as well as for the first quarter of 2006 in the amount of RUR2.27 (approximately US\$0.08) per share.  |
| September | New Head of Beverages Business Unit, Silviu Popovici, appointed. Mr. Popovici has extensive experience in sales, marketing, operations and general management with global companies Bristol-Myers Squibb and Coca-Cola in Romania, Russia and Ukraine.                                 |
| September | We acquired 100% stake in Surgut City Dairy Plant. The acquisition allows us to strengthen our presence in the wider target markets of the Urals and Siberia.  |

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November Group Head of Marketing and Innovation, Grant Winterton, appointed. This new senior position underscores our strategic focus on marketing. Along with directing the marketing heads of the Dairy, Beverages and Baby Food Units, Mr. Winterton also oversees the Research and Development division, in order to ensure new product development is aligned with market expectations and demand.

November Certain shareholders in our controlling group of shareholders, some of whom are members of our board of directors, completed a secondary offering of common stock on the Russian stock market. Russian and foreign institutional investors acquired 4,400,000 local common shares of Wimm-Bill-Dann Foods (or 10% of the outstanding shares) in an underwritten public offering. The company did not sell any shares in, or receive any of the proceeds from, the offering. The shares were offered to the market within a US\$36 to US\$39 per share range, and sold at US\$37.5 per share.

November We acquired a 93.74% stake in Moscow-based Ochakovo Dairy Plant, the fourth largest dairy producer in Russia and one of the largest dairy enterprises in Moscow.

December We acquired 100% of Omsk-based dairy producer Manros, the largest independent dairy product manufacturer in Siberia and Russia's Far East. The deal reflects our strategy of acquiring successful companies with leading market positions in their respective regions, possessing strong brand portfolios.

December In December, at Wimm-Bill-Dann's Extraordinary General Meeting of Shareholders, the board recommended the payment of dividends for the 9 months of 2006 in the amount of RUR 7.86 (approximately US\$0.30) per share.

December We acquired an 83.36% stake in MOLKA dairy plant in Irkutsk region, an important milk processing enterprise in Eastern Siberia, one of our key target markets.

**2007**

February On February 8, 2007 our executives, directors and shareholders marked the fifth anniversary of the company's initial public offering on the New York Stock Exchange by ringing the opening bell of the NYSE trading session. At the close of trading that day, our share price was US\$66.0 and market capitalization was US\$2.73bn.

February UBS (Luxembourg) S.A. issued 7.5% Loan Participation Notes due 2008 for the sole purpose of funding a \$150 million loan (the Loan). The Loan will mature on May 14, 2008 and bears interest at an annual rate of 7.5%, payable in arrears on November 14, 2007 and May 14, 2008. The loan agreement contains a number of covenants, including requirements to maintain certain financial ratios.

March We sold our 87.13% stake in Novokuibyshevsk Dairy Plant, which was impaired in the third quarter of 2006. This transaction brought the overall number of our production facilities to 36.

April New Head of the Baby Food Business Unit, Gary Sobel, was appointed. Mr. Sobel began his career at Procter and Gamble, where over 13 years he worked in various positions in Canada, the US, the UK and Russia. From 2005, Mr. Sobel headed Dirol Cadbury (a division of Cadbury Schweppes) in Russia.

|       |  |
|-------|--|
| April | On April 25, 2007, the following subsidiaries were merged into Wimm-Bill-Dann (formerly Lianozovsky Dairy Plant): Tsaritsyno Dairy Plant, Ufa Dairy Plant, Siberian Milk Dairy Plant, Rubtsovsk Dairy Plant, Siberian Cheese Plant, Nizhny Novgorod Dairy Plant, Baltic Milk Dairy Plant, PAG Rodnik, Nazarovo Dairy Plant, Pervouralsk Dairy Plant. |
| May   | On May 29, 2007, we acquired an additional 30.12% stake in the founding capital of Obninsk Dairy Plant OJSC, increasing our share to 96.45% of its charter capital.  |
| May   | On May 31, 2007, the following subsidiaries were merged into Wimm-Bill-Dann: Kursk Baby Food Plant, Moscow Baby Food Plant, Timashevsk Dairy Plant and Vladivostok Dairy Plant.  |

## Results of Operations

The following table summarizes the results of our operations for the years ended December 31, 2006, 2005 and 2004:

|                                     | 2006<br>(in thousands) | % of<br>sales | 2005<br>(in thousands) | % of<br>sales | 2004<br>(in thousands) | % of<br>sales |
|-------------------------------------|------------------------|---------------|------------------------|---------------|------------------------|---------------|
| Sales                               | \$ 1,762,127           | 100.0         | \$ 1,394,590           | 100.0         | \$ 1,183,986           | 100.0         |
| including:                          |                        |               |                        |               |                        |               |
| Dairy                               | 1,320,901              | 75.0          | 1,003,601              | 72.0          | 818,279                | 69.1          |
| Beverages                           | 324,074                | 18.4          | 303,147                | 21.7          | 301,050                | 25.4          |
| Baby Food                           | 117,152                | 6.6           | 87,839                 | 6.3           | 64,657                 | 5.5           |
| Cost of sales                       | (1,194,159 )           | 67.8          | (999,006 )             | 71.6          | (858,767 )             | 72.5          |
| Gross profit                        | 567,968                | 32.2          | 395,584                | 28.4          | 325,219                | 27.5          |
| Selling and distribution expenses   | (246,054 )             | 14.0          | (191,990 )             | 13.8          | (173,433 )             | 14.6          |
| General and administrative expenses | (134,481 )             | 7.6           | (109,642 )             | 7.9           | (92,816 )              | 7.8           |
| Other operating expenses            | (31,812 )              | 1.8           | (6,457 )               | 0.5           | (6,047 )               | 0.5           |
| Operating income                    | 155,621                | 8.8           | 87,495                 | 6.3           | 52,923                 | 4.5           |
| Financial income and expenses, net  | (15,480 )              | 0.9           | (22,868 )              | 1.6           | (14,618 )              | 1.2           |
| Provision for income taxes          | (41,560 )              | 2.4           | (30,712 )              | 2.2           | (12,170 )              | 1.0           |
| Minority interest                   | (3,197 )               | 0.2           | (3,649 )               | 0.3           | (3,161 )               | 0.3           |
| Net Income                          | \$ 95,384              | 5.4           | \$ 30,266              | 2.2           | \$ 22,974              | 1.9           |
| Volume                              |                        |               |                        |               |                        |               |
| Dairy (th. tons)                    | 1,354                  |               | 1,195                  |               | 1099                   |               |
| Beverages (th. liters)              | 447                    |               | 436                    |               | 463                    |               |
| Baby Food (th. tons)                | 66                     |               | 58                     |               | 50                     |               |

**Year Ended December 31, 2006 Compared to Year Ended December 31, 2005****Sales**

Sales increased by 26.4% to \$1,762.1 million in 2006 from \$1,394.6 million in 2005. The dairy business was our largest segment, representing 75.0% of sales in 2006 compared to 72.0% in 2005.

|                   | Year ended December 31, |               |                        |               |
|-------------------|-------------------------|---------------|------------------------|---------------|
|                   | 2006<br>(in thousands)  | % of<br>sales | 2005<br>(in thousands) | % of<br>sales |
| Dairy products    | \$ 1,320,901            | 75.0          | \$ 1,003,601           | 72.0          |
| Beverage products | 324,074                 | 18.4          | 303,147                | 21.7          |
| Baby food         | 117,152                 | 6.6           | 87,839                 | 6.3           |
| Other             | 0                       | 0.0           | 3                      | 0.0           |
|                   | \$ 1,762,127            | 100.0         | \$ 1,394,590           | 100.0         |

Sales in our dairy segment increased by 31.6% to \$1,320.9 million in 2006 from \$1,003.6 million in 2005. We sold 1,353.5 thousand tons of dairy products in 2006 and 1,195.3 thousand tons of dairy products in 2005. The average selling price increased by 16.2% from \$0.840 per kilogram in 2005 to \$0.976 per kilogram in 2006 driven by a favorable sales mix, incremental ruble price increases and ruble appreciation. Our improved dairy sales were driven by our increased presence in the regions of Russia and the CIS, especially in Siberian and Southern Russia, the addition of new products to our portfolio and further optimization of our product portfolio, the launch of new product lines and increased marketing activities.

Sales in our beverages segment increased by 6.9% to \$324.1 million in 2006 from \$303.1 million in 2005. We sold 447.0 million liters of juice and water in 2006 and 436.2 million liters of juice and water in 2005. The average selling price increased by 4.3% from \$0.695 per liter in 2005 to \$0.725 per liter in 2006, primarily due to incremental ruble price increases and ruble appreciation, partially offset by changes in our product mix in favor of lower priced brands.

Sales in our baby food segment increased by 33.4% to \$117.2 million in 2006 from \$87.8 million in 2005. We sold 66.3 thousand tons of baby food products in 2006 and 57.8 thousand tons in 2005. The average selling price increased by 16.3% from \$1.520 per kilogram in 2005 to \$1.768 per kilogram in 2006 driven by incremental ruble price increases, ruble appreciation and a change in our product mix favoring value-added products. Our improved baby food sales were driven by the addition of new products to our portfolio and increased sales in new regions.

In 2006, 67% of our revenues came from sales outside of the Moscow region in other parts of Russia and the CIS. Regional sales represented 71%, 63% and 22% of dairy, beverages and baby food segment revenues in 2006. Over the last two years, we have focused on sales growth in the regions through the expansion of our distribution and production capabilities in various regions, as well as certain CIS countries.

**Cost of Sales**

Cost of sales primarily consists of expenses relating to raw materials (raw milk for dairy and baby food products, concentrates for juices and packaging materials for all products), which accounted for 82.6% and 83.7% of our total cost of sales in 2006 and 2005, respectively. The table below sets forth these costs for both 2006 and 2005:

|                               | Year ended December 31, |       |                        |      |
|-------------------------------|-------------------------|-------|------------------------|------|
|                               | 2006<br>(in thousands)  | %     | 2005<br>(in thousands) | %    |
| Raw materials                 | \$ 986,477              | 82.6  | \$ 836,404             | 83.7 |
| Personnel                     | 68,464                  | 5.7   | 50,030                 | 5.0  |
| Depreciation and amortization | 50,136                  | 4.2   | 41,921                 | 4.2  |
| Utilities                     | 29,240                  | 2.5   | 21,222                 | 2.1  |
| Goods for resale              | 22,556                  | 1.9   | 16,724                 | 1.7  |
| Other                         | 37,286                  | 3.1   | 32,705                 | 3.3  |
| Total cost of sales           | \$ 1,194,159            | 100.0 | \$ 999,006             | 100  |

Raw material costs increased by 17.9% between 2006 and 2005 but decreased as a percentage of sales to 56.0% in 2006 from 60.0% in 2005, primarily due to the increase in selling prices. Raw material costs as a percentage of dairy segment sales were lower (57.5% in 2006 compared to 62.8% in 2005) because of the increases in selling prices, which outpaced the increase in raw milk prices. Raw material costs as a percentage of baby food segment sales slightly decreased from 44.7% to 41.2% for the same reason. Raw material costs as a percentage of beverages segment sales remained at the level of 55.0% in 2006 and in 2005. In the dairy segment, 83.9% of our raw material costs were ruble-denominated and 16.1% were hard-currency-denominated in 2006, whereas 78.0% of these costs were ruble-denominated and 22% were hard-currency-denominated in 2005. In the baby food segment, 65.6% of our raw material costs were ruble-denominated and 34.4% were hard-currency-denominated in 2006, whereas 67.0% of these costs were ruble-denominated and 33.0% were hard-currency-denominated in 2005. In the beverages segment, the majority of our raw material costs were hard-currency-denominated in 2006 and 2005.

Personnel expenses increased in absolute terms by 36.9% in 2006 as compared to 2005. The average number of production personnel increased in 2006 by 10.7% to 10,811 (excluding newly acquired dairy plants, Surgut, Manros, Ochakovo, and MOLKA) compared to 9,766 in 2005 mainly due to increased utilization of manufacturing facilities and the related growth of production volumes in 2006.

Production personnel costs per employee increased by 21.3% to \$6,212 in 2006 from \$5,123 in 2005 (including the dairy farm employees). This was mainly driven by manning reduction initiative which commenced in the end of 2006, with subsequent compensatory payments reported in 2006, as well as increased salaries in 2006.

Depreciation and amortization increased by 19.6% from \$41.9 million in 2005 to \$50.1 million in 2006, reflecting significant capital expenditures we have been making to increase our production capacity by improving our facilities and overall infrastructure.

Utility costs increased in absolute terms by 37.8% in 2006 due to larger production and warehousing facilities, as well as an increase in production volumes and electricity and gas tariffs.

Goods for resale include various dairy products that we purchase from independent producers and resell.

## Gross Profit

Our gross profit increased by 43.6% to \$568.0 million in 2006 from \$395.6 million in 2005. Our gross margin increased to 32.2% in 2006 from 28.4% in 2005.

Gross margin in our dairy segment increased to 30.5% in 2006 from 25.2% in 2005 due to enhanced efficiency and increased selling prices and volumes.

Despite additional cost control measures undertaken in 2006, gross margin in our beverages segment decreased to 35.3% in 2006 from 36.1% in 2005. This decrease was primarily due to higher sugar and concentrate costs, a shift in our product mix in favor of lower margin products and, as a result, a faster increase of cost of sales than of the average price.

Gross margin in our baby food segment increased to 43.1% in 2006 from 38.0% in 2005 mainly due to increased selling prices and a shift in our product mix in favor of higher margin, value-added products.

## Selling and Distribution Expenses

Selling and distribution expenses increased by 28.2% between 2006 and 2005. As a percentage of sales, selling and distribution expenses increased to 14.0% in 2006 from 13.8% in 2005. Our selling and distribution expenses in 2006 and 2005 were as follows:

|   | Year ended<br>December 31,<br>2006 | 2005       |
|---|------------------------------------|------------|
|   | (in thousands)                     |            |
| Advertising and marketing               | \$ 76,194                          | \$ 57,936  |
| Personnel                               | 55,955                             | 47,665     |
| Shipping and handling                   | 73,565                             | 52,995     |
| Bad debt expense                        | 3,130                              | 3,908      |
| Materials and supplies                  | 9,369                              | 10,446     |
| Warehouse                               | 10,986                             | 9,525      |
| Other                                   | 16,855                             | 9,515      |
| Total selling and distribution expenses | \$ 246,054                         | \$ 191,990 |

Advertising and marketing expenses increased in 2006 by 31.5% or \$18.3 million in absolute terms, and increased by 0.2% as a percentage of sales to 4.3% in 2006 from 4.1% in 2005. The increase in expenses was due to our continued investments into major brand promotions, media inflation on Russia's leading national television channels, which, in 2006, reached 35% and general increases in marketing costs. Despite this media inflation, we were able to obtain volume discounts and manage the cost increases more effectively. In 2006 and 2005, television advertising expenses represented more than half of our advertising budget.

Personnel expenses increased by 17.4% in 2006 as compared to 2005. The average number of employees in our selling and distribution department decreased to 5,355 in 2006 from 5,713 in 2005 due to the development of our branch network in 2006. Our payroll cost per employee increased by 23.9% to \$10,336 in 2006 (excluding newly acquired dairy plants Surgut, Manros, Ochakovo, and MOLKA) from \$8,343 in 2005 mainly due to performance based reward system implementation in 2006. Our personnel costs as a percentage of sales decreased to 3.2% in 2006 from 3.4% in 2005.



Shipping and handling costs, which primarily consist of external transportation costs, increased by 38.8% in 2006 as compared to 2005. Our transportation expenses as a percentage of sales slightly increased to 4.2% in 2006 from 3.8% in 2005. The increase in transportation costs was mainly due to the expansion of our sales volumes in the regions and increased transportation tariffs.

In particular, ruble tariffs for railway transportation, which accounted for more than half of the total beverages transportation expenses, increased by 14.0%, which slightly exceeded inflation.

We continued to maintain control of our bad debt expenses, which remained stable at 0.2% as a percentage of sales in 2006. See B. Liquidity and Capital Resources Critical Accounting Policies and Estimates Allowance for Doubtful Accounts below.

### General and Administrative Expenses

General and administrative expenses increased by 22.7% in 2006 as compared to 2005, and decreased as a percentage of sales to 7.6% in 2006 from 7.9% in 2005. Our general and administrative expenses in 2006 and 2005 were as follows:

|   | Year ended<br>December 31, |            |
|---|----------------------------|------------|
|   | 2006                       | 2005       |
|   | (in thousands)             |            |
| Personnel                                 | \$ 78,227                  | \$ 61,830  |
| Taxes other than income tax               | 12,789                     | 13,194     |
| Audit, consulting and legal fees          | 10,506                     | 5,567      |
| Depreciation                              | 7,215                      | 5,711      |
| Materials and supplies                    | 2,462                      | 3,268      |
| Communication costs                       | 2,731                      | 2,880      |
| Rent                                      | 2,670                      | 2,177      |
| Other                                     | 17,881                     | 15,015     |
| Total general and administrative expenses | \$ 134,481                 | \$ 109,642 |

Personnel expenses increased by 26.5%, while the average number of employees decreased to 3,159 in 2006 compared to 3,478 in 2005. Our average cost per employee increased by 38.0% to \$24,532 in 2006 from about \$17,778 in 2005 (excluding newly acquired dairy plants Surgut, Manros, Ochakovo, and MOLKA), due to the hiring of new managers, wage inflation and compensatory payments made during the process of personnel headcount optimization.

Our expenses for audit, consulting and legal services increased by 88.7% in 2006 compared to 2005, primarily due to the increased restructuring costs, strategic business consulting costs, costs associated with improving professional skills of our employees and general increases in audit-related fees, as well as compliance costs with respect to the Sarbanes-Oxley Act of 2002.

Depreciation expense increased by 26.3% from \$5.7 million to \$7.2 million, reflecting capital expenditures made to support our expansion into the regions of Russia and the CIS.

### Operating Income

Operating income increased by 77.9% to \$155.6 million in 2006 from \$87.5 million in 2005. As a percentage of sales, operating income increased to 8.8% in 2006 from 6.3% in 2005. As discussed above, the increase in operating income was primarily due to the improvement in the gross margin as a result of cost control procedures. Our major acquisitions also contributed to the improvement of our operating income.

**Financial Income and Expenses**

Financial income and expenses comprised the following:

|   | <b>Year ended<br/>December 31,<br/>2006<br/>(in thousands)</b> | <b>2005</b> |
|---|--|-------------|
| Interest expense                        | \$ 27,898  | \$ 23,388   |
| Interest income                         | (4,372 )   | (1,569 )    |
| Currency remeasurement gains            | (10,288 )  | (1,231 )    |
| Bank charges                            | 2,070  | 1,983       |
| Other financial expense (income)        | 172  | 297         |
| Total financial income and expense, net | \$ 15,480  | \$ 22,868   |

Interest expense increased by 19.3% in 2006 compared to 2005. This was mainly due to the increased interest rate payable on our variable rate 3,000,000 non-convertible ruble notes issued in December 2005, as well as an overall increase in our debt.

We received interest income of \$4.4 million from free cash management in 2006 compared to \$1.6 million in 2005.

In 2006, we incurred total currency remeasurement gains of \$10.3 million, which comprised of gains and losses from U.S. dollar-denominated notes and Euro-denominated loan respectively. For accounting purposes for our U.S. dollar-denominated notes, we used the exchange rate as of December 31, 2006, which depreciated nominally by 8.5% against the December 31, 2005 exchange rate resulting in a currency remeasurement gains.

**Provision for Income Taxes**

Our provision for income taxes for the years ended December 31, 2006 and 2005 was as follows:

|                                      | <b>Year ended<br/>December 31,<br/>2006<br/>(in thousands)</b> | <b>2005</b> |
|--------------------------------------|--|-------------|
| Current provision                    | \$ 48,232  | \$ 27,385   |
| Deferred income tax charge/(benefit) | (6,672 )   | 3,327       |
| Total provision for income taxes     | \$ 41,560  | \$ 30,712   |

Provision for income taxes amounted to \$41.6 million in 2006 and \$30.7 million in 2005. These provisions comprise current income tax charges of \$48.2 million in 2006 and \$27.4 million in 2005, and a deferred tax benefit of \$6.7 million in 2006 and the expense of \$3.3 million in 2005. Deferred tax benefits and charges arise on temporary differences between the bases of computing income under domestic tax principles and U.S. GAAP.

In 2006, our effective income tax rate was 29.7% compared to the Russian statutory income tax rate of 24.0% and, in 2005, our effective income tax rate was 47.5% compared to the Russian statutory income tax rate of 24.0%. This decrease in 2006 of our effective income tax rate is primarily driven by an increase in taxable profits accompanied by a decrease in the group's non-deductible expenses as a percentage of sales in 2006, compared to 2005.

Had we not taken advantage of the small enterprise tax benefit, our income tax expense would have been higher by \$1.3 million in 2004 and by \$0.3 million in 2005. The income tax benefit for small enterprises was abolished from January 1, 2002, except that the benefit continues to be available to

enterprises that were established before July 1, 2001. See Item 3. Key Information D. Risk Factors Risks Relating to Our Financial Condition The elimination of a tax privilege from which we currently benefit and/or a successful challenge by the tax authorities of our use of this tax privilege would materially adversely affect our results of operations.

### Minority Interest

The minority interest reflects the net income and losses of our subsidiaries that are attributable to the minority shareholders in those subsidiaries. In 2006, net profits attributable to minority shareholders of our subsidiaries decreased to \$3.2 million from \$3.6 million in 2005. Most of the minority expenses are attributable to the dairy segment, which had minority expenses of \$1.9 million in 2006, while most of minority expenses of \$3.6 million in 2005 and \$2.9 million in 2004 were attributed to Moscow Baby Food Plant. The \$0.4 million decrease in 2006 was partially offset by the other minority interest on losses.

### Net Income

Net income increased in 2006 to \$95.4 million (5.4% of sales) from \$30.3 million (2.2% of sales) in 2005, primarily as a result of the increase in operating income and financial income explained above, which was partially offset by an increase in income tax expense.

### Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

#### Sales

Sales increased by 17.8% to \$1,394.6 million in 2005 from \$1,184.0 million in 2004. The dairy segment was our largest business segment, representing 72.0% of sales in 2005 compared to 69.1% in 2004.

|                   | Year ended December 31, |                        | % of sales | % of Sales |
|-------------------|-------------------------|------------------------|------------|------------|
|                   | 2005<br>(in thousands)  | 2004<br>(in thousands) |            |            |
| Dairy products    | \$ 1,003,601            | \$ 818,279             | 72.0       | 69.1       |
| Beverage products | 303,147                 | 301,050                | 21.7       | 25.4       |
| Baby food         | 87,839                  | 64,657                 | 6.3        | 5.5        |
| Other             | 3                       | 0                      | 0.0        | 0.0        |
|                   | \$ 1,394,590            | \$ 1,183,986           | 100.0      | 100.0      |

Sales in our dairy segment increased by 22.6% to \$1,003.6 million in 2005 from \$818.3 million in 2004. The sales growth was made up of selling price increases of 12.8% in U.S. dollar terms and sales volume growth of 8.8%. We sold 1,195 thousand tons of dairy products in 2005 and 1,099 thousand tons of dairy products in 2004. The average selling price increased by 12.8% from \$0.745 per kilogram in 2004 to \$0.840 per kilogram in 2005 driven by incremental ruble price increases and ruble appreciation. Our improved dairy sales were driven by our increased presence in the regions of Russia and CIS, especially in southern and northwest Russia, the addition of new products to our product portfolio and further optimization of our product portfolio, the launch of new product lines and increased marketing activities.

Sales in our beverages segment increased by 0.7% to \$303.1 million in 2005 from \$301.1 million in 2004. We sold 436.2 million liters of juice and water in 2005 and 462.6 million liters of juice and water in 2004. The sales volume decrease of 5.7% was due to the highly competitive environment. The average selling price increased by 6.8% from \$0.651 per liter in 2004 to \$0.695 per liter in 2005, primarily due to incremental ruble price increases and ruble appreciation, partially offset by continuing changes in our product mix in favor of lower priced brands

Sales in our baby food segment increased by 35.9% to \$87.8 million in 2005 from \$64.7 million in 2004. The sales growth was made up of selling price increases of 17.6% in U.S. dollar terms and sales volume growth of 15.5%. We sold 57.8 thousand tons of baby food products in 2005 and 50.1 thousand tons in 2004. The average selling price increased by 17.6% from \$1.293 per kilogram in 2004 to \$1.520 per kilogram in 2005 driven by incremental ruble price increases, ruble appreciation and a change in the product mix favoring value-added products. Our improved baby food product sales were driven mainly by expanding our presence in the Moscow region.

In 2005, approximately 62% of our revenues came from sales in the regions of Russia and the CIS. By segment, regional sales represented 66%, 63% and 19% of dairy, beverages and baby food segment revenues in 2005, respectively. Over the last two years, we have focused on sales growth in the regions through the expansion of our distribution and production capabilities in various regions, as well as certain CIS countries.

### Cost of Sales

Cost of sales primarily consists of expenses relating to raw materials (raw milk for dairy and baby food products, concentrates for juices and packaging materials for all products), which accounted for 71.6% and 72.5% of our total cost of sales in 2005 and 2004, respectively. The table below sets forth these costs for both 2005 and 2004:

|                               | Year ended December 31, |       | 2004           |       |
|-------------------------------|-------------------------|-------|----------------|-------|
|                               | 2005                    | %     |                | %     |
|                               | (in thousands)          |       | (in thousands) |       |
| Raw materials                 | \$ 836,404              | 83.7  | \$ 726,934     | 84.6  |
| Personnel                     | 50,030                  | 5.0   | 44,283         | 5.2   |
| Depreciation and amortization | 41,921                  | 4.2   | 34,577         | 4.0   |
| Utilities                     | 21,222                  | 2.1   | 17,378         | 2.0   |
| Goods for resale              | 16,724                  | 1.7   | 6,663          | 0.8   |
| Other                         | 32,705                  | 3.3   | 28,932         | 3.4   |
| Total cost of sales           | \$ 999,006              | 100.0 | \$ 858,767     | 100.0 |

Raw material costs increased by 15.1% between 2005 and 2004 but decreased as a percentage of sales to 60.0% in 2005 from 61.4% in 2004, primarily due to the increase in selling prices. Raw material costs as a percentage of dairy sales were lower (62.8% in 2005 compared to 64.5% in 2004) because of the increases in selling prices, which outpaced the increase in raw milk prices. Raw material costs as a percentage of baby food segment sales slightly decreased to 44.7% in 2005 from 45.3% in 2004 for the same reason. Raw material costs as a percentage of beverages segment sales decreased to 55.0% in 2005 from 56.5% in 2004 due to certain cost control measures undertaken in 2005, including more cost efficient purchasing.

In the dairy segment, 78.0% of our raw material costs were ruble-denominated and 22.0% were hard-currency-denominated in 2005, whereas 77.0% of these costs were ruble-denominated and 23.0% were hard-currency denominated in 2004. In the baby food segment, 33.0% of raw material costs were hard-currency-denominated and 67% were ruble-denominated in 2005, whereas 66% of these costs were ruble-denominated and 34% were hard-denominated in 2004. In the beverages segment, substantially all of our raw material costs were hard-currency-denominated in 2005 and 2004.

Personnel expenses increased in absolute terms by 13.0% in 2005 as compared to 2004. The average number of production personnel increased to 9,766 in 2005 from 8,561 in 2004 mainly from our acquisitions of dairy farms in late 2004 and 2005. Production personnel costs per employee (excluding the dairy farm employees, which are reported as other operating expenses) increased to \$5,849 in 2005 from \$5,173 in 2004 due to salary increases in line with the inflation rate in Russia.

Depreciation and amortization increased by 21.3% from \$34.6 million in 2004 to \$41.9 million in 2005, reflecting the significant capital expenditures we have been making to increase our production capacity by improving our facilities and overall infrastructure.

Utility costs increased in absolute terms by 22.1% in 2005 due to larger production and warehouse facilities, as well as an increase in production volume and electricity and gas tariffs.

Goods for resale include various dairy products that we purchase from independent producers and resell.

### Gross Profit

Our gross profit increased by 21.6% to \$395.6 million in 2005 from \$325.2 million in 2004. Our gross margin increased to 28.4% in 2005 from 27.5% in 2004.

Gross margin in our dairy segment increased to 25.2% in 2005 from 24.4% in 2004 due to the increase in selling prices, which was partially offset by further increases in raw milk prices.

Gross margin in our beverages segment increased to 36.1% in 2005 from 33.8% in 2004. This increase was primarily due to the additional cost control measures undertaken in 2005, such as the implementation of more cost efficient purchasing and economy of scales realized following the consolidation of our juice and water business units.

Gross margin in our baby food segment increased to 38.0% in 2005 from 37.2% in 2004, mainly due to increase in selling prices and a shift in our product mix in favor of higher margin, value-added products.

### Selling and Distribution Expenses

Selling and distribution expenses increased by 10.7% between 2005 and 2004. As a percentage of sales, selling and distribution expenses decreased to 13.8% in 2005 from 14.6% in 2004. Our selling and distribution expenses in 2005 and 2004 were as follows:

|   | <b>Year ended<br/>December 31,</b> |             |
|---|------------------------------------|-------------|
|   | <b>2005</b>                        | <b>2004</b> |
|   | <b>(in thousands)</b>              |             |
| Advertising and marketing               | \$ 57,936                          | \$ 54,298   |
| Personnel                               | 47,665                             | 43,831      |
| Shipping and handling                   | 52,995                             | 45,938      |
| Bad debt expense                        | 3,908                              | 3,722       |
| Materials and supplies                  | 10,446                             | 8,447       |
| Warehouse                               | 9,525                              | 8,937       |
| Other                                   | 9,515                              | 8,260       |
| Total selling and distribution expenses | \$ 191,990                         | \$ 173,433  |

Advertising and marketing expenses increased in 2005 by \$3.6 million, or 6.7% in absolute terms, and decreased by 0.5% in relation to sales, to 4.2% in 2005 from 4.6% in 2004. The increase in expenses was due to our continued investments into major brand promotions, media inflation on Russia's leading national television channels which, in 2005, reached 28% and general increases in marketing costs. Despite this media inflation, we were able to obtain volume discounts and manage the cost increases more effectively. In 2005 and 2004, television advertising expenses represented more than half of our advertising budget.

Personnel expenses increased in absolute terms by 8.7% in 2005 as compared to 2004. The average number of employees in our selling and distribution department decreased to 5,713 in 2005 from 6,008 in

2004 as we optimized our distribution network in the regions. Our payroll cost per employee increased by 14.4% to \$8,343 in 2005 from approximately \$7,295 in 2004 due to increased bonuses paid to our sales personnel, as well as wage inflation. Our personnel costs as a percentage of sales decreased to 3.4% in 2005 from 3.7% in 2004.

Shipping and handling costs, which primarily consist of external transportation costs, increased by 15.4% in 2005 as compared to 2004. Our transportation expenses as a percentage of sales decreased to 3.8% in 2005 from 3.9% in 2004. This increase was mainly due to the expansion of our sales volumes in the regions and increased transportation tariffs.

In particular, ruble tariffs for railway transportation, which accounted for more than half of the total beverages transportation expenses, increased by 17.7%, which exceeded inflation by 1.8 times. Our efforts to control costs and optimize routes resulted in a 0.1% decrease in transportation costs as a percentage of sales.

We continued to control our bad debt expenses, which remain stable at 0.3% as a percentage of sales in 2005. See B. Liquidity and Capital Resources Critical Accounting Policies and Estimates Allowance for Doubtful Accounts below.

### General and Administrative Expenses

General and administrative expenses increased by 18.1% in 2005 as compared to 2004, and increased as a percentage of sales to 7.9% in 2005 from 7.8% in 2004. Our general and administrative expenses in 2005 and 2004 were as follows:

|   | Year ended<br>December 31,<br>2005 | 2004      |
|---|------------------------------------|-----------|
|   | (in thousands)                     |           |
| Personnel                                 | \$ 61,830                          | \$ 53,250 |
| Taxes other than income tax               | 13,194                             | 11,782    |
| Audit, consulting and legal fees          | 5,567                              | 4,655     |
| Depreciation                              | 5,711                              | 4,576     |
| Materials and supplies                    | 3,268                              | 3,226     |
| Communication costs                       | 2,880                              | 2,331     |
| Rent                                      | 2,177                              | 2,268     |
| Other                                     | 15,015                             | 10,728    |
| Total general and administrative expenses | \$ 109,642                         | \$ 92,816 |

Personnel expenses increased by 16.1%, while the average number of employees increased to 3,478 in 2005 compared 3,140. Our average cost per employee increased by 4.8% to \$17,778 in 2005 from \$16,960 in 2004, which is slight when taking into account wage inflation throughout Russia and especially in Moscow, where our head office is located.

Taxes, other than income tax, include property tax, which is levied on our property, advertising tax, which is levied on our advertising expenses and miscellaneous local taxes. The increase in these taxes of 12.0% in 2005 compared to 2004 was mainly due to our increased property, plant and equipment following our substantial capital expenditures.

Our expenses for audit, consulting and legal services increased by 19.6% in 2005 compared to 2004, primarily due to the costs associated with improving our internal control functions and general increases in audit-related fees.

Depreciation expense increased by 24.8% from \$4.6 million to \$5.7 million, reflecting the capital expenditures made to support our expansion into the regions of Russia and the CIS.

### Operating Income

Operating income increased by 65.3% to \$87.5 million in 2005 from \$52.9 million in 2004. As a percentage of sales, operating income increased to 6.3% in 2005 from 4.5% in 2004. As discussed above, the increase in operating income was primarily due to improvement in the gross margin as a result of cost control procedures. The farm operations also contributed to the improvement of our operating income.

### Financial Income and Expenses

Financial income and expenses comprised the following:

|   | Year ended<br>December 31, |           |
|---|----------------------------|-----------|
|   | 2005                       | 2004      |
|   | (in thousands)             |           |
| Interest expense                        | \$ 23,388                  | \$ 22,348 |
| Interest income                         | (1,569 )                   | (1,421 )  |
| Currency remeasurement gains            | (1,231 )                   | (7,673 )  |
| Bank charges                            | 1,983                      | 1,857     |
| Other financial expense (income)        | 297                        | (493 )    |
| Total financial income and expense, net | \$ 22,868                  | \$ 14,618 |

Interest expense increased by 4.7% in 2005 compared to 2004. This was mainly due to the increased interest rate payable on our variable rate 1,500,000 non-convertible ruble notes issued in April 2003, as well as an overall increase in our debt.

We received interest income of \$1.6 million from placement of temporary free funds in 2005 compared to \$1.4 million in 2004.

In 2005 we incurred total currency remeasurement gains of \$1.2 million, which comprised of gains and losses from Euro- and U.S. dollar-denominated obligations, respectively, as well as remeasurement gains from our operations in Ukraine. For purposes of accounting for our U.S. dollar-denominated notes, we used the exchange rate as of December 31, 2005, which depreciated nominally by 3.7% against the December 31, 2004 exchange rate resulting in a currency remeasurement loss. On the other hand, as the value of the ruble increased against the Euro, our Euro-denominated obligations resulted in currency remeasurement gains. With respect to ruble-denominated liabilities of our Ukrainian subsidiary, we incurred currency remeasurement gains due to the depreciation of the ruble against the Ukrainian hryvna.

### Provision for Income Taxes

Our provision for income taxes for the years ended December 31, 2005 and 2004 was as follows:

|                                      | Year ended<br>December 31, |           |
|--------------------------------------|----------------------------|-----------|
|                                      | 2005                       | 2004      |
|                                      | (in thousands)             |           |
| Current provision                    | \$ 27,385                  | \$ 18,189 |
| Deferred income tax charge/(benefit) | 3,327                      | (6,019 )  |
| Total provision for income taxes     | \$ 30,712                  | \$ 12,170 |

Provision for income taxes amounted to \$30.7 million in 2005 and \$12.2 million in 2004. These provisions comprise current income tax charges of \$27.4 million in 2005 and \$18.2 million in 2004, and a deferred tax expense of \$3.3 million in 2005 and a benefit of \$6.0 million in 2004. Deferred tax benefits and charges arise on temporary differences between the bases of computing income under domestic tax principles and U.S. GAAP.

In 2005, our effective income tax rate was 47.5% compared to the Russian statutory income tax rate of 24.0% and, in 2004, our effective income tax rate was 31.8% compared to the Russian statutory income tax rate of 24.0%. This increase in 2005 of our effective income tax rate is primarily due to the increase of taxable losses in certain of our subsidiaries, which were fully provided for deferred tax purposes and which we were unable to offset against our profits since taxes cannot be paid on a consolidated basis under Russian tax law. In addition, our non-deductible expenses for Russian taxation purposes increased in 2005 compared to 2004 and, furthermore, our tax privileges for small business enterprises expired in 2005. In 2003 and, to a lesser extent, in 2004, we benefited from small enterprise tax legislation, which was used by companies operating in our juice segment. Under income tax legislation which was in effect before January 1, 2002, small enterprises involved in certain activities were exempt from income taxes for the first two years of operations and, in the third and fourth years, income taxes were levied at a rate of 25% and 50% of the income tax rate, respectively. Had we not taken advantage of the small enterprise tax benefit, our income tax expense would have been higher by \$1.3 million in 2004 and by \$0.3 million in 2005. The income tax benefit for small enterprises was abolished from January 1, 2002, except that the benefit continues to be available to enterprises that were established before July 1, 2001. See Item 3. Key Information D. Risk Factors Risks Relating to Our Financial Condition The elimination of a tax privilege from which we currently benefit and/or a successful challenge by the tax authorities of our use of this tax privilege would materially adversely affect our results of operations.

#### **Minority Interest**

The minority interest reflects the net income and losses of our subsidiaries that are attributable to the minority shareholders in those subsidiaries. In 2005 and 2004, net profits attributable to minority shareholders of our subsidiaries increased to \$3.6 million from \$3.2 million. Most of the minority expenses are attributable to the Moscow Baby Food Plant, which had minority interest expenses of \$3.6 million in 2005 and \$2.9 million in 2004. The \$0.7 million increase in 2005 was partially offset by the other minority interest on losses.

#### **Net Income**

Net income increased in 2005 to \$30.3 million (2.2% of sales) from \$23.0 million (1.9% of sales) in 2004, primarily as a result of the increase in operating income explained above, which was partially offset by an increase in income tax expense and financial expenses.

### **B. Liquidity and Capital Resources**

#### **Capital Requirements**

We need capital to finance the following:

- repayment of debt;
- capital expenditures, consisting of purchases of property, plant and equipment;
- acquisitions; and
- dividend payouts.



We anticipate that the repayment of long-term debt including Loan Participation Notes, capital expenditures and acquisitions will represent the most significant use of funds for several years to come. In 2006, we continued to purchase property, plant and equipment in order to increase production capacity and to improve infrastructure at our new and existing subsidiaries in anticipation of the expected further growth in the Russian economy and rising incomes.

### Capital Expenditures

Our total capital expenditures in 2006, excluding acquisitions, amounted to \$130.0 million, including new vendor credits. Capital expenditures in our dairy segment amounted to \$93.3 million and related to the improvement of our existing dairy and cheese production facilities, warehouses facilities and quality control procedures for raw milk used in production. Capital expenditures in our beverages segment amounted to \$13.5 million and related mainly to the installation of new production lines and other operating equipment at our production sites. Capital expenditures in our baby food segment amounted to \$19.4 million and related mainly to the modernization of our recently acquired Kursk Baby Food Plant. Our corporate and common capital expenditures, including those relating to IT infrastructure and software, totaled \$3.8 million.

Our capital expenditures, excluding acquisitions, for the period from 2004 to 2006 are set forth in the following table:

|                                   | <b>Year ended<br/>December 31,</b> |             |             |              |
|-----------------------------------|------------------------------------|-------------|-------------|--------------|
|                                   | <b>2006</b>                        | <b>2005</b> | <b>2004</b> | <b>Total</b> |
|                                   | <b>(in millions)</b>               |             |             |              |
| Dairy segment                     | 93.3                               | 59.9        | 57.1        | 210.3        |
| Beverages segment                 | 13.5                               | 12.9        | 8.8         | 35.2         |
| Baby food segment                 | 19.4                               | 1.8         | 5.1         | 26.3         |
| Corporate and common expenditures | 3.8                                | 0.5         | 1.6         | 5.9          |
| <b>Total capital expenditures</b> | <b>130.0</b>                       | <b>75.1</b> | <b>72.6</b> | <b>277.7</b> |

As of December 31, 2006, our capital commitments amounted to \$10.0 million mainly for construction projects. As of March 31, 2007, we had capital commitments of approximately \$30.0 million, primarily for construction projects at our production sites and purchase of equipment. We plan to finance our capital commitments through operating cash flow.

**Acquisitions of Subsidiaries and Purchase of Minority Stakes**

During 2006, 2005 and 2004, we made a number of acquisitions for the total consideration of \$137.3 million, \$24.3 million and \$5.3 million, respectively. The goal of these acquisitions was to expand into new markets, strengthen our operational presence in the regions of Russia and the CIS and to purchase minority stakes. The following table summarizes our acquisitions in the last three years:

|   | Direct ownership<br>interest<br>acquired, % | Cash cost of<br>investment<br>(in thousands) |
|---|---|--|
| <b>2006</b>   |   |  |
| Ochakovo Dairy Plant  | 93.74                                       | \$ 66,792                                    |
| Manros  | 100   | 51,336                                       |
| Angarsky Dairy Plant (MOLKA)  | 83.36                                       | 4,908  |
| Surgut Dairy Plant  | 100   | 4,536  |
| Wimm-Bill-Dann OJSC (formerly Lianozovsky Dairy Plant) (purchase of minority stake) | 0.26  | 812  |
| Nazarovo Dairy Plant (purchase of minority stake)                                   | 30.35                                       | 1,982  |
| Moscow Baby Food Plant (purchase of minority stake)                                 | 20  | 6,955  |
| <b>Total</b>  |   | <b>\$ 137,321</b>                            |
| <b>2005</b>   |   |  |
| Essentuki Mineral Water Plant at CMW (Caucasian Mineral Water) Ltd                  | 100   | \$ 5,505                                     |
| Nazarovskoe Milk OJSC   | 63.5  | 5,167  |
| Pervouralsk City Dairy  | 100   | 119  |
| Plemzavod Za Mir i Trud OJSC  | 100   | 1,689  |
| Zavety Ilicha   | 99.34                                       | 344  |
| Trud  | 63.5  | 420  |
| Kursk Baby Food Plant CJSC  | 100   | 3,527  |
| Obninsk Dairy Plant   | 66.3  | 6,365  |
| Siberian Dairy Plant (purchase of minority stake)                                   | 10  | 1,050  |
| Other   | various                                     | 120  |
| <b>Total</b>  |   | <b>\$ 24,306</b>                             |
| <b>2004</b>   |   |  |
| Tsaritsino Dairy Plant (purchase of minority stake)                                 | 6   | \$ 3,406                                     |
| Atamanskoe  | 88.4  | 904  |
| Ramenskiy Plant (purchase of minority stake)  | 25  | 534  |
| Fruktopak (formerly Depsona) (purchase of minority stake)                           | 5   | 129  |
| Other   | various                                     | 344  |
| <b>Total</b>  |   | <b>\$ 5,317</b>                              |

See Item 4. Information on Our Company for more information on our acquired businesses and Note 4 to our Consolidated Financial Statements included elsewhere herein. In addition to the acquisitions mentioned above, as of December 31, 2006, we also issued a cash advance for the further purchases of minority stakes in certain of our legal entities, which are not included in the summary table above.

**Capital Resources**

We generally rely on operating cash flows and debt issuance to finance capital expenditures and acquisitions. In addition, we finance a portion of our equipment purchases through vendor financings. The

availability of external financing is influenced by many factors, including our financial position and market conditions. Under certain circumstances, we may be required to repay certain indebtedness. See Item 3. Key Information D. Risk Factors Risks Relating to Our Financial Condition Covenants in our debt agreements restrict our ability to borrow, invest and engage in various activities, which could impair our ability to expand or finance our future operations.

## Debt

Our debt consists of notes, bank loans and vendor financing for property, plant and equipment, of which 81% are at fixed rates. The following table summarizes our debt position as of December 31, 2006 and 2005:

|   | At December 31,<br>2006<br>(in thousands) | At December 31,<br>2005 |
|---|---|-------------------------|
| <b>Long-term debt, including current portion:</b> |   |                         |
| Notes   | \$ 248,742                                | \$ 304,024              |
| Bank loans  | \$ 34,219                                 | \$ 5,647                |
| Vendor financing                                  | \$ 36,189                                 | \$ 42,421               |
| <b>Total</b>                                      | <b>\$ 319,150</b>                         | <b>\$ 352,092</b>       |
| Short-term debt                                   | \$ 123,849                                | \$ 19,554               |
| <b>Total debt(1)</b>                              | <b>\$ 442,999</b>                         | <b>\$ 371,646</b>       |
| <b>Denominated in:</b>                            |   |                         |
| U.S. dollars                                      | \$ 171,013                                | \$ 180,689              |
| Euro  | \$ 21,702                                 | \$ 15,081               |
| Rubles  | \$ 250,284                                | \$ 175,876              |

(1) In November and December 2006, we raised \$120.5 million in short-term loans primarily to finance our acquisitions.

Our debt matures as follows:

| Year                | (in thousands) |
|---------------------|----------------|
| 2007                | 143,270        |
| 2008                | 167,068        |
| 2009                | 14,744         |
| 2010                | 110,256        |
| 2011 and thereafter | 7,661          |

## Notes

### *U.S. Dollar Notes*

On May 21, 2003, UBS (Luxembourg) S.A. issued 8.5% Loan Participation Notes due 2008 for the sole purpose of funding a \$150 million loan to WBD Foods. The loan will mature on May 21, 2008 and bears interest at an annual rate of 8.5%, payable semi-annually in arrears on May 21 and November 21 of each year. Two of our subsidiaries unconditionally, irrevocably, jointly and severally guarantee our obligation under the loan. The loan agreement contains a number of covenants including requirements to maintain certain financial ratios.

On February 06, 2007, UBS (Luxembourg) S.A. issued 7.5% Loan Participation Notes due 2008 for the sole purpose of funding a \$150 million loan to WBD Foods. The loan will mature on May 14, 2008 and bears interest at an annual rate of 7.5%, payable in two installments on November 14, 2007 and

May 14, 2008. The loan agreement contains a number of covenants including requirements to maintain certain financial ratios.

#### **Ruble Notes**

On December 21, 2005, WBD Foods issued 3 million non-convertible ruble denominated notes at a face value of 1,000 rubles each. The offering raised a total of 3 billion rubles (\$113.9 million at the exchange rate as of December 31, 2006). The notes are redeemable by WBD Foods on December 15, 2010. The interest rate of the coupon is 9%. Interest is payable semi-annually in arrears commencing on June 21, 2006.

#### **Bank Loans**

Substantially all of our long-term bank loans as of December 31, 2006 consisted of ruble and euro-denominated loans from Sberbank, Russian Agricultural Bank and Moscow City Government at interest rates ranging from 3.3% to 6.2%. Our short-term debt balance as of December 31, 2006 consisted of subsidized loans from Alfa-bank and the Moscow City Government at interest rates ranging from 3.5% to 3.8%. We also had loans from the International Moscow Bank, Raiffaisenbank and Alfa-bank at interest rates ranging from 7.8% to 9.1%. Our newly acquired Manros and Molka plants have unsubsidized loans at interest rates ranging from 9.3% to 14.0%.

#### **Vendor Finance**

We have agreements with suppliers of equipment which provide financing for the periods ranging from 1 to 9 years. As of December 31, 2006 and 2005, vendor financing obligations were \$21.0 million and \$29.7 million, respectively, EURO 10.6 million and EURO 10 million (equivalent to \$14.0 million and \$11.9 million as of December 31, 2006 and 2005, respectively) 30.9 million rubles and 23.2 million rubles (equivalent to \$1.2 million and \$0.8 million as of December 31, 2006 and 2005, respectively). This financing is provided at interest rates of LIBOR plus 1.5%, EURIBOR plus 1.5% and 14.0% for U.S. dollar, EURO and ruble denominated contracts, respectively. The majority of equipment financing is provided by one supplier, Tetra Pak. As of December 31, 2006 and 2005, property, plant and equipment amounting to \$33.1 million and \$47.7 million, respectively, served as collateral under these financing agreements.

#### **Cash Flows**

A summary of our cash flows from continuing operations is as follows:

|  | <b>Year ended December 31,</b> |              |              |
|--|--------------------------------|--------------|--------------|
|  | <b>2006</b>                    | <b>2005</b>  | <b>2004</b>  |
|  | <b>(in thousands)</b>          |              |              |
| Cash provided by operating activities                            | \$ 167,252                     | \$ 113,937   | \$ 71,720    |
| Cash used in investing activities                                | (228,158 )                     | (125,157 )   | (73,808 )    |
| Cash provided (used in) by financing activities                  | 1,359                          | 82,619       | (16,159 )    |
| Impact of exchange rate differences on cash and cash equivalents | 6,754                          | (2,087 )     | 1,774        |
| Net increase (decrease) in cash                                  | (52,793 )                      | 69,312       | (16,473 )    |
| Cash paid for acquisition of property, plant and equipment       | \$ (127,713 )                  | \$ (72,805 ) | \$ (68,103 ) |
| Cash paid for acquisition of subsidiaries, net of cash acquired  | (134,367 )                     | (24,964 )    | (6,697 )     |
| Vendor financed acquisitions of property, plant and equipment    | 5,561                          | 5,709        | 7,335        |

In 2006, we financed our capital expenditures and acquisitions exclusively through operating cash flows.

We spent \$228.2 million on our investment activities in 2006, including acquisitions of property, plant and equipment of \$127.7 million, acquisitions of subsidiaries of \$134.4 million and investments in direct financing leases of \$1.5 million, offset by \$33.1 million proceeds from return of short-term bank deposits, \$0.9 million proceeds from disposal of property, plant and equipment and \$1.4 million proceeds from other long-term assets.

Vendor financed acquisitions of property, plant and equipment totaled \$5.6 million in 2006 compared to \$5.7 million in 2005 because of an overall reduction in our vendor financed capital expenditures, including the improvement of packaging facilities. Instead, we are shifting our capital expenditures towards construction and installation projects, which are typically not vendor-financed.

Net cash provided by operating activities in 2006 was \$167.3 million, compared to \$113.9 million in 2005. The increase in 2006 was due to profitable growth and better management of our working capital, including a reduction of tax receivables balance.

### **Working Capital**

Our short-term demands for liquidity, including seasonal fluctuations in working capital requirements, are met by cash flows from operations and short-term debt.

As of December 31, 2006, our cash and cash equivalents balance was \$40.3 million, of which \$39.2 million was ruble-denominated and \$1.1 million were euro and U.S. dollar-denominated. We used cash to repay our ruble notes redeemable on April 11, 2006 and partly finance acquisitions in the fourth quarter of 2006. Our working capital balance was \$90.4 million. Our working capital position as of December 31, 2006 decreased compared to \$199.9 million as of December 31, 2005 primarily due to an increase in trade accounts payable and short-term loans, outpacing trade receivables and inventory growth. We believe that our working capital is sufficient for our present requirements.

Tax receivables decreased by \$10.3 million to \$51.2 million as of December 31, 2006 from \$61.5 million as of December 31, 2005. Tax receivables represent VAT and other taxes owed to us by the state budget. The decrease as of December 31, 2006 was primarily due to our recovery of certain VAT receivables from the state budget for previous years. Under existing tax legislation, we are able to offset this VAT against income taxes and other taxes payable to the state budget and to recover from the state budget. We are taking all legally available steps, including filing litigation claims, to facilitate the recovery of tax receivables from the state budget. In 2006, \$31.2 million in VAT tax was recovered from the state budget in cash and \$9.4 million was reimbursed by an offset. We also received \$1.97 million from the tax authorities as interest that was accrued on the amount of VAT not refunded within the established time limit.

Trade accounts payables increased to \$104.1 million at December 31, 2006 from \$65.8 million at December 31, 2005. Trade payables turnover averaged 26 days as of December 31, 2006 and 24 days as of December 31, 2005.

Trade receivables increased from \$60.0 million as of December 31, 2005 to \$89.9 million as of December 31, 2006 after the allowance for bad debts of \$7.1 million, as compared to \$5.1 million as of December 31, 2005. Trade receivables turnover averaged 16 days as of December 31, 2006 and 16 days as of December 31, 2005.

Inventory increased from \$130.6 million as of December 31, 2005 to \$174.1 million as of December 31, 2006. Turnover of inventory in days as of December 31, 2006 amounted to 47 days, as compared to 56 days as of December 31, 2005. The increase in inventory levels was mainly due to an increase in our stock of

finished goods as a result of adding Manros and Ochakovo dairy plants to our balance sheet at the end of 2006.

### Credit Rating Discussion

Our credit ratings impact our ability to obtain short- and long-term financing, and the cost of such financing. In determining our credit ratings, the rating agencies consider a number of factors, including our operating cash flows, total debt outstanding, commitments, interest requirements, liquidity needs and availability of liquidity. Other factors considered may include our business strategy, the condition of our industry and our position within the industry. Although we understand that these and other factors are among those considered by the rating agencies, each agency might calculate and weigh each factor differently.

Our credit ratings as of the date of this document are as follows:

| Rating Agency        | Company's rating | Long-Term Debt Rating | Outlook/Watch |
|----------------------|------------------|-----------------------|---------------|
| Moody's(1)           | B1               | B1                    | positive      |
| Standard & Poor's(2) | B+               | B+                    | positive      |

(1) Rated on March 29, 2007.

(2) Rated on December 23, 2005.

The two loan agreements relating to each of our two \$150 million loan participation notes due 2008 contain, in each case, provisions requiring, subject to certain conditions, our prepayment of the loan in full in the event that a change in control or merger results in a decline in our credit ratings

### Critical Accounting Policies and Estimates

Critical accounting policies are those policies that require the application of management's most challenging, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies involve judgments that are sufficiently sensitive to give materially different results under different assumptions and conditions. We believe that our most critical accounting policies are those described below. For a detailed discussion of these and other accounting policies, see Note 3 to our Consolidated Financial Statements included elsewhere herein.

### Estimates and assumptions

The preparation of the consolidated financial statements in conformity with U.S. 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. Examples include estimates of provisions for bad and doubtful accounts, obsolete inventory, and valuation allowance for deferred tax assets. Actual results could differ from those estimates.

### **Allowance for Doubtful Accounts**

Allowance for doubtful accounts is established if there is objective evidence that we will not be able to collect the amounts due according to original contractual terms and reduces receivables to amounts expected to be collected. In estimating uncollectible amounts, we consider factors such as current overall economic conditions, industry-specific economic conditions, historical customer performance and anticipated customer performance. Our provisions cover individual balances where there is evidence that losses are probable as at the balance sheet date. We use significant judgment in estimating uncollectible amounts. While we believe our processes effectively address our exposure for doubtful accounts, changes in the economy, industry or specific customer conditions may require adjustments to the allowance for doubtful accounts recorded in our Consolidated Financial Statements.

### **Accounting for Income Taxes**

We assess the temporary differences resulting from differential treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are recognized in our Consolidated Financial Statements. We assess our deferred tax assets on an ongoing basis by assessing our valuation allowance and adjusting the valuation allowance appropriately. In calculating our valuation allowance we consider the future taxable incomes and the feasibility of tax planning initiatives. If we estimate that the deferred tax asset cannot be realized at the recorded value, a valuation allowance is created with a charge to the statement of income in the period in which such assessment is made.

### **Inventory Valuation**

We review our inventory balances to determine if inventories can be sold at amounts equal to or greater than their carrying amounts. The review includes identification of slow moving inventories, obsolete inventories, expired inventories and discontinued products or lines of products. The identification process includes historical performance of the inventory, current operational plans for the inventory, as well as industry and customer specific trends. Obsolete items are provided or written off. If our actual results differ from our expectations with respect to the selling of our inventories at amounts equal to or greater than their carrying amounts, we would be required to adjust our inventories accordingly.

### **Depreciation periods for property, plant and equipment**

Depreciation periods of property, plant and equipment are based on estimated useful lives of related assets. The adoption of depreciation periods requires judgment in determining appropriate estimated useful lives over which the related assets will be utilized. In estimating useful lives, we consider factors such as our historical experience and the industry, manufacturers' estimates, anticipated use and our maintenance policies. As these factors change, management estimates may change and we could be required to reassess depreciation periods for property, plant and equipment and consider impairment.

### **Impairment of Goodwill and Long-Lived Assets**

When events and circumstances occur indicating that the carrying amount of a long-lived asset (group) may not be recoverable, we estimate the future undiscounted cash flows expected to derive 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), we would then calculate the impairment as the excess of the carrying value of the asset (group) over the estimate of its recoverable amount, which is the higher of either fair market value or value in use. We carry out the impairment test for property, plant and equipment and goodwill when indicators exist.

For purposes of determining goodwill recognition, we perform a review for possible impairment of goodwill at least on an annual basis at the reporting unit level. If the fair value of the reporting unit is less

than the carrying amount of the reporting unit including goodwill, we would then calculate the impairment loss as the excess of the carrying value of the goodwill over its implied fair value, which is to be recognized in same manner as the amount of goodwill is recognized in a business combination.

#### **Accounting Pronouncements Issued But Not Yet Adopted**

In July 2006, the Financial Accounting Standard Board ( the FASB ) issued FASB Interpretation No. 48 ( FIN 48 ) Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109, Accounting for Income Taxes. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 clearly scopes out income taxes from Financial Accounting Standards Board Statement No. 5, Accounting for Contingencies .

The adoption of the provisions of FIN 48 did not have material impact on our financial position and results of operations.

In February 2006, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 155 Accounting for Certain Hybrid Financial Instruments, which amends SFASs No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets.

SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS No. 155 amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. These provisions of SFAS No. 155 are effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of the provisions of SFAS No. 155 is not expected to have an impact on our results of operations, financial position or cash flows.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets, which amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

This Statement requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. These provisions of SFAS No. 156 are effective at the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of the provisions of SFAS No. 156 is not expected to have an impact on our results of operations, financial position or cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements.



This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements.

This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, which amends SFASs No. 87, 88, 106 and 132(R).

This Statement improves financial reporting by requiring an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006.

The adoption of the provisions of SFAS No. 158 is not expected to have an impact on our results of operations, financial position or cash flows as we do not have a defined benefit postretirement plan.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* including an amendment of SFAS No. 115.

This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007; however, early adoption is allowed.

The adoption of the provisions of SFAS No. 159 is not expected to have an impact on our results of operations, financial position or cash flows.

### C. Research and Development, Patents and Licenses, etc.

We invest significant financial and human resources in new product development, focusing on long-term strategic projects aimed at creating innovative products and technologies. Our research and development department focuses on new project development for all three of our business segments. It is located at Lianozovsky Dairy Plant and has more than 40 employees.

A new structure uniting all quality control departments has also been put in place and is presently located at Lianozovsky Dairy Plant. These departments often cooperate with third parties such as Russian research institutions, specialized research firms and suppliers. In 2006, 2005 and 2004, we spent approximately \$1.5 million, \$1.3 million and \$0.6 million on activities associated with new product development. For a more detailed discussion of new product development see Item 4. Information on Our Company B. Business Overview New Product Development.

## D. Trend Information

### Markets

The Russian economy continues to experience growth, with gross domestic product growing at rates of 6.7%, 6.4% and 7.1% in 2006, 2005 and 2004, respectively. Disposable income also continues to grow, although disposable income levels in the regions will continue to lag behind Moscow levels. We believe these macroeconomic improvements in Russia are supporting the favorable industry trends we have seen. Dairy consumption is shifting towards packaged products whereas the share of unpackaged dairy products is steadily decreasing. In addition, consumers in Russia have, in recent years, been demanding more juice-containing, dessert and enriched products. We expect the increasing preference for juice over fresh fruit, which generally accompanies increased incomes, will result in the consumption of vitamin-rich products with different tastes and nutritional characteristics, including increased demand for juice-containing beverages. However, both the dairy and juice markets will continue to become more competitive, with producers engaging in aggressive advertising and marketing strategies, as well as making substantial investments in modernizing packaging and manufacturing equipment. The dairy industry is also seeing the stronger presence of small regional producers.

In 2005 and 2006, demand for baby food products increased significantly and, as a result, we created a separate baby food segment. Prior to 2005, baby food was part of our dairy segment. We believe that the baby food market, which increased by 29% in terms of value in 2005 and continued to grow in 2006 driven mainly by stronger sales in the regional markets. However, we also expect that the baby food market will become more competitive in the near future, which could negatively impact our profit margins.

### Dairy Segment

In recent years, raw milk volumes decreased in Russia mainly due to livestock reduction. However, in 2006, the raw milk supply increased by 0.6% compared to 2005 due to significant investments into farm development by major dairy producers, enhanced effectiveness of cattle-breeding methods, the application of modern technologies by Russian farms and the National Program of Agro-Industrial Development, a government sponsored initiative offering interest free loans for the development of agriculture and the creation of large farming enterprises and regional milk collection centers.

Although domestic raw milk production increased only by 0.6% in 2006, industry experts estimate that the Russian dairy market grew by 6.8% in 2006. The most significant growth was seen in UHT milk, dairy desserts and cheese..

Our market leadership in the Russian dairy market depends on adaptation to a rapidly changing marketplace. The emergence of a middle class, not only in Moscow and a handful of large cities, but across the country is translating into greater health awareness and busier lifestyles. According to Rosstat, by 2010, 54% of the population will be classified as middle (monthly incomes of US\$500 or higher) or lower middle class (monthly incomes of US\$250 or higher), compared to 41% in 2005. The value growth of the dairy market is expected to rise faster than volume growth, with 12% value growth and 4% volume growth projected for 2007(based on our estimates and market data). Once challenging markets such as Siberia and the Urals are seeing rapid growth in consumer spending and will be a continued focus going forward. At the same time, emerging CIS markets are still several years behind Russia in terms of consumer market development but are enjoying higher rates of growth than Russia.

The regional structure of Russia's dairy market continued to shift in 2006, with dairy product sales increasing in regional markets at a more rapid rate than in Moscow and the Central region of Russia. We expect that the growth in regional dairy sales will continue to outpace growth in Moscow during 2007.

A focus on core dairy brands is essential going forward. We were the twelfth largest television advertiser overall in 2006. As advertising rates continue to rise above inflation, our marketing efforts will aim to be more effective and targeted, conveying key values of health and wellness.

### **Beverages Segment**

At the end of 2006, we witnessed price increases in juice concentrate and other ingredients resulting, in part, from bad harvests and poor weather conditions in juice-concentrate producing regions. We expect substantial price increases for juice concentrate and other materials during 2007, which would have a negative impact on our profit margins in the beverages segment. Also, as the ruble has appreciated against the US dollar in 2006 and a significant part of our concentrate and packaging materials is denominated in US dollars, such costs of juice production were lower in 2006 than in 2005.

Average selling prices of our juice products increased during 2006. We expect further increases in juice sales prices in ruble terms in 2007.

In 2005, in order to increase our presence in the regions through engaging lower-middle income consumers, we successfully re-launched the *Lovely Garden* brand. We sponsored and promoted the brand through television commercial and print advertisements in 2005 and 2006, which resulted in steady sales growth of the *Lovely Garden* juices and nectars. Although we expect further growth of juice sales in the lower-middle segment, we believe that average selling prices in the regions will generally continue to be lower than average selling prices in Moscow and St. Petersburg due to the consumer preferences in the regions, where household incomes are typically lower, for lower priced products, which have a negative effect on our gross margin. For the Central region of Russia where incomes are higher, we are focusing our efforts on providing beverage products in the upper-middle and premium segments.

We entered the mineral water market in 2003. We estimate that the mineral water market in Russia is growing annually at approximately 10% in volume. Our water offerings include the premium *Essentuki* brand, which is traditionally known to be used for medical purposes.

The increase in the cost of raw materials and packaging is expected to be substantial in 2007. These increased costs coupled with an increase in transportation and promotional and marketing expenses could negatively impact our profit margins and operating income in the beverages segment.

### **Baby Food Segment**

Baby food consumption in Russia is growing due to increased health awareness and knowledge of the critical importance of proper nutrition in the earliest years for later life. Currently, higher and upper middle income groups are driving consumption, with income growth expanding demand for healthy, specialized products for babies across Russia.

With a fast-growing middle class, Russian per capita consumption of baby food is expected to rapidly catch up with Central and Eastern European levels. In addition, purchases by publicly owned institutions such as hospitals and children's homes, as well as targeted state-run programs aimed at childhood nutrition, continue to play an important role, although the share of government purchases of the overall market is expected to decline.

The baby food market is currently relatively fragmented and new players, foreign and domestic, are entering the market. We expect the market to consolidate, and we believe that we are well positioned to benefit from consolidation. Expansion into regional markets will require increased marketing and sales expenditure as well as increased transportation costs. We continue to review options for expanding our baby food production capacity in terms of volume and type of production as well as geographic location.

## Selling and Distribution Expenses

Our selling and distribution costs increased in 2006 as compared to 2005 in absolute terms and as a percentage of sales. In particular, our transportation, personnel and advertising costs increased, in large part, as a result of our regional expansion program. Advertising costs were also driven upwards by increases in prices charged by the media. Similarly, increased transportation costs were driven by increased transportation tariffs. We expect these trends to continue and, to the extent that they do, such expenses may outpace our sales growth.

## Exchange Rates and Inflation

A significant part of our costs and expenditures, as well as liabilities, are either denominated in or tightly linked to the U.S. dollar and the Euro. These include capital expenditures and borrowings, as well as costs of packaging materials, juice concentrates and certain other raw materials. As a result, a decline in the value of the ruble against the U.S. dollar or the Euro can adversely affect us by increasing our costs in ruble terms. If we cannot increase our ruble selling prices in line with the ruble's decline in value due to competitive pressures, our margins will suffer. Additionally, if the ruble declines and prices cannot keep pace, we could have difficulty covering our U.S. dollar-denominated or Euro-denominated costs or repaying our U.S. dollar-denominated or Euro-denominated indebtedness. In nominal terms, the ruble appreciated against the U.S. dollar in 2006 (4.0%), 2005 (1.9%) and 2004 (6.5%), according to the Central Bank of Russia.

Certain of our costs, such as salaries and supplies, are also sensitive to rises in the general price level in Russia. Inflation in Russia for 2006 and 2005 was 9.7% and 10.9%, respectively. In the future, due to competitive pressures, we may not be able to raise the prices for our products sufficiently to preserve operating margins. Accordingly, high rates of inflation could increase our costs and decrease our operating margins.

Real appreciation of the ruble against the U.S. dollar positively affects our revenues. According to the Central Bank of Russia, the ruble appreciated in real terms against the U.S. dollar by 10.7%, 10.8% and 15.1% in 2006, 2005 and 2004, respectively.

## E. Off-balance Sheet Arrangements

As of December 31, 2006, we did not have any off-balance sheet arrangements.

## F. Contractual Obligations

We have various contractual obligations and commercial commitments to make future payments, including capital commitments, notes payable and vendor equipment financing obligations.

The following table summarizes our future obligations and commitments under these contracts due by the periods indicated as of December 31, 2006:

| Contractual Obligations            | Payments due by periods<br>At December 31, 2006 |                     |           |                               |
|------------------------------------|---|---------------------|-----------|-------------------------------|
|                                    | Total<br>(in thousands)                         | Less than<br>1 year | 1-3 years | 4-5 years<br>After<br>5 years |
| Notes payable                      | 248,742   |                     | 150,000   | 98,742                        |
| Vendor financing obligations       | 36,189  | 15,284              | 18,575    | 2,330                         |
| Long-term loans                    | 34,219  | 4,137               | 13,237    | 16,845                        |
| Unconditional purchase obligations | 10,078  | 10,078              |           |                               |
| Short-term loans                   | 123,849   | 123,849             |           |                               |
| Total                              | 453,077   | 153,348             | 181,812   | 117,917                       |

Interest payable for the future periods is not included. We do not have any contingent commitments as at December 31, 2006. For additional information, see Item 11. Quantitative and Qualitative Disclosures about Market Risk Interest Rate Risk.

**Item 6. Directors, Senior Management and Employees**

**A. Directors and Senior Management**

Our directors and executive officers, and their respective ages and positions as of the date of this annual report were as follows:

| <b>Name</b>                  | <b>Year of Birth</b> | <b>Position</b>  |
|------------------------------|----------------------|--|
| David Iakobachvili(1)        | 1957                 | Chairman   |
| Sergei A. Plastinin(1)       | 1968                 | Director   |
| Guy de Selliers(2)(3)        | 1952                 | Director   |
| Mikhail V. Dubinin(1)        | 1969                 | Director   |
| Michael A. O Neill(3)        | 1945                 | Director   |
| Alexander S. Orlov(1)        | 1948                 | Director   |
| Vladimir N. Sherbak(2)(3)    | 1939                 | Director   |
| Earnest Linwood Tipton(2)(3) | 1934                 | Director   |
| Victor A. Tutelyan(3)        | 1942                 | Director   |
| Evgeny G. Yasin(3)           | 1934                 | Director   |
| Gavril A. Yushvaev(1)        | 1957                 | Director   |
| Tony D. Maher                | 1956                 | Chief Executive Officer, Chairman of the Management Board        |
| Dmitry A. Anisimov           | 1971                 | Chief Financial Officer, Management Board Member                 |
| Vera V. Eliseeva             | 1958                 | Head of Human Resources, Management Board Member                 |
| Marina G. Kagan              | 1968                 | Head of Public Affairs, Management Board Member                  |
| Gennady K. Krainov           | 1951                 | Head of Asset Protection Department, Management Board Member     |
| Oleg E. Kuzmin               | 1969                 | Head of Dairy Business Unit, Management Board Member             |
| Silviu Popovici              | 1968                 | Head of Beverages Business Unit, Management Board Member         |
| Grant Winterton              | 1970                 | Group Head of Marketing and Innovations, Management Board Member |
| Garry Sobel                  | 1967                 | Head of Baby Food Business Unit                                  |

(1) Party to the Amended and Restated Partnership and Cooperation Agreement. See Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions and Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry We are controlled by a group of shareholders whose interests could conflict with those of the holders of our securities.

(2) Member of the Audit Committee.

(3) Independent Director.

**David Iakobachvili** has served as Chairman of Wimm-Bill-Dann's Board of Directors since May 2001. He also serves on the board of directors of a number of businesses that he founded and developed into large agricultural, real estate and entertainment holdings, namely RusAgroProject CJSC, Agrocomplex Gorki-2 CJSC, Mill Plant #4 OJSC, Eisk Port Elevator OJSC and Metelitsa-Club CJSC. He also serves as the director of Airport Financial Services Limited, a company that provides financial services. Mr. Iakobachvili also serves on the board of directors of a number of our subsidiaries: Moscow Baby Food Plant OJSC, Vladivostok Dairy Plant OJSC, Wimm-Bill-Dann Ukraine OJSC, Bishkeksut OJSC, Timashevsk Dairy Plant OJSC, Wimm-Bill-Dann Beverages OJSC and Gulkevichi Creamery CJSC. In addition he serves on the boards of a number of national and international organizations, including non-commercial partnership RusBrand, Russian Union of Industrialists and Entrepreneurs, Russian Chamber of Commerce and Industry, National Corporate Governance Council, Russian-American Business Council, Russo-British Chamber of Commerce, Senate of Economic Advisers of the European Democracy Forum, World Economic Forum and Monaco World Summit.

**Sergei A. Plastinin** has served as a member of Wimm-Bill-Dann's Board of Directors since May 2001. He served as the Chairman of the Management Board, which is the chief executive officer position, from 2001 to April 2006. Mr. Plastinin is also a founder and the chief executive officer of a number of businesses in the agricultural, real estate and fashion industries, including, among others, Taly Enterprises Limited and Lendero Limited. Mr. Plastinin also serves on the board of directors of a number of our subsidiaries: Wimm-Bill-Dann Beverages OJSC, Timashevsk Dairy Plant OJSC, Vladivostok Dairy Plant OJSC, Wimm-Bill-Dann Ukraine OJSC, Bishkekesut OJSC, Karasuk CJSC and Gulkevichi Creamery CJSC.

**Guy de Selliers** has served as a member of Wimm-Bill-Dann's Board of Directors since December 2001. Currently, Mr. de Selliers serves as a member of the board of directors and a Chairman of the Audit Committee at Norilsk Nickel OJSC and a member of the board of directors of furniture manufacturer Shatura OJSC and Allied Resources Inc. He is also a director and member of the Audit Committee of Solvay S.A., a global group of pharmaceutical and chemical companies. Mr. de Selliers is also the Chairman of Apprion Group Ltd, HB Advisers (UK) and Partners in Hope. During 2004 and 2005, Mr. de Selliers was a member of the international supervisory board at Fortis Group, an international financial services provider and, from 2001 to 2003, he acted as Chairman of Leader Capital equity fund. During 1998 to 2000, he headed up the European business of Fleming Investment Bank. Mr. de Selliers served as chief executive officer of MC BBL investment bank from 1997 to 1998. He was also a Deputy Vice President of EBRD from 1991 to 1997. He received a degree in engineering in 1975 and in economics in 1977 at the University of Lourain.

**Mikhail V. Dubinin** has served as a member of Wimm-Bill-Dann's Board of Directors since May 2001. Currently, Mr. Dubinin serves on the board of directors of several real estate companies that he founded or co-founded, namely Istra Springs LLC, Nadezhny Fundament LLC, Petri-trade LLC, Cliff-Real Estate LLC, Non-commercial partnership Benelux Residence, non-commercial organization International community council on Golden Falcon order awarding.

**Michael A. O'Neill** has served as a member of Wimm-Bill-Dann's Board of Directors since December 2001. Currently, Mr. O'Neil serves as chief executive officer of Coca-Cola Icecek in Turkey. He also serves on the board of directors of Efes Breweries International. From 1989 to 2000, Mr. O'Neill held various executive positions within the Coca-Cola Company. He received a degree in Industrial Engineering from the College of Commerce Rathmines in 1967.

**Alexander S. Orlov** has served as a member of Wimm-Bill-Dann's Board of Directors since May 2001. From 1992 and 1997, he was director of the dairy department and the general director of the Moscow Baby Food Plant. From 1997 to 1998, he was general director of the Lianozovsky Dairy Plant. Mr. Orlov graduated from the Moscow Technology Institute of Meat and Dairy Industry in 1975.



**Vladimir N. Sherbak** has served as a member of Wimm-Bill-Dann's Board of Directors since May 2001. From 1996 to 2000, Mr. Sherbak was Deputy Minister of Agriculture of the Russian Federation. He graduated from Krasnodar Polytechnic Institute in 1966 and the Academy of Social Science in 1982.

**Earnest Linwood Tipton** has served as a member of Wimm-Bill-Dann's Board of Directors since May 2002. He has held various posts at the U.S. International Dairy Food Association (IDFA) and its organizations for over 35 years, culminating with his appointment to president and chief executive officer in 1983. Prior to joining IDFA, Mr. Tipton worked as an economist for a milk producers' cooperative and as a dairy economic consultant. He also served as an officer in the U.S. Army Finance Corp. and holds Bachelor's and Master's degrees from the University of Missouri.

**Victor A. Tutelyan** has served as a member of Wimm-Bill-Dann's Board of Directors since December 2001. Currently, Mr. Tutelyan is the head of the Institute of Nutrition of the Russian Academy of Medical Science. He is an academician of the Russian Academy of Medical Science and has been the chief secretary of its Presidium since 2000. From 1980 to 2000, Mr. Tutelyan was the Deputy Director of the Institute of Nutrition of the Russian Academy of Medical Science. He graduated from the Moscow Medical Institute in 1965.

**Evgeny G. Yasin** has served as a member of Wimm-Bill-Dann's Board of Directors since December 2001. He has been a professor of the State University High School of Economics since July 1998. Mr. Yasin also serves on the board of directors in a number of businesses, namely Seversta 1 Auto, Otkrytie Investitsii OJSC, Echo of Moscow CJSC and Insurance Group Alfainurance. He also serves as the president of non-governmental fund Expert Institute. From 1994 to 1998, Mr. Yasin was Russia's Minister of the Economy. He graduated from the Hydrotechnical Institute in 1957 with a degree in engineering and in 1963 from Moscow State University with a degree in economics.

**Gavril A. Yushvaev** has served as a member of Wimm-Bill-Dann's Board of Directors since June 2005. He also serves as a member of the board of directors of a number of businesses that he founded and developed into large agricultural and real estate holdings, namely RusAgroProject CJSC, Agrocomplex Gorki-2 CJSC, Mill Plant #4 OJSC, Eisk Port Elevator OJSC and Cattle Farm Naroosanovsky OJSC. Mr. Yushvaev also serves as the president of RusAgroProject CJSC.

**Tony D. Maher** has served as Wimm-Bill-Dann's Chief Executive Officer and Chairman of the Management Board since April 2006. Prior to joining Wimm-Bill-Dann, he served as chairman of the board of directors of Multon, a Russian juice company. He also held a variety of senior positions in Western, Central and Eastern European markets within the Coca-Cola group of companies, including Region Managing Director for Coca-Cola HBC, one of the largest bottlers of non-alcoholic beverages in Europe.

**Dmitry A. Anisimov** has served as Wimm-Bill-Dann's Chief Financial Officer and a member of the Management Board since April 2005. Prior to his appointment, Mr. Anisimov served as the finance director of the Dairy Business Unit, a position he held since May 2003. He also serves on the board of directors of a number of our subsidiaries: Tuimazy Dairy Plant OJSC, Wimm-Bill-Dann Ukraine OJSC, Bishkeksut OJSC and Karkov Dairy Plant OJSC. Before joining Wimm-Bill-Dann, he served as regional corporate finance manager for Motorola's operations in Russia and the CIS from November 1997 to May 2003. Prior to that, he worked for Cadbury Confectionary and British Petroleum PLC. Mr. Anisimov has a degree in economics from the Moscow State Institute of International Relations (MGIMO).

**Vera V. Eliseeva** has served as Wimm-Bill-Dann's Head of Human Resources and a member of the Management Board since October 2004. Prior to joining Wimm-Bill-Dann, she worked for PATHWAYS HR training & consultancy as a senior partner from May 2003 to October 2004. She served as the director of human resources for Troika Dialog from November 1999 to April 2003. From September 1997 to November 1999, she worked as a compensation and benefits manager at Nestle Food LLC. Ms. Eliseeva





graduated from Moscow State Institute of International Relations (MGIMO) and received a Master's Degree in business economics from California State University, Hayward.

**Marina G. Kagan** has served as Wimm-Bill-Dann's Head of Public Affairs and a member of the Management Board since May 2004. From 1991 to 1998, Ms. Kagan worked for BBC radio and TV, and served as a Moscow correspondent for the BBC World Service from 1995 to 1998. She joined Gavin Anderson & Co, an international investor and public relations consultancy in 1998, where she served on the Board of Directors until 2001. From 2001 to 2004, Ms. Kagan worked as a partner at Shared Value, a London-based international financial public relations and investor relations firm. Ms. Kagan graduated from Westminster University in London, England.

**Gennady K. Krainov** has served as Wimm-Bill-Dann's Head of Asset Protection Department since December 2003 and as a member of the Management Board since June 2005. From 1975 until 2003, Mr. Krainov held managerial positions within national security bodies and at the tax police. He also worked for the Russian External Trade Ministry and Chamber of Commerce and Industry. Mr. Krainov graduated from the Moscow Geology Institute and the Higher School of Committee for State Security, where he received a legal degree.

**Oleg E. Kuzmin** has served as Wimm-Bill-Dann's Head of Dairy Business Unit since August 2004 and as a member of the Management Board since 2005. Mr. Kuzmin serves on the board of directors of a number of our subsidiaries: Kharkov Dairy Plant OJSC, Wimm-Bill-Dann Ukraine OJSC, Tuimazy Dairy Plant OJSC, Bishkeksut OJSC, Karasuk CJSC, Buryl Dairy Plant OJSC and Obninsk Dairy Plant OJSC. He also serves as chief executive officer of our subsidiaries Wimm-Bill-Dann OJSC and Moscow Baby Food Plant OJSC. Mr. Kuzmin has been employed by Wimm-Bill-Dann since 1995. From September 2003 to August 2004, he was head of operations of the dairy business unit. Prior to that, he served in various managerial positions, including head of the cheese project, director of the Nizhny Novgorod Dairy Plant, strategy director of the Lianozovsky Dairy Plant and marketing director of Wimm-Bill-Dann's Trading Company. Mr. Kuzmin graduated from Moscow State Bauman Technical University and Moscow State University. He also received an MBA from the Academy of the National Economy of the Government of the Russian Federation.

**Silviu Popovici** has served as Wimm-Bill-Dann's Head of Beverages Business Unit since September 2006 and as a member of the Management Board since May 2007. Mr. Popovici has extensive experience in sales, marketing, operations and general management with Bristol-Myers Squibb and Coca-Cola in Romania, Russia and Ukraine. In the two and a half years before he joined the company, Mr. Popovici worked as country manager for Coca-Cola HBC Ukraine. He has a degree in physics from the University of Bucharest and is currently completing an MBA at the London Business School in the UK.

**Grant Winterton** has served as Wimm-Bill-Dann's Group Head of Marketing and Innovations since November 2006 and as a member of the Management Board since May 2007. He has extensive experience in marketing and sales with multinational companies, including Wella Haircare, Campbell Soup Company (Arnotts Snacking) and Coca-Cola in Australia, Russia, Ukraine, Belarus and China. He also has dairy industry experience with three years in both the milk and soft dairy divisions of National Dairies, Australia's largest dairy producer. Over the course of 14 years before joining Wimm-Bill-Dann, Mr. Winterton worked in a variety of senior marketing, sales and managerial positions in these fast-moving consumer goods companies. Mr. Winterton holds a Bachelor of Commerce degree from the University of New South Wales, Australia, where he graduated with a double major in marketing and finance.

**Gary Sobel** has served as Head of Baby Food Business Unit since March 2007. Mr. Sobel began his career at Procter and Gamble, where over 13 years he worked in various positions in Canada, the United States, the United Kingdom and Russia. His experience included working in Procter & Gamble's Wal-Mart Customer Team, as well as heading up In-store Marketing and New Product Performance for



their Baby Care Division. He headed Dirol Cadbury (a division of Cadbury Schweppes) in Russia. Mr. Sobel graduated from Concordia University (Montreal, Canada) with honors and received a B.A. in Business Administration, as well as an MBA from the University of Western Ontario (Canada).

All of our directors were elected on June 30, 2006 and, pursuant to Russian law, their terms will expire on the date of our next annual shareholders meeting, which will take place on June 27, 2007.

## **B. Compensation of Directors and Senior Management**

In 2006, the aggregate amount of compensation to the directors and Management Board members of Wimm-Bill-Dann Foods OJSC as a group for services in all capacities was \$6.5 million. In 2006 the Company entered into a share-based award agreement with some of its executives. Commencing April 2007 Stock Appreciation Rights incentive program linked to ADS has been approved for wider senior management. See Note 3 to our Consolidated Financial Statements included under Item 18. Financial Statements.

No funds were set aside for pension, retirement and other similar benefits for the same directors and executive officers as of December 31, 2006.

We compensate each board of directors member \$70,000 annually, plus transportation and lodging expenses incurred in connection with board meeting attendance, and up to \$2,000 per year for other expenses incurred in connection with board-related activities. The Chairman of the Board is compensated \$320,000 annually plus transportation and lodging expenses incurred in connection with board meeting attendance, and up to \$2,000 per year for other expenses incurred in connection with board-related activities. We also compensate each member of the Personnel and Compensation Committee and each member of the Investment and Strategic Planning Committee \$3,000 and each member of the Audit Committee \$5,000 for participation in each planned direct Committee meeting.

## **C. Board Practices**

### **Board of Directors**

Members of our Board of Directors are elected by a majority vote of shareholders at our annual general meeting using a cumulative voting system. Each director is elected for a term that lasts until the next annual general meeting and may be re-elected an unlimited number of times. Our Board of Directors currently consists of eleven members, six of whom are independent directors. The Board of Directors has the authority to make overall management decisions for the Company, except those matters reserved to the shareholders. See Item 10. Additional Information B. Charter and Certain Requirements of Russian Legislation General Meetings of Shareholders for more information regarding the competence of our shareholders meetings. The members of our Board of Directors serve pursuant to a contract. The contracts do not provide for benefits to the board members upon termination of their employment. We indemnify each member of our Board of Directors pursuant to agreements, under which we indemnify them against, among others, expenses and costs incurred by them in connection with any claims, suits or proceedings arising out of or as a result of their service as a director, subject to certain limitations. The agreements also limit the liability of the directors to compensate us for any losses caused by them, as well as our ability to take any action against them, subject to certain exclusions.

The business address for all of our officers and directors is 16 Yauzsky Boulevard, Moscow 109028, Russian Federation.

## **Management Board**

The composition of our Management Board, which consists of our executive officers, is determined by the Board of Directors and currently consists of eight members: Tony D. Maher, Dmitry A. Anisimov, Marina G. Kagan, Vera V. Eliseeva, Oleg E. Kuzmin, Grant Winterton, Silviu Popovici and Gennady K. Krainov. Members of the Management Board are nominated by the Chairman of the Management Board and confirmed by our Board of Directors for a term of three years. The Management Board is the collective executive body of the Company and, under the direction of the Chairman of the Management Board, is responsible for our day-to-day management. We indemnify each member of our Management Board pursuant to agreements, under which we indemnify them against, among others, expenses and costs incurred by them in connection with any claims, suits or proceedings arising out of or as a result of their service as a Management Board member, subject to certain limitations. The agreements also limit the liability of the Management Board members to compensate us for any losses caused by them, as well as our ability to take any action against them, subject to certain exclusions.

## **Chairman of the Management Board**

In accordance with our current charter, the Board of Directors appoints the Chairman of our Management Board, our chief executive officer, for a term of three years, which term we intend to extend to five years by amending our charter. We concluded an employment contract with the current Chairman of our Management Board for a term of five years. The rights, obligations and the times and amounts of payment for the Chairman's services are determined pursuant to our charter and by contract. The Chairman of the Management Board is responsible for day-to-day management of our activities.

## **Board of Directors Committees**

### **Audit Committee**

The Audit Committee of our Board of Directors was established on April 24, 2003 by a decision of our Board of Directors and functions pursuant to bylaws approved by the Board. It is currently comprised of three independent directors, G. de Selliers, E. Linwood Tipton and V. Sherbak. Our Board of Directors has determined that G. de Selliers is an audit committee financial expert as defined in Item 16A of Form 20-F.

The goals and objectives of the Audit Committee, as set forth in the bylaws, are to assist the Board of Directors in carrying out its oversight responsibilities in the areas of:

- our financial statements and the processes of their preparation;
- our internal accounting and financial control system;
- work of the internal audit service and independent auditors;
- qualifications and independence of the independent auditors;
- our compliance with ethical principles; and
- requirements of legislative and normative acts.

According to the bylaws, the Audit Committee shall meet, separately from the non-independent directors, at least once during each fiscal quarter and more frequently as the Committee deems desirable. To improve the effectiveness of the Audit Committee, a major auditing firm (other than our independent auditor) has been hired to advise the Audit Committee.

### **Investment and Strategic Planning Committee**

The Investment and Strategic Planning Committee of our Board of Directors was formed on April 24, 2003 by a decision of our Board of Directors and functions pursuant to bylaws approved by the Board. It is



composed of M. O'Neill, an independent director who serves as the Committee Chairman, S. Plastinin, M. Dubinin and V. Tutelyan. According to its bylaws, the Investments and Strategic Planning Committee is designed to assist the Board of Directors in approving and carrying out its oversight responsibilities in relation to significant investment programs, mergers and acquisitions and strategic planning.

According to the bylaws, the Investment and Strategic Planning Committee shall meet not less than once during each fiscal quarter.

#### **Corporate Governance Committee**

Our Board of Directors made the decision to establish the Board of Directors Governance Committee. Although the Committee's bylaws and its members have not yet been approved, the Board of Directors outlined the main goals and objectives of the Governance Committee as follows:

- development and observance of governance principles and corporate rules of conduct, established by the Company; and
- appraisal of director's independence.

#### **Personnel and Compensation Committee**

The Personnel and Compensation Committee of our Board of Directors was formed on April 24, 2003 by a decision of our Board of Directors and functions pursuant to bylaws approved by the Board. It is composed of E. Yasin, an independent director who serves as Committee Chairman, G. Yushvaev and A. Orlov. According to the bylaws, the Personnel and Compensation Committee is tasked with assisting in the selection of Board of Directors candidates. Its members also assist the Management Board in formulating and implementing:

- a uniform personnel policy for all of our subsidiaries;
- a personnel appraisal, rotation, dismissal, education and training policy and administrative accounting standards;
- a remuneration and compensation policy, as well as other incentive programs (stock option and pension plans, social programs); and
- a corporate ethics and communications policy.

According to the bylaws, the Personnel and Compensation Committee shall meet not less than once during each fiscal quarter.

#### **Company Committees**

##### **Disclosure Committee**

Our Disclosure Committee was formed on March 24, 2003 by order of the Chairman of our Management Board. It is currently composed of our Chief Financial Officer, Head of Corporate Communications and Investor Relations, Head of the Legal Department, Head of the Treasury, Head of Internal Audit, Head of the Dairy Unit, Financial Director of the Dairy Unit, Head of the Beverages Unit, Financial Director of the Beverages Unit, Head of the Baby Food Unit, Financial Director of the Baby Food Unit and the Head of the Reporting, Budgeting and Analysis Department. The Committee's activities are coordinated by a senior investor relations manager.

The Disclosure Committee functions pursuant to bylaws and meets as determined by the Committee. It is directly supervised by and reports to the Chairman of the Management Board and Chief Financial Officer.

According to its bylaws, the Disclosure Committee is tasked with:

- overseeing the gathering, evaluating and reporting of information relating to our disclosure obligations;
- evaluating our system of disclosure controls and procedures; and
- preparing written confirmations relating to our observance of the information disclosure rules and principles.

As set forth in the bylaws, the Disclosure Committee is also responsible for all aspects of information disclosure, including ensuring proper documentary execution, transmission, implementation and performance of our rules and principles of information disclosure, as well as for coordinating the work of our legal department, external and internal auditors and our other departments for the purpose of preparation of our annual reports and other disclosure documents in accordance with applicable law. Furthermore, the head and financial director of each of our business units have reviewed this annual report on Form 20-F and to the best of his knowledge believes the disclosure herein is accurate and complete.

#### **Audit Commission (for financial reporting under Russian law)**

The Audit Commission verifies the accuracy of our financial reporting under Russian law and generally supervises our financial activity. The members of our Audit Commission are nominated and elected by our shareholders for a term of one year. A Director may not simultaneously be a member of the Audit Commission. Our Audit Commission currently has six members. Our Audit Commission operates in accordance with terms set forth in specific guidelines. The terms of all of our Audit Commission members expire on the date of our next annual shareholders meeting, which will take place in June 2007.

#### **Corporate Governance**

We are required under the New York Stock Exchange listing rules to disclose any significant differences between the corporate governance practices that we follow under Russian law and applicable listing standards and those followed by U.S. domestic companies under New York Stock Exchange listing standards. This disclosure is posted on our website [http://www.wbd.com/f\\_reports/corp\\_govern/](http://www.wbd.com/f_reports/corp_govern/).

#### **D. Employees**

In 2006, we had an average of 19,325 employees within Russia and the other countries of the CIS, including 10,811 production employees, 5,355 marketing, sales and distribution employees and 3,159 general and administrative employees. We do not employ a significant number of part-time employees. In 2006, we experienced a higher level of departures due to headcount optimization. We have not experienced any work stoppages, and we consider our relations with employees to be strong. Some of our employees are unionized and are employed pursuant to collective labor agreements.

| Average for the year ended<br>December 31, | Production | Marketing<br>Sales<br>and<br>Distribution | General and<br>Administrative | Percent<br>Increase<br>(Decrease) over<br>Prior Year |
|--|------------|---|-------------------------------|--|
| 2006(1)                                    | 10,811     | 5,355                                     | 3,159                         | 2 % <sup>(2)</sup>                                   |
| 2005                                       | 9,766      | 5,713                                     | 3,478                         | 7 %  |
| 2004                                       | 8,561      | 6,008                                     | 3,140                         | (3 )%  |

(1) Excluding employees of businesses we acquired in 2006 (Surgut, Ochakovo, Manros and MOLKA).



(2) Despite a workforce reduction of over 900 people in the period from June to December 2006, we still had a 2% increase in the average number of personnel in 2006 vs. 2005. This growth was due to an increase in production personnel caused by increasing utilization of manufacturing facilities in 2006, growing Agro business, and relaunching the plants acquired in 2005 (Obninsk, Pervouralsk and Nazarovo dairy plants).

Our personnel enjoy a relatively high level of social benefits. We provide subsidies for meals, medical care and summer vacations for employees and their children. Our employees have opportunities to upgrade their qualifications by participating in professional education programs. Starting in 1998, leading managers of our subsidiaries have been involved in programs to upgrade their professional skills through a program of the Russian government. We seek to maintain effective management teams at our plants by recruiting qualified new employees, as well as through customized retraining programs and on-site training in our leading plants. Programs for training personnel have been developed and implemented at all our regional plants as well as sales offices and managing company. In addition, in 2005, we created a corporate university to educate and train our personnel, create an internal management pool and provide an opportunity for employees to share their knowledge and experience as well as an opportunity to advance their careers. In 2006, we also initiated various HR projects in the Compensation & Benefits domain. In 2006 we commenced Key Performance Indicators (KPI) system implementation across all business units and introduced individual development plans for top 500 employees. All our employees now have variable salaries linked to performance. Their progress is monitored through semi-annual performance review.

#### E. Share Ownership

Each ADS is the economic equivalent of one share of our common stock.

The aggregate beneficial interest of our directors, senior management and employees as of June 5, 2007 was as follows:

| Number of Shares of Common Stock | Number of GDSs | % Capital Stock Outstanding |
|----------------------------------|----------------|-----------------------------|
| 17,297,734                       | 3,187,663      | 47.58                       |

For further description of the individual interest of our directors and senior management, see Item 7. Major Shareholders and Related Party Transactions A. Major Shareholders.

**Item 7. Major Shareholders and Related Party Transactions****A. Major Shareholders**

The following table sets forth information regarding the beneficial ownership of our common stock as of June 5, 2007:

| Name of Beneficial Owner         | Number of Shares Owned | Percentage of Shares Outstanding | Number of ADSs/GDSs Owned | Percentage of Shares Outstanding | Total Number of Shares Owned (Shares + ADSs/GDSs) | Total Percentage of Shares Outstanding (Shares + ADSs/GDSs) |
|----------------------------------|------------------------|----------------------------------|---------------------------|----------------------------------|---|---|
| Gavril A. Yushvaev(1)(2)         | 7,538,624              | 17.13 %                          | 1,020,894                 | 2.32 %                           | 8,559,518   | 19.45 %   |
| Sergei A. Plastinin(1)(2)(3)     | 3,139,604              | 7.14 %                           | 636,143                   | 1.45 %                           | 3,775,747   | 8.58 %  |
| David Iakobachvili(1)(2)         | 3,673,476              | 8.35 %                           | 786,039                   | 1.79 %                           | 4,459,515   | 10.14 %   |
| Mikhail V. Dubinin(1)(2)         | 1,809,260              | 4.11 %                           | 357,233                   | 0.81 %                           | 2,166,493   | 4.92 %  |
| I.M. Arteks Holdings Limited(4)  | 183,639                | 0.42 %                           |                           |                                  | 183,639   | 0.42 %  |
| Alexander S. Orlov(1)(2)         | 1,097,064              | 2.49 %                           | 229,688                   | 0.52 %                           | 1,326,752   | 3.02 %  |
| Mikhail I. Vishnyakov(2)         | 304,512                | 0.69 %                           | 135,488                   | 0.31 %                           | 440,000   | 1.00 %  |
| Viktor E. Evdokimov(2)           | 0.00                   | 0.00 %                           | 22,178                    | 0.05 %                           | 22,178  | 0.05 %  |
| Other holders of ordinary shares | 8,658,821              | 19.68 %                          |                           |                                  | 8,658,821   | 19.68 %   |
| Holders of American Shares(5)    |                        |                                  | 14,407,337                | 32.7439 %                        | 14,407,337  | 32.7439 %   |
| <b>Total</b>                     | <b>26,405,000</b>      | <b>60.0114 %</b>                 | <b>17,595,000</b>         | <b>39.9886 %</b>                 | <b>44,000,000</b>                                 | <b>100.00 %</b>   |

(1) Member of our Board of Directors.

(2) Party to the Amended and Restated Partnership and Cooperation Agreement.

(3) This figure contains 1% of shares owned by Lendero Ltd. controlled by Sergei A. Plastinin.

(4) According to a press release issued by I.M. Arteks Holdings Limited, or Arteks, dated 7 June 2004, Arteks transferred 5.29% of our shares to Parex Banka JSC as security under a credit agreement, which amount was reduced to 4.92%. Arteks is a party to the Amended and Restated Partnership and Cooperation Agreement. Arteks owned 4.81% of our shares which were held by Parex Banka JSC as security under a credit agreement. On 22 March 2005 Arteks disposed of 0.48% of our shares. In November 2006 Arteks redeemed all its shares from Parex.

(5) According to its latest public statements and 13D filing, Groupe Danone, together with its subsidiaries, holds a 13.7% stake in Wimm-Bill-Dann Foods OJSC.

As of June 5, 2007, we had 44,000,000 shares of common stock outstanding. The total number of ADSs outstanding was 14,407,337 representing underlying ownership of 14,407,337 shares, or 32.7439% of our outstanding shares. The total number of GDSs outstanding was 3,187,663 representing underlying ownership of 3,187,663 shares, or 7.2447% of our outstanding shares. The shares underlying the ADSs and GDSs are deposited with Deutsche Bank Trust Company Americas and the local custodian is

OOO Deutsche Bank. All shares of common stock have the same voting rights. According to Capital Bridge Analytics we have 34 record holders in the U.S., holding ADSs and/or shares comprising at least 0.034% of our total outstanding share capital.

Based on our share register, we believe we are not directly or indirectly owned or controlled by another corporation or government, and that there are no arrangements the operation of which may result in a change of control. During 2004, 2005 and 2006, there have not been any significant changes in the percentage ownership held by any major shareholders except as described below.

In March 2005, certain shareholders in our controlling group of shareholders, some of whom are members of our Board of Directors, sold shares held by them amounting to approximately 3.0% of our total outstanding shares. In February 2006, Mr. Iakobachvili and Gavril Yushvaev, members of our Board of Directors and members of the controlling group of shareholders, purchased all shares owned by Evgeny Yaroslavsky, thereby increasing their respective ownership stakes to 10.12% and 19.45%, respectively. Following the disposal of his ownership stake, Mr. Yaroslavsky ceased to be a party to the Amended and Restated Partnership and Cooperation Agreement. In November 2006, certain shareholders in our controlling group of shareholders, some of whom are members of our Board of Directors, sold 10.00% of shares, thereby decreasing their ownership to 48.38%. In April 2007, our shareholders Mr. Dubinin, Mr. Orlov and Mr. Plastinin sold 0.25%, 0.15% and 0.43%, respectively. In January and April 2007, Mr. Iakobachvili bought shares totaling 0.02%, increasing his shareholding up to 10.14% See Item 3. Key Information D. Risk Factors We are controlled by a group of shareholders whose interests could conflict with those of the holders of our securities.

## **B. Related Party Transactions**

See Note 30 (Related Parties) to the Consolidated Financial Statements included elsewhere in this document.

## **C. Interests of Experts and Counsel**

Not applicable.

## **Item 8. Financial Information**

### **A. Consolidated Statements and Other Financial Information**

**8.A.1-4 See Item 18. Financial Statements.**

**8.A.5-6 Not applicable.**

#### **8.A.7 Litigation**

Prior to January 1, 2003, we used certain tax optimization initiatives, which resulted in tax savings of approximately \$3.8 million. Although we believe these tax optimization initiatives comply with Russian tax law, the tax authorities may nonetheless challenge such initiatives and attempt to recover the full amount of the savings, as well as seek penalties. Starting January 1, 2003, we discontinued using these tax optimization initiatives.

From 2002 to March 2005, certain of our juice producing subsidiaries benefited from small enterprise tax legislation. If we had not taken advantage of this benefit, our tax expenses would have increased by approximately \$9.4 million during this period. None of our subsidiaries currently takes advantage of the small enterprise tax benefits. However, our prior use of this benefit in the past has been challenged by the tax authorities and the tax authorities may continue to retroactively challenge these previous tax benefits enjoyed by our subsidiaries and seek to recover the full amount of tax savings plus penalties. Such challenges, if successful, could materially adversely affect our results of operations.

See also Item 3. Key Information D. Risk Factors Risks Relating to Our Financial Condition If the various initiatives we have used to reduce our tax burden and/or our calculation of our VAT and profit tax liabilities are successfully challenged by the Russian tax authorities, we will face significant losses associated with the assessed amount of tax and related interest and penalties, which would have a material impact on our financial condition and results of operations. The elimination of a tax privilege from which we currently benefit and/or a successful challenge by the tax authorities of our use of this tax privilege would materially adversely affect our results of operations and We are only able to conduct banking transactions with a limited number of creditworthy Russian banks, as the Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business, materially adversely affecting our business, financial position and results of operations.

#### **8.A.8 Dividend Distribution Policy**

We do not have a formal dividend policy, and annual dividend payments, if any, must be recommended by our board of directors and approved by our shareholders. In particular, dividends may be paid only out of net profits for the current year calculated under Russian accounting principles and as long as the following conditions have been met:

- our charter capital has been paid in full;
- the value of our net assets, minus the proposed dividend payment, is greater than the total of our charter capital and our reserve fund;
- we have repurchased all shares from shareholders having the right to demand repurchase; and
- we are not, and would not become as the result of payment of dividends, insolvent.

In June 2006 the General Meeting of Shareholders approved payments of dividends, recommended by the board, for the financial years 2002, 2003 and 2004 in the amount of RUR 4.60 (approximately \$0.17) per share, as well as for the first quarter of 2006 in the amount of RUR 2.27 (approximately \$0.08) per share.

In December 2006, the General Meeting of Shareholders approved payment of dividends, recommended by the board, for the 9 months of 2006 in the amount of RUR 7.86 (approximately \$0.30) per share. We have paid to the shareholders all the dividends approved by GM.

In May 2007, the Board recommended the Annual General Meeting of Shareholders, to be held on June 27, 2007, to approve payment of dividends for the full year 2006 in the amount of 3.18 RUR (approximately \$0.12) per share.

We anticipate that any dividends we may pay in the future on the shares represented by the ADSs will be declared and paid to the depositary in rubles and will be converted into U.S. dollars by the depositary and distributed to holders of ADSs, net of the depositary's fees and expenses. Accordingly, the value of dividends received by holders of ADSs will be subject to fluctuations in the exchange rate between the ruble and the U.S. dollar. For a discussion of our policy on dividend distributions, see Item 10. Additional Information B. Charter and Certain Requirements of Russian Legislation Dividends.

#### **B. Significant Changes**

On February 6, 2007, UBS (Luxembourg) S.A. issued 7.5% Loan Participation Notes due 2008 for the sole purpose of funding a \$150 million loan (the Loan) to WBD Foods. The Loan will mature on May 14, 2008 and bears interest at an annual rate of 7.5%, payable in two installments on November 14, 2007 and May 14, 2008. The loan agreement contains a number of covenants including requirements to maintain certain financial ratios.

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On April 25, 2007, the following subsidiaries were merged into Wimm-Bill-Dann (formerly Lianozovsky Dairy Plant): Tsaritsyno Dairy Plant, Ufa Dairy Plant, Siberian Milk Dairy Plant, Rubtsovsk Dairy Plant, Siberian Cheese Plant, Nizhny Novgorod Dairy Plant, Baltic Milk Dairy Plant, Pag Rodnik, Nazarovo Dairy Plant and Pervouralsk Dairy Plant.

On May 29, 2007 we acquired an additional 30.12% stake in the founding capital of Obninsk Dairy Plant OJSC, increasing our share to 96.45% of its charter capital.

On May 31, 2007 the following subsidiaries were merged into Wimm-Bill-Dann (formerly Lianozovsky Dairy Plant): Kursk Baby Food Plant, Moscow Baby Food Plant, Timashevsk Dairy Plant, Vladivostok Dairy Plant.

### *Item 9. Offer and Listing Details*

(Only items 9.A.4 and 9.C are applicable.)

#### A. Market Price Information

The following table sets forth the monthly high and low market closing prices per ADS on the New York Stock Exchange for each of the most recent six months; the quarterly high and low market closing prices per ADS for each quarter of 2005 and 2006 and the first quarter of 2007; and the annual high and low market closing prices per ADS during 2002, 2003, 2004, 2005 and 2006. Also set forth are the high and low market closing prices for shares of our common stock on the RTS.

|                     | Shares of<br>Common Stock<br>High | Shares of<br>Common Stock<br>Low | ADS<br>High | ADS<br>Low |
|---------------------|-----------------------------------|----------------------------------|-------------|------------|
| May 2007            | \$ 67.67                          | \$ 60.08                         | \$ 84.18    | \$ 76.70   |
| April 2007          | \$ 69.16                          | \$ 64.41                         | \$ 85.55    | \$ 80.10   |
| March 2007          | \$ 67.02                          | \$ 50.34                         | \$ 79.86    | \$ 59.00   |
| February 2007       | \$ 56.88                          | \$ 51.78                         | \$ 69.10    | \$ 60.90   |
| January 2007        | \$ 52.57                          | \$ 49.13                         | \$ 65.59    | \$ 56.49   |
| December 2006       | \$ 56.24                          | \$ 39.84                         | \$ 66.59    | \$ 49.75   |
| First Quarter 2007  | \$ 67.02                          | \$ 49.13                         | \$ 79.86    | \$ 56.49   |
| Fourth Quarter 2006 | \$ 56.24                          | \$ 37.75                         | \$ 66.59    | \$ 41.20   |
| Third Quarter 2006  | \$ 40.11                          | \$ 27.77                         | \$ 47.85    | \$ 36.55   |
| Second Quarter 2006 | \$ 36.93                          | \$ 25.20                         | \$ 39.50    | \$ 27.90   |
| First Quarter 2006  | \$ 26.80                          | \$ 20.50                         | \$ 28.36    | \$ 22.60   |
| Fourth Quarter 2005 | \$ 18.40                          | \$ 17.00                         | \$ 24.10    | \$ 17.84   |
| Third Quarter 2005  | \$ 16.90                          | \$ 16.90                         | \$ 19.20    | \$ 16.42   |
| Second Quarter 2005 | \$ 17.60                          | \$ 16.50                         | \$ 19.81    | \$ 16.12   |
| First Quarter 2005  | \$ 18.00                          | \$ 15.50                         | \$ 19.38    | \$ 14.42   |
| 2006                | \$ 67.02                          | \$ 25.20                         | \$ 66.59    | \$ 22.60   |
| 2005                | \$ 19.25                          | \$ 15.50                         | \$ 24.10    | \$ 14.42   |
| 2004                | \$ 18.28                          | \$ 12.85                         | \$ 19.98    | \$ 12.49   |
| 2003                | \$ 20.45                          | \$ 17.48                         | \$ 21.90    | \$ 15.62   |
| 2002                | \$ 18.28                          | \$ 17.00                         | \$ 24.95    | \$ 16.35   |

#### C. Markets

In Russia, our common stock is listed on the RTS under the symbol WBDF, and is admitted for trading on the Moscow Interbank Currency Exchange (MICEX). American Depositary Receipts, each representing one share of our common stock, have been listed on the New York Stock Exchange under the

symbol WBD since February 8, 2002. Our American Depositary Receipts are also traded on the Frankfurt Stock Exchange pursuant to a broker-established unsponsored facility.

**Item 10.** *Additional Information*

**A.** Share Capital

Not applicable.

**B.** Charter and Certain Requirements of Russian Legislation

We describe below material provisions of our charter in effect on the date of this document and certain requirements of Russian legislation. In addition to this description, we urge you to review our charter to learn its complete terms.

**Our Purpose**

Article 4.1 of our charter provides that our main goal is to provide the fullest and highest-quality satisfaction of the needs of legal entities and individuals for the products and services we offer, as well as to generate profits.

We are registered with the Moscow Inter-District Inspectorate No. 39 of the Russian Ministry of Taxes and Duties under the state registration number 1037700236738.

**General Matters**

Pursuant to our charter, we have the right to issue registered shares of common stock, shares of preferred stock and other securities provided for by legal acts of the Russian Federation with respect to securities. Our capital stock currently consists of 44,000,000 common shares, each with a nominal value of 20 rubles, all of which are fully paid, issued and outstanding. Under Russian legislation, charter capital refers to the aggregate nominal value of the issued and outstanding shares. We are also authorized to issue 44,000,000 common shares with a nominal value of 20 rubles each. No preferred shares are authorized or outstanding. Preferred shares may only be issued if corresponding amendments have been made to our charter pursuant to a resolution of the general meeting of shareholders. We have issued only shares of common stock. The Federal Law on Joint Stock Companies requires us to dispose of any of our shares that we acquire within one year of their acquisition or, failing that, reduce our charter capital. We refer to such shares as treasury shares for the purposes hereof. Russian legislation does not allow for the voting of such treasury shares.

**Rights Attaching to Shares**

Holders of our common stock have the right to vote at all shareholders meetings. As required by the Federal Law on Joint Stock Companies and our charter, all shares of our common stock have the same nominal value and grant identical rights to their holders. Each fully paid share of common stock, except for treasury shares, gives its holder the right to:

- freely transfer the shares without consent of other shareholders;
- receive dividends;
- participate in shareholders meetings and vote on all matters within shareholders competence;
- transfer voting rights to its representative on the basis of a power of attorney;
- participate in the election and dismissal of members for the board of directors and review commission;



- if holding, alone or with other holders, 2% or more of the voting stock, within 30 days after the end of our fiscal year, make proposals for the agendas of the annual shareholders meeting and nominate candidates to the board of directors, management board, counting commission, review commission and for the general director;
- if holding, alone or with other holders, 10% or more of the voting stock, demand from the board of directors the calling of an extraordinary shareholders meeting or an unscheduled audit by the review commission or an independent auditor;
- demand, under the following circumstances, the repurchase by us of all or some of the shares owned by it, as long as such holder voted against or did not participate in the voting on the decision approving the following:
  - any reorganization;
  - the conclusion of a major transaction, as defined under Russian law; and
  - any amendment of our charter or approval of a restated version of our charter in a manner that restricts the holder's rights;
- upon liquidation, receive a proportionate amount of our property after our obligations are fulfilled;
- have access to certain company documents, receive copies for a reasonable fee and, if holding alone or with other holders, 25% or more of the voting stock, have free access to accounting documents and minutes of the company's management board meetings; and
- exercise other rights of a shareholder provided by our charter, Russian legislation and decisions of shareholders meeting approved in accordance with its competence.

#### **Preemptive Rights**

The Federal Law on Joint Stock Companies and our charter provide existing shareholders with a preemptive right to purchase shares or securities convertible into shares during an open subscription in the amount proportionate to their existing shareholdings. In addition, the Federal Law on Joint Stock Companies provides shareholders with a preemptive right to purchase shares or securities convertible into shares, in an amount proportionate to their existing shareholdings, during a closed subscription if the shareholders voted against or did not participate in the voting on the decision approving such subscription. The preemptive right does not apply to a closed subscription to existing shareholders provided that such shareholders may each acquire a whole number of shares or securities convertible into shares being placed in an amount proportionate to their existing shareholdings. We must provide shareholders with written notice of the proposed sale of shares at least 45 days prior to the offering, during which time shareholders may exercise their preemptive rights.

#### **Dividends**

The Federal Law on Joint Stock Companies and our charter set forth the procedure for determining the quarterly and annual dividends that we may distribute to our shareholders. We may declare dividends based on our first quarter, six month, nine month or annual results. Dividends are recommended to a shareholders meeting by a majority vote of the board of directors, and approved by the shareholders meeting by a majority vote. A decision on quarterly, six month and nine month dividends must be taken within three months of the end of the respective quarter at the shareholders meeting; and a decision on annual dividends must be taken at the annual general shareholders meeting. The dividend approved at the shareholders meeting may not be more than the amount recommended by the board of directors. Dividends are distributed to holders of our shares as of the record date for the shareholders meeting.



approving the dividends. See General Meetings of Shareholders Notice and Participation. Dividends are not paid on treasury shares.

The Federal Law on Joint Stock Companies allows dividends to be declared only out of net profits calculated under Russian accounting standards and as long as the following conditions have been met:

- the charter capital of the company has been paid in full;
- the value of the company's net assets on the date of adoption of a decision to pay dividends is not less (and would not become less as a result of the proposed dividend payment) than the sum of the company's charter capital, the company's reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred shares of the company;
- the company has repurchased all shares from shareholders having the right to demand repurchase; and
- the company is not, and would not become, insolvent as the result of the proposed dividend payment.

#### **Distributions to Shareholders on Liquidation**

Under Russian legislation, liquidation of a company results in its termination without the transfer of rights and obligations to other persons as legal successors. The Federal Law on Joint Stock Companies and our charter allow us to be liquidated:

- by a three-quarters majority vote of a shareholders' meeting; or
- by a court order.

Following a decision to liquidate us, the right to manage our affairs would pass to a liquidation commission appointed by a shareholders' meeting. In the event of an involuntary liquidation, the court may vest the duty to liquidate the company to its shareholders. Creditors may file claims within a period to be determined by the liquidation commission, but such period must not be less than two months from the date of publication of notice of liquidation by the liquidation commission.

The Civil Code of the Russian Federation gives creditors the following order of priority during liquidation:

- individuals owed compensation for injuries, deaths or moral damages;
- employees;
- federal and local governmental entities claiming taxes and similar payments to the federal and local budgets and to non-budgetary funds; and
- other creditors in accordance with Russian legislation.

Claims of creditors in obligations secured by a pledge of the company's property (secured claims) are satisfied out of the proceeds of sale of the pledged property prior to claims of any other creditors except for the creditors of the first and second priorities described above, provided that claims of such creditors arose before the pledge agreements in respect of the company's property were made. To the extent that the proceeds of sale of the pledged property are not sufficient to satisfy secured claims, the latter are satisfied simultaneously with claims of the fourth priority creditors as described above.

The Federal Law on Insolvency (Bankruptcy), however, provides for a different order of priority for creditors' claims in the event of bankruptcy.



The remaining assets of a company are distributed among shareholders in the following order of priority:

- payments to repurchase shares from shareholders having the right to demand repurchase;
- payments of declared but unpaid dividends on preferred shares and the liquidation value of the preferred shares determined by the company's charter, if any; and
- payments to holders of common and preferred shares.

#### **Liability of Shareholders**

The Civil Code of the Russian Federation and the Federal Law on Joint Stock Companies generally provide that shareholders in a Russian joint stock company are not liable for the obligations of a joint stock company and bear only the risk of loss of their investments. This may not be the case, however, when one person or entity is capable of determining decisions made by another person or entity. The person or entity capable of determining such decisions is called an effective parent. The person or entity whose decisions are capable of being so determined is called an effective subsidiary. The effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between such persons; and
- the effective parent gives binding instructions to the effective subsidiary.

Thus, a shareholder of an effective parent is not itself liable for the debts of the effective parent's effective subsidiary, unless that shareholder is itself an effective parent of the effective parent. Accordingly, a shareholder will not be personally liable for our debts or those of our effective subsidiaries unless such shareholder controls our business and the conditions set forth above are met.

In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt resulting from the action or omission of an effective parent only when the effective parent has used the right to give binding instructions knowing that they would result in insolvency of the effective subsidiary. This is the case no matter how the effective parent's capability to determine decisions of the effective subsidiary arises, such as through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent that caused the effective subsidiary to take any action or fail to take any action knowing that such action or failure to take action would result in losses.

#### **Alteration of Capital**

##### **Charter Capital Increase**

We may increase our charter capital by:

- issuing new shares, or
- increasing the nominal value of previously issued shares.

A decision on any issuance of shares or securities convertible into shares by closed subscription, or an issuance by open subscription of common shares or securities convertible into common shares constituting 25% or more of the number of issued common shares, requires a three-quarters majority vote of a shareholders' meeting. In addition, a decision to increase the charter capital by increasing the nominal value of issued shares requires a majority vote of a shareholders' meeting. In addition, the issuance of

shares above the number of authorized and non-issued shares provided in our charter necessitates a charter amendment, which requires a three-quarters majority vote of a shareholders meeting.

The Federal Law on Joint Stock Companies requires that the value of newly issued shares be determined by the board of directors based on their market value but not less than their nominal value, except in limited circumstances where (i) existing shareholders exercise a preemptive right to purchase shares at not less than 90% of the price paid by third parties, or (ii) fees of up to 10% are paid to intermediaries, in which case the fees paid may be deducted from the price. The price may not be set at less than the nominal value of the shares. The board of directors shall value any in-kind contributions for new shares based on the appraisal report of an independent appraiser.

Russian securities regulations set out detailed procedures for the issuance and registration of shares of a joint stock company. These procedures require:

- prior registration of a share issuance with the FSFM;
- public disclosure of information relating to the share issuance; and
- following the placement of the shares, registration and public disclosure of the results of the placement of shares.

#### **Charter Capital Decrease; Share Buy-Backs**

The Federal Law on Joint Stock Companies does not allow a company to reduce its charter capital below the minimum charter capital required by law, which is 100,000 rubles for an open joint stock company or approximately \$3,500. Our charter requires that any decision to reduce our charter capital, whether through the repurchase and cancellation of shares or a reduction in the nominal value of the shares, be made by a majority vote of a shareholders meeting. Additionally, within 30 days of a decision to reduce our charter capital, we must issue a written notice to our creditors and publish this decision. Our creditors would then have the right to demand, within 30 days of publication or receipt of our notice, early termination or discharge of relevant obligations by us, as well as compensation for damages.

The Federal Law on Joint Stock Companies and our charter allow our shareholders or our board of directors to authorize the repurchase of up to 10% of our shares in exchange for cash. The repurchased shares must be resold at market value within one year of their repurchase or, failing that, the shareholders must decide to cancel such shares and decrease the charter capital. The shares repurchased pursuant to a decision of our shareholders meeting to decrease the overall number of shares, are canceled at their redemption. Repurchased shares do not bear voting rights.

The Federal Law on Joint Stock Companies allows us to repurchase our shares only if, at the time of repurchase:

- our charter capital is paid in full;
- we are not and would not become, as a result of the repurchase, insolvent;
- the value of our net assets at the time of repurchase of our shares is not less (and would not become less, as a result of the proposed repurchase) than the sum of our charter capital, the reserve fund and the difference between the liquidation value and par value of our issued and outstanding preferred shares; and

- we have repurchased all shares from shareholders having the right to demand repurchase of their shares in accordance with Russian law, as described immediately below.

The Federal Law on Joint Stock Companies and our charter provide that our shareholders may demand repurchase of all or some of their shares so long as the shareholder demanding repurchase voted against or did not participate in the voting on the decision approving any of the following actions:

- reorganization;
- conclusion of a major transaction, as defined under Russian law; or
- amendment of our charter or approval of a restated version of our charter in a manner which restricts shareholders rights.

We may spend up to 10% of our net assets calculated under Russian accounting standards on the date of the adoption of the decision which gives rise to a share redemption demanded by the shareholders. If the value of the shares in respect of which shareholders have exercised their right to demand repurchase exceeds 10% of our net assets, we will repurchase shares from each such shareholder on a pro-rata basis.

#### **Registration and Transfer of Shares**

Russian legislation requires that a joint stock company maintain a register of its shareholders. Ownership of our registered shares is evidenced solely by entries made in such register. Any of our shareholders may obtain an extract from our register certifying the number of shares that such shareholders hold. Since July 14, 2001, Central Moscow Depository OJSC has maintained our register of shareholders.

The purchase, sale or other transfer of shares is accomplished through the registration of the transfer in the shareholder register, or the registration of the transfer with a depository if shares are held by a depository. The registrar or depository may not require any documents in addition to those required by Russian legislation in order to transfer shares in the register. Refusal to register the shares in the name of the transferee or, upon request of the beneficial holder, in the name of a nominee holder, is not allowed except in certain instances provided for by Russian legislation, and may be challenged in court.

#### **Reserve Fund**

Russian legislation requires that each joint stock company establish a reserve fund to be used only to cover the company's losses, redeem the company's bonds and repurchase the company's shares in cases when other funds are not available. Our charter provides for a reserve fund of 5% of our charter capital, funded through mandatory annual transfers of at least 5% of our net profits until the reserve fund has reached the 5% requirement.

#### **Disclosure of Information**

Russian securities regulations require us to make the following periodic public disclosures and filings:

- filing quarterly reports with the FSFM containing information about us, our shareholders and depository, the structure of our management bodies, the members of the board of directors, our branches and representative offices, our shares, bank accounts and auditors, important developments during the reporting quarter and other information about our financial and business activity;
- filing with the FSFM and publishing in the FSFM's periodical print publication, as well as in other media, any information concerning material facts and changes in our financial and business activity,

including our reorganization, certain changes in the amount of our assets, decisions on share issuances, certain changes in ownership and shareholding, as well as shareholder resolutions;

- disclosing information on various stages of share placement, issuance and registration through publication of certain data as required by the securities regulations;
- disclosing our annual report and annual financial statements prepared in accordance with Russian accounting standards;
- filing with the FSFM on a quarterly basis a list of our affiliated persons and disclosing the same on our website, on the same basis; and
- other information as required by applicable Russian securities legislation.

#### **General Meetings of Shareholders**

##### *Procedure*

The powers of a shareholders' meeting are set forth in the Federal Law on Joint Stock Companies and in our charter. A shareholders' meeting may not decide on issues that are not included in the list of its competence by the Federal Law on Joint Stock Companies and our charter. Among the issues which the shareholders have the power to decide are:

- charter amendments;
- reorganization or liquidation;
- election and removal of the members of the board of directors;
- determination of the number, nominal value, category/type of authorized shares and rights granted by such shares;
- changes in our charter capital;
- appointment and removal of the members of our review commission and counting commission;
- approval of our external auditor;
- approval of certain interested party transactions and major transactions;
- distribution of profits and losses, including approval of dividends;
- redemption by the company of issued shares in cases provided for by the Federal Law on Joint Stock Companies;
- decision on our participation in holding companies, commercial or industrial groups or other associations of commercial entities;
- approval of certain internal documents and corporate records; and
- other issues, as provided for by the Federal Law on Joint Stock Companies and our charter.

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Voting at a shareholders' meeting is generally based on the principle of one vote per share of common stock, with the exception of the election of the board of directors, which is done through cumulative voting. Decisions are generally passed by a majority vote of the voting shares present at a shareholders' meeting. However, Russian law requires a three-quarters majority vote of the voting shares present at a shareholders' meeting to approve the following:

- charter amendments;

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- reorganization or liquidation;
- major transactions involving assets in excess of 50% of the balance sheet value of the company's assets;
- determination of the number, nominal value and category (type) of authorized shares and the rights granted by such shares;
- repurchase by the company of its issued shares;
- any issuance of shares or securities convertible into shares of common stock by closed subscription; or
- issuance by open subscription of shares of common stock or securities convertible into common stock, in each case, constituting 25% or more of the number of issued and outstanding shares of common stock.

The quorum requirement for our shareholders' meetings is met if shareholders (or their representatives) accounting for more than 50% of the issued voting shares are present. If the 50% quorum requirement is not met, another shareholders' meeting with the same agenda may (and, in the case of an annual shareholders' meeting, must) be scheduled and the quorum requirement is satisfied if shareholders (or their representatives) accounting for at least 30% of the issued voting shares are present at that meeting.

The annual shareholders' meeting must be convened by the board of directors between March 1 and June 30 of each year, and the agenda must include the following items:

- election of members of the board of directors;
- approval of the annual report and the annual financial statements, including the balance sheet and profit and loss statement;
- approval of distribution of profits, including approval of annual dividends and losses, if any;
- appointment of an independent auditor; and
- appointment of the member of the review commission.

A shareholder or group of shareholders owning in the aggregate at least 2% of the issued voting shares may introduce proposals for the agenda of the annual shareholders' meeting and may nominate candidates to the board of directors, management board, counting commission, review commission and for the general director. Any agenda proposals or nominations must be provided to the company no later than 30 calendar days after the preceding financial year end.

Extraordinary shareholders' meetings may be called by the board of directors on its own initiative, or at the request of the review commission, independent auditor or a shareholder or group of shareholders owning, in the aggregate, at least 10% of the issued voting shares as of the date of the request.

A general meeting of shareholders may be held in the form of a meeting or by absentee ballot. The form of a meeting contemplates the adoption of resolutions by the general meeting of shareholders through the attendance of the shareholders or their authorized representatives for the purpose of discussing and voting on issues of the agenda, provided that if a ballot is mailed to shareholders for participation at a meeting convened in such form, the shareholders may complete and mail the ballot back to the company without personally attending the meeting. A general meeting of the shareholders by absentee ballot contemplates the determination of shareholders' opinions on issues on the agenda by means of a written poll.





The following issues cannot be decided by a shareholders' meeting by absentee ballot:

- election of the members of the board of directors;
- election of the review commission;
- approval of a company's independent auditor; and
- approval of the annual report, the annual financial statements, including balance sheet, profit and loss statement and any distribution of profits and losses, including approval of annual dividends, if any.

#### ***Notice and Participation***

All shareholders entitled to participate in a general shareholders' meeting must be notified of the meeting, whether the meeting is to be held in the form of a meeting or by absentee ballot, no less than 30 days prior to the date of the meeting, and such notification shall specify the agenda for the meeting. However, if it is an extraordinary shareholders' meeting to elect the board of directors, shareholders must be notified at least 50 days prior to the date of the meeting. Only those items that were set out in the agenda to shareholders may be voted upon at a general shareholders' meeting.

The list of shareholders entitled to participate in a general shareholders' meeting is to be compiled on the basis of data in our shareholders register on the date established by the board of directors, which date may neither be earlier than the date of adoption of the board resolution to hold a general shareholders' meeting nor more than 50 days before the date of the meeting (or, in the case of an extraordinary shareholders' meeting to elect the board of directors, not later than 65 days before the date of the meeting).

The right to participate in a general meeting of shareholders may be exercised by a shareholder as follows:

- by personally participating in the discussion of agenda items and voting thereon;
- by sending an authorized representative to participate in the discussion of agenda items and to vote thereon;
- by absentee ballot; or
- by delegating the right to fill out the absentee ballot to an authorized representative.

#### **Board of Directors**

The Federal Law on Joint Stock Companies and our charter provide that our entire board of directors is up for election at each annual general shareholders' meeting and that our board of directors is elected through cumulative voting. Under cumulative voting, each shareholder may cast an aggregate number of votes equal to the number of voting shares held by such shareholder multiplied by the number of persons to be elected to our board of directors, and the shareholder may give all such votes to one candidate or spread them between two or more candidates. Before the expiration of their term, the directors may be removed as a group at any time without cause by a majority vote of a shareholders' meeting.

The Federal Law on Joint Stock Companies requires at least a five-member board of directors for all joint stock companies, at least a seven-member board of directors for a joint stock company with more than 1,000 holders of voting shares, and at least a nine-member board of directors for a joint stock company with more than 10,000 holders of voting shares. Only natural persons (as opposed to legal entities) are entitled to sit on the board. Members of the board of directors are not required to be shareholders of the company. The actual number of directors is determined by the company's charter or a

decision of the shareholders' meeting. Our charter provides that our board of directors shall consist of eleven members.

The Federal Law on Joint Stock Companies generally prohibits a board of directors from acting on issues that fall within the exclusive competence of the general shareholders' meeting. Our board of directors has the power to perform the general management of the company, and decide, among others, the following issues:

- determination of our business priorities;
- convening annual and extraordinary shareholders' meetings, except in certain circumstances specified in the Federal Law on Joint Stock Companies;
- approval of the agenda of a shareholders' meeting and determination of the record date for shareholders entitled to participate in a shareholders' meeting;
- placement of our bonds and other securities in cases specified in the Federal Law on Joint Stock Companies;
- determination of the price of our property and of our securities to be placed or repurchased, as provided for by the Federal Law on Joint Stock Companies;
- repurchase of our shares, bonds and other securities in certain cases provided for by the Federal Law on Joint Stock Companies;
- formation of our executive bodies and early termination of their powers;
- election of our management board and its chairman and the establishment of their compensation;
- recommendations on the amount of remuneration and compensation to be paid to the members of our review commission and on the fees payable for the services of an independent auditor;
- recommendations on the amount of the dividend and the payment procedure thereof;
- the use of our reserve and other funds;
- approval of our internal documents, except for those documents whose approval falls within the competence of our shareholders or executive bodies;
- the creation of branches and representative offices;
- approval of major and interested party transactions in certain cases as provided for by the Federal Law on Joint Stock Companies;
- approval of our share registrar;
- our participation in, or exit from, other companies, unless such matters fall under the jurisdiction of our shareholders or executive bodies;
- other issues, as provided for by the Federal Law on Joint Stock Companies and our charter.

Our charter generally requires a majority vote of the directors present for an action to pass, with the exception of actions for which Russian legislation requires a unanimous vote or a majority vote of the disinterested and independent directors, as described herein. A board meeting is

considered duly assembled and legally competent to act when at least six directors are present.

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### Interested Party Transactions

Under the Federal Law on Joint Stock Companies, certain transactions defined as interested party transactions require approval by disinterested directors or shareholders of the company. Interested party transactions include transactions involving a member of the board of directors or a member of any executive body of the company (including the company's chief executive officer and/or the company's managing organization), any person that owns, together with any affiliates, at least 20% of a company's issued voting shares or any person who is able to direct the actions of the company, if that person and/or that person's spouse, parents, children, adoptive parents or children, brothers or sisters or affiliates, is/are:

- a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary;
- the owner of at least 20% of the issued shares of a legal entity that is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary; or
- a member of the board of directors or a member of any management body of a company that is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary, or a member of the board of directors or any management body of a management organization of such a company.

The Federal Law on Joint Stock Companies requires that an interested party transaction by a company with more than 1,000 shareholders be approved by a majority vote of the independent directors of the company who are not interested in the transaction. For purposes of this rule, an independent director is a person who is not, and within the year preceding the decision to approve the transaction was not, the general director, a member of any executive body or an affiliate of the company, or a member of the board of directors or any management body of the company's management organization. Additionally, such person's spouse, parents, children, adoptive parents or children, brothers or sisters may not, and within the year preceding the date of the decision to approve the transaction did not, occupy positions in the executive bodies of the company or positions on the board of directors or of any management body of the company's management organization. For companies with 1,000 or fewer shareholders, an interested party transaction must be approved by a majority vote of the directors who are not interested in the transaction if the number of these directors is sufficient to constitute a quorum.

Approval by a majority of shareholders who are not interested in the transaction is required if:

- the value of such transaction or a number of interrelated transactions is 2% or more of the balance sheet value of the company's assets determined under Russian accounting standards;
- the transaction or a number of interrelated transactions involves the issuance, by subscription, of voting shares or securities convertible into voting shares, or secondary market sale of such securities, in an amount exceeding 2% of the company's issued voting stock;
- the number of directors who are not interested in the transaction is not sufficient to constitute a quorum; or
- all the members of the board of directors of the company are interested parties, or none of them is an independent director.

Approval by a majority of shareholders who are not interested in the transaction may not be required, until the next annual shareholders' meeting, for an interested party transaction if such transaction is substantially similar to transactions concluded by the company and the interested party in the ordinary course of business before such party became an interested party with respect to the transaction.

The approval of interested party transactions is not required in the following instances:

- the company has only one shareholder that simultaneously performs the functions of the executive body of the company;
- all shareholders of the company are deemed interested in such transactions;
- the transactions arise from the shareholders executing their preemptive rights to purchase newly issued shares of the company;
- the transactions arise from the repurchase, whether mandatory or not, by the company of its issued shares;
- the company merges with another company, and the latter owns more than three-fourths of the voting capital stock of the company; or
- the transactions that are mandatory a company pursuant to Russian law and must be concluded on the basis of fixed prices and tariffs adopted by a competent state body.

#### **Major Transactions**

The Federal Law on Joint Stock Companies defines a major transaction as a transaction, or a number of interrelated transactions, involving the acquisition or disposal, or a possibility of disposal (whether directly or indirectly) of property having a value of 25% or more of the balance sheet value of the assets of a company determined under Russian accounting standards, with the exception of transactions conducted in the ordinary course of business or transactions involving the placement of shares of common stock, or securities convertible into shares of common stock. Major transactions involving assets having a value ranging from 25% to 50% of the balance sheet value of the assets of a company require unanimous approval by all members of the board of directors or, failing to receive such approval, a simple majority vote of a shareholders meeting. Major transactions involving assets having a value in excess of 50% of the balance sheet value of the assets of a company require a three-quarters vote by a shareholders meeting.

#### **Change in Control**

##### ***Anti-takeover Protection***

Russian legislation provides as follows:

- A person intending to acquire 30% or more of an open joint stock company's ordinary shares and voting preferred shares (including, for such purposes, shares already owned by such person and its affiliates), will be entitled to make a public tender offer to other holders of such shares or securities convertible into such shares.
- A person that has acquired 30% or more of the totality of an open joint-stock company's ordinary shares and voting preferred shares (including, for such purposes, shares already owned by such person and its affiliates, but excluding shares that were acquired pursuant to previous voluntary or mandatory offers) will generally be required to make, within 35 days of acquiring such shares, a public tender offer for other shares of the same class and for securities convertible into such shares, at a price which is not less than the price determined based on a weighted market price of the shares, or on a price supplied by an independent appraiser if the shares have no or insufficient trading history. From the moment of acquisition of 30% or more of the shares until the moment of delivery of an offer to the security holders, the person making an offer and its affiliates will be able to register for quorum and vote only 30% of the shares of the company (regardless of the size of their actual holdings). These rules are also applied (or reapplied) to acquisitions resulting in a person or a group of persons owning more than 50% and 75% of a company's outstanding shares.



- A person that as a result of such an offer becomes (individually or with its affiliates) the owner of more than 95% of the company's ordinary shares and voting preferred shares, must buy out the remaining shares of the company as well as other securities convertible into such shares upon request of the holders of such shares or other securities, and may require such holders to sell such shares and other securities, at a price based on the prices of the preceding acquisition by the offeror.
- An offer of the kind described in either of the preceding three paragraphs must be accompanied by a bank guarantee of payment. If the company is publicly traded, prior notice of the offer must be filed with the FSFM; otherwise, notice must be filed with the FSFM no later than the date of the offer. The FSFM may order amendments to the terms of the offer (including price) in order to bring them into compliance with the rules.
- Once such an offer has been made, competing offers for the same securities can be made by third parties and, in certain circumstances, acceptance of the initial offer may be withdrawn by the security holders who choose to accept such competing offer. From the making of such an offer until 20 days after its expiry (which period may in certain cases exceed 100 days) the company's shareholders meeting will have the sole power to make decisions on charter capital increase, issuance of securities, approval of certain major transactions, and on certain other significant matters.

The above rules may be supplemented through FSFM rulemaking, which may result in a wider, narrower or more specific interpretation of these rules by the government and judicial authorities, as well as by market participants.

#### ***Approval of the Federal Antimonopoly Service***

Pursuant to the Federal Law on Competition, acquisitions of voting stock capital of a joint stock company, involving companies with a combined value of assets or annual revenues, exceeding a certain threshold under Russian Accounting Standards, or companies registered as having more than a 35% share of a certain commodity market, and which would result in a shareholder (or a group of affiliated shareholders) holding more than 25%, 50% or 75% of the voting capital stock of such company, or in a transfer between such companies of assets or rights to assets, the value of which exceeds a certain amount, must be approved in advance by the Federal Antimonopoly Service.

#### **Disclosure of Ownership**

A holder of our common shares is required to disclose information concerning its holdings in the following cases:

- the holder acquires 20% or more of our common shares;
- the holder increases its percentage holding of our common shares to a level in excess of 5% (or an integral multiple thereof) higher than 20% thereof; and
- the holder decreases its percentage holding of our common shares to a level in excess of 5% (or an integral multiple thereof) higher (but not lower) than 20% thereof.

Effective July 1, 2006, a holder of our common shares is required to publicly disclose an acquisition of 5% or more of the outstanding common shares of the company, as well any change in the amount of common shares held by such holder, if as a result of such change the percentage of common shares held by the holder becomes greater or lesser than 5, 10, 15, 20, 25, 30, 50 or 75 percent of the outstanding common shares of the company.



### **Notification of Foreign Ownership**

Foreign persons registered as individual entrepreneurs in Russia who acquire shares in a Russian joint stock company and foreign companies that acquire shares in a Russian joint stock company may need to notify the Russian tax authorities within one month following such acquisition. However, the procedure of notifying the Russian tax authorities by foreign companies that are not registered with such tax authorities at the time of their share acquisition remains unclear.

### **C. Material Contracts**

The following is a description of contracts that have been entered into by us and/or our subsidiaries or shareholders that may be material to our business.

#### **Loan Agreement relating to the Loan Participation Notes and Guarantee**

On May 14, 2003, we entered into a loan agreement with UBS (Luxembourg) S.A. as lender, pursuant to which UBS (Luxembourg) S.A. lent to us a principal amount of \$150 million on May 21, 2003. The loan matures on May 21, 2008, and interest is payable by us semi-annually in arrears at an annual rate of 8.5%. For the sole purpose of financing this loan to us, UBS (Luxembourg) S.A. issued \$150 million 8.5% Loan Participation Notes due 2008 on May 21, 2003.

The above-mentioned loan to us is unconditionally, irrevocably, jointly and severally guaranteed by the Lianozovsky Dairy Plant, Tsaritsino Dairy Plant, Timashevsk Dairy Plant, Trade Company Wimm-Bill-Dann and Baltic Milk pursuant to a guarantee dated May 14, 2003 entered into with UBS (Luxembourg) S.A. On July 10, 2006, WBD Foods with the consent of UBS Luxembourg terminated the guarantee of Timashevsk Dairy Plant and Baltic Milk.

On February 6, 2007, we entered into a loan agreement with UBS (Luxembourg) S.A. as lender, pursuant to which UBS (Luxembourg) S.A. lent to us a principal amount of \$150 million on February 8, 2007. The loan matures on May 14, 2008, and interest is payable by us semi-annually in arrears at an annual rate of 7.5%. For the sole purpose of financing this loan to us, UBS (Luxembourg) S.A. issued \$150 million 7.5% Loan Participation Notes due 2008 on February 8, 2007.

Both the loan agreements and the guarantee are governed by English law. In the loan agreements, we agreed to certain covenants in respect of, among other things, liens, asset sales, transactions with affiliates and related persons, change of control, mergers and similar transactions, limitation on dividend or other payments affecting our subsidiaries and maintenance of certain ratios. In the guarantee, the Lianozovsky Dairy Plant, Tsaritsino Dairy Plant, Timashevsk Dairy Plant, Trade Company Wimm-Bill-Dann, Baltic Milk, Lianozovo-Samara LLC and the Ural, Krasnodar, Don and Nevsky Dairy Trade Houses agreed to similar covenants.

#### **Ruble Bonds**

On April 15, 2003, WBD Foods issued 1.5 million non-convertible ruble denominated notes at a face value of 1,000 rubles each guaranteed by Vitafrukt, one of our juice subsidiaries. The offering raised a total of 1,500 million rubles (\$52.1 million at the exchange rate as of December 31, 2005, of which \$2.3 million had been repaid as at December 31, 2005). Interest was payable semi-annually in arrears commencing on October 14, 2003, and the interest rate for each coupon period was based on the Consumer Price Index, published by Goskomstat of the Russian Federation. The interest rate for the first, second, third, fourth, fifth and sixth coupon periods were 12.9%, 11.98%, 9.38%, 8.48%, 10.78% and 11.24%, respectively. The notes were redeemable by WBD Foods on April 11, 2006 and we redeemed the remaining outstanding notes on this date.

On December 21, 2005, we issued five-year, 3.0 million non-convertible ruble denominated notes at a face value of 1,000 rubles each. The offering raised a total of approximately \$104.2 million at the exchange rate as of December 31, 2005. The notes are redeemable by us on December 15, 2010. The issue was priced at par with a coupon of 9% payable semi-annually.

#### **Tetra Pak Agreements**

On January 1, 2007, the Wimm-Bill-Dann (formerly Lianozovsky Dairy Plant) entered into a supply agreement to purchase packages for our milk products from JSC Tetra Pak AO of Moscow. The contract terminates on December 31, 2007. The total amount of our purchases is estimated under the contract at approximately 18.0 million excluding VAT. On January 1, 2007, Wimm-Bill-Dann Beverages (formerly Ramensky Dairy Plant) entered into a supply agreement to purchase packages for its products from JSC Tetra Pak AO of Moscow. The contract terminates on December 31, 2007. The total amount of our purchases is estimated under the contract at approximately 18.0 million excluding VAT. We expect that the total expenditures in 2007 by Wimm-Bill-Dann Purchaser pursuant to the current contract will be higher due to increased sales. We purchase a vast majority of our packaging materials from Tetra Pak, and in 2006, we purchased approximately 60% of our total packaging materials (including carton, plastic, foil and other materials) from Tetra Pak.

#### **Amended and Restated Partnership and Cooperation Agreement**

Our current shareholders Gavril Yushvaev, Mikhail Dubinin, Sergei Plastinin, Alexander Orlov, David Iakobachvili, Mikhail Vishnyakov, Viktor Evdokimov and I.M. Arteks Holdings Limited are parties to an Amended and Restated Partnership and Cooperation Agreement which requires the parties to vote the same way, as well as:

*Independent Directors.* The parties to the agreement undertake to use their best efforts to ensure that a majority of our directors are independent. A director is considered independent if that person is not:

- our employee or an employee or director of any of our subsidiaries;
- a party to the agreement
- an employee or director of a party to the agreement; a family member of a party to the agreement; a person or entity controlled by a party to the agreement; any other person or entity controlled by a family member of a party to the agreement; or a person or entity controlled by any employee or director of any of the parties to the agreement; or
- a person or entity controlled by any family member of a party to the agreement or a person or entity controlled by any employee or director of a party to the agreement.

*Voting.* The parties to the agreement are required to vote all of our shares that they own in the same way. In order to determine how the parties will vote, the agreement requires them to attempt to agree unanimously on a single voting position on each item on the agenda for a shareholders meeting. If they are unable to do so, then the following procedures are followed:

- The parties will vote their shares as determined by parties holding a two-thirds majority of the shares held by the parties;
- If there is no two-thirds majority among the parties, then the parties will vote their shares consistent with the recommendation of the majority of individuals who are on our board of directors; and
- If no voting position can be determined using the procedures noted above, then the parties will abstain from voting on that issue, in which case a quorum will not be present under Russian law and the issue would fail to be adopted.



*Third-Party Beneficiaries.* Beneficial owners of our ADSs are third-party beneficiaries of the agreement and are entitled to enforce and bring actions in respect of the agreement. An action may only be brought, however, if beneficial owners of ADSs constituting more than 50% of our outstanding ADSs, excluding any ADSs held by the parties to the agreement, are parties to such action.

*Dispute Resolution.* The governing law of the agreement is the law of the State of New York. Any dispute, controversy or cause of action brought arising under the agreement will be settled by arbitration under the Commercial Arbitration Rules of the American Arbitration Association. Any cause of action brought by beneficial owners of more than 50% of the outstanding ADSs, excluding any ADSs held by parties to the agreement, at the option of these owners, may be brought in arbitration under the Commercial Arbitration Rules of the American Arbitration Association or may be litigated in the federal or state courts in the Borough of Manhattan. The parties to the agreement expect to appoint CT Corporation System, 111 Eighth Avenue, New York, New York 10011, as agent for service of process in New York.

*Term.* The agreement may not be terminated until the earlier to occur of:

- any party to the agreement owning all of our issued and outstanding shares;
- we are liquidated pursuant to the laws of the Russian Federation; or
- January 16, 2004 (provided that a party / the parties give 30 days prior written notice).

Upon the occurrence of the first two events described above, the agreement automatically terminates. Otherwise, the agreement continues in full force and effect until terminated by any party to the agreement by giving 30 days prior written notice to all other parties to the agreement and to us. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry We are controlled by a group of shareholders whose interests could conflict with those of the holders of our securities.

#### **D. Exchange Controls**

The Federal Law on Currency Regulation and Currency Control which came into effect as of June 18, 2004, sets forth certain restrictions on settlements between residents of Russia with respect to transactions involving foreign securities (including ADSs), including requirements for settlement in Russian rubles.

##### **Repatriation of Export Proceeds**

Russian companies must repatriate 100% of their receivables from the export of goods and services (with a limited number of exceptions concerning, in particular, certain types of secured financing) within seven days of the date on which they were received (also with a limited number of exceptions).

##### **Restrictions on the remittance of dividends, interest or other payments to non-residents**

The Federal Law on Foreign Investments in the Russian Federation of July 9, 1999, specifically guarantees foreign investors the right to repatriate their earnings from Russian investments. However, the evolving Russian exchange control regime may affect your ability to do so. Ruble dividends on common shares may be paid to the depository or its nominee and converted into U.S. dollars by the depository for distribution to owners of ADSs without restriction. Also, ADSs may be sold by non-residents of Russia for U.S. dollars outside Russia without regard to Russian currency control laws as long as the buyer is not a Russian resident for currency control purposes. However, the ability to convert rubles into U.S. dollars is also subject to the availability of U.S. dollars in Russia's currency markets. Although there is an existing market within Russia for the conversion of rubles into U.S. dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is



uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of Russia and a limited emerging market in which to hedge ruble and ruble-denominated investments.

#### E. Taxation

The following discussion describes the material United States federal and Russian income and withholding tax consequences to you if you are a U.S. holder (generally, a United States person, as the term is defined in the United States Internal Revenue Code of 1986, as amended (the Code )) of common stock or ADSs and a resident of the United States for purposes of the Convention between the United States of America and the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital (the United States-Russia income tax treaty ) and are fully eligible for benefits under the United States-Russia income tax treaty. Subject to certain provisions of the United States-Russia income tax treaty relating to limitations on benefits, you generally will be a resident of the United States for treaty purposes that is entitled to treaty benefits if you are:

- liable, under the laws of the United States, to U.S. tax (other than taxes in respect only of income from sources in the United States or capital situated therein) by reason of your domicile, residence, citizenship, place of incorporation, or any other similar criterion (and, for income derived by a partnership, trust or estate, residence is determined in accordance with the residence of the person liable to tax with respect to such income); and
- not also a resident of the Russian Federation for purposes of the United States-Russia income tax treaty.

The benefits under the United States-Russia income tax treaty discussed in this document generally are not available to U.S. persons who hold ADSs or common stock in connection with the conduct of a business in the Russian Federation through a permanent establishment as defined in the United States-Russia income tax treaty. Subject to certain exceptions, a U.S. person's permanent establishment under the United States-Russia income tax treaty is a fixed place of business through which such person carries on business activities in the Russian Federation (generally including, but not limited to, a place of management, a branch, an office, and a factory). Under certain circumstances, a U.S. person may be deemed to have a permanent establishment in the Russian Federation as a result of activities carried on in the Russian Federation through agents of the U.S. person. This summary does not address the treatment of holders described in this paragraph.

The following discussion is based on:

- the Code, the Treasury regulations promulgated thereunder, and judicial and administrative interpretations thereof;
- Russian legislation; and
- the United States-Russia income tax treaty (and judicial and administrative interpretations thereof);

all as in effect on the date of this document. All of the foregoing are subject to change, possibly on a retroactive basis, after the date of this document. This discussion is also based, in part, on representations of the depository, and assumes that each obligation in the deposit agreement and any related agreements will be performed in accordance with its terms. The discussion with respect to Russian legislation is based on our understanding of current Russian law and Russian tax rules, which are subject to frequent change and varying interpretations.

We believe, and the following discussion assumes, that for United States federal income tax purposes, we were not a passive foreign investment company for the taxable year ending in 2006, we will not be a

passive foreign investment company for the current taxable year and we will not become a passive foreign investment company in the future. However, passive foreign investment company determinations are made annually and may involve facts that are not within our control. If we were to be a passive foreign investment company, materially adverse tax consequences could result for investors who are United States persons as defined in the Code.

The following discussion is not intended as tax advice to any particular investor. It is also not a complete analysis or listing of all potential United States federal or Russian income and withholding tax consequences to you of ownership of common stock or ADSs. We urge you to consult your own tax adviser regarding the specific United States federal, state, and local and Russian tax consequences of the ownership and disposition of the common stock or ADSs under your own particular factual circumstances.

### **Russian Income and Withholding Tax Considerations**

The Russian tax rules applicable to U.S. holders are characterized by significant uncertainties and limited interpretive guidance. Russian tax authorities have provided limited guidance regarding the treatment of ADS arrangements, and there can be no certainty as to how the Russian tax authorities will ultimately treat those arrangements. In 2005 and 2006, the Russian Ministry of Finance stated that ADS holders should be treated as the beneficial owners of the underlying shares for purposes of the double tax treaty provisions applicable to taxation of dividend income from the underlying shares. However, double tax treaty relief is available only if, before the transfer of dividends to the depository, the latter has provided the issuer with a list of ADS holders accompanied by each holder's tax residency certificate (confirmation of the country of tax residence). It is currently unclear whether depositories will be willing or able to provide residency certificates for ADS holders or implement procedures for holders to benefit from applicable tax treaties. Thus, while a U.S. holder may technically be entitled to benefit from the provisions of the United States-Russia income tax treaty, in practice such relief may be difficult or impossible to obtain.

Russian tax law and procedures are also not well developed, and local tax inspectors have considerable autonomy and often interpret tax rules without regard to the rule of law. Both the substantive provisions of Russian tax law and the interpretation and application of those provisions by the Russian tax authorities may be subject to more rapid and unpredictable change than in jurisdictions with more developed capital markets.

Currently, the Russian government is in the process of replacing the existing tax legislation with a comprehensive Tax Code, but it is unclear when this process will be completed and how U.S. holders would be affected. As of January 1, 1999, Part 1 (General) of the Tax Code went into effect. This law defines the general principles of taxation in Russia, defines the legal status of taxpayers and tax agencies and determines general rules of tax filings and tax control, as well as procedures for challenging tax agencies. Part 1 also specifies all the taxes that can be imposed by federal and local authorities. Further, on January 1, 2001, Part 2 of the Tax Code went into effect, providing a description of the most significant taxes, and several additional chapters of the tax code as well as significant amendments became effective during 2003, 2004, 2005 and 2006.

### **Taxation of Dividends**

Dividends paid to U.S. holders generally will be subject to Russian withholding tax at a 15% rate for legal entities (including U.S. corporations, partnerships or other entities) and up to a 30% rate for individual holders. This tax may be reduced to 5% or 10% under the United States-Russia income tax treaty for U.S. holders; a 5% rate applies for U.S. holders who are legal entities owning 10% or more of the company's outstanding shares, and a 10% rate applies to dividends paid to U.S. holders, including

individuals and legal entities, owning less than 10% of the company's outstanding shares. See United States-Russia Income Tax Treaty Procedures.

If the appropriate documentation (*i.e.*, residency certificate) has not been provided to us before the dividend payment date, we are required to withhold tax at the full rate, and U.S. holders qualifying for a reduced rate under the United States-Russia income tax treaty then would be required to file claims for refund within three years with the Russian tax authorities. There is significant uncertainty regarding the availability and timing of such refunds.

### **Taxation of Capital Gains**

U.S. holders generally should not be subject to any Russian income or withholding taxes in connection with the sale, exchange, or other disposition of ADSs or common stock outside of Russia if the shares or ADSs are not sold to a Russian resident or persons other than Russian residents who conduct business in the Russian Federation through a permanent establishment or are tax registered in Russia based on other grounds.

However, sales or other dispositions of ADSs or common stock by a U.S. holder that is a legal entity to Russian residents or persons other than Russian residents who conduct a business in Russia through a permanent establishment or are tax registered in Russia based on other grounds may be subject to Russian income or withholding taxes. Specifically, the purchaser may be required to withhold 20% of the purchase price (or 24% of the gain if the seller can confirm the cost basis of the security in accordance with Russian rules) if more than 50% of our assets consists of immovable property located in Russia. Regardless of the residence of the purchaser, a U.S. holder that is a legal entity should not be subject to any Russian income or withholding taxes in connection with the sale, exchange, or other disposition of ADSs if immovable property constitutes 50% or less of our assets or if ADSs are sold via foreign exchanges where they are legally circulated.

Sales or other dispositions of ADSs or common stock by U.S. holders who are individuals to Russian residents or persons other than Russian residents who conduct business in Russia through a permanent establishment or are tax registered in Russia based on other grounds may be subject to Russian income or withholding taxes, and for such a sale by a U.S. holder, the purchaser may be required to withhold 30% of any gain realized on the sale.

U.S. holders may be able to claim the benefits of a reduced rate of withholding under the United States-Russia income tax treaty on the disposition of common stock or ADSs to Russian residents, or obtain a refund of any withheld amounts at rates different from those provided in the treaty, by relying on the United States-Russia income tax treaty and complying with the appropriate procedures described below.

### **United States-Russia Income Tax Treaty Procedures**

Under current rules, to claim the benefit of a reduced rate of withholding under the United States-Russia income tax treaty, a non-resident generally must provide official certification from the U.S. tax authorities of eligibility for the treaty benefits in the manner required by Russian law.

A U.S. holder may obtain the appropriate certification by mailing completed forms, together with the holder's name, taxpayer identification number, the tax period for which certification is required and other applicable information to the United States Internal Revenue Service. The procedures for obtaining certification are described in greater detail in Internal Revenue Service Publication 686 and in the instructions to Internal Revenue Service Form 8802. As obtaining the required certification from the Internal Revenue Service may take at least six to eight weeks, U.S. holders should apply for such certification as soon as possible.



If tax is withheld by a Russian resident on dividends or other amounts at a rate different from that provided in the tax treaty, a U.S. holder may apply for a tax refund by filing a package of documents with the Russian local tax inspectorate to which the withholding tax was remitted within three years from the withholding date for U.S. holders which are legal entities, and within one year from the end of the year in which the withholding occurred for individual U.S. holders. The package should include the appropriate form (1011DT (2002) for non-dividend income and 1012DT (2002) for dividend income), confirmations of residence of the foreign holder (IRS Form 6166), a copy of the agreement or other documents substantiating the payment of income, documents confirming the beneficial ownership of the dividends recipient and the transfer of tax to the budget. Under the provisions of the Tax Code, the refund of the tax should be effected within one month after the submission of the documents. However, procedures for processing such claims have not been clearly established, and there is significant uncertainty regarding the availability and timing of such refunds.

Neither the depositary nor us has or will have any obligation to assist an ADS holder with the completion and filing of any tax forms.

#### **United States Federal Income Tax Considerations**

The following is a general description of the material United States federal income tax consequences that apply to you if you are, for United States federal income tax purposes, a beneficial owner of ADSs or common stock who is a citizen or resident of the United States, a corporation (including any entity treated as a corporation for United States federal income tax purposes) created or organized in or under the laws of the United States, any State thereof or the District of Columbia, an estate the income of which is subject to U.S. tax regardless of its source, or a trust, if a United States court can exercise primary supervision over the administration of the trust and one or more United States persons can control all substantial trust decisions, or if the trust was in existence on August 20, 1996 and has properly elected to continue to be treated as a United States person. If a partnership (including any entity treated as a partnership for United States federal income tax purposes) is a beneficial owner of ADSs or common stock, the United States federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. Since your United States federal income and withholding tax treatment may vary depending upon your particular situation, you may be subject to special rules not discussed below. Special rules will apply, for example, if you are:

- an insurance company;
- a tax-exempt organization;
- a financial institution;
- a person subject to the alternative minimum tax;
- a person who is a broker-dealer in securities;
- an S corporation;
- an expatriate subject to Section 877 of the Code;
- an owner of, directly, indirectly or by attribution, 10% or more of the outstanding shares of the Company's common stock; or
- an owner holding ADSs or common stock as part of a hedge, straddle, synthetic security or conversion transaction.

In addition, this summary is generally limited to persons holding common stock or ADSs as capital assets within the meaning of Section 1221 of the Code and whose functional currency is the U.S. dollar. The

discussion below also does not address the effect of any United States state or local tax law or foreign tax law.

For purposes of applying United States federal income and withholding tax law, a holder of an ADS should be treated as the owner of the underlying shares of common stock represented by that ADS.

The United States Treasury has expressed concerns that parties to whom ADSs are pre-released may be taking actions that are inconsistent with the claiming, by United States persons holding ADSs, of foreign tax credits for United States federal income tax purposes. Such actions would also be inconsistent with the claiming of the reduced rate of tax applicable to dividends received by certain non-corporate United States persons, as described below. Accordingly, the analysis of the creditability of Russian taxes described below, and the availability of the reduced tax rate for dividends received by certain non-corporate United States persons, could be affected by future actions that may be taken by the United States Treasury.

#### **Taxation of Dividends on Common Stock or ADSs**

For United States federal income tax purposes, the gross amount of a distribution, including any Russian withholding taxes, with respect to common stock or ADSs will be treated as a taxable dividend to the extent of our current and accumulated earnings and profits, computed in accordance with United States federal income tax principles. For taxable years beginning before January 1, 2011, if you are a non-corporate taxpayer, such dividends may be taxed at the lower applicable capital gains rate provided (1) certain holding period requirements are satisfied, (2) either (a) our ADSs continue to be listed on the New York Stock Exchange (or other national securities exchange that is registered under section 6 of the Securities Exchange Act of 1934, as amended, or the Nasdaq Stock Market) or (b) we are eligible for the benefits of the United States-Russia income tax treaty, and (3) we are not, for the taxable year in which the dividend was paid, or in the preceding taxable year, a passive foreign investment company. Non-corporate U.S. holders are strongly urged to consult their own tax advisors as to the applicability of the lower capital gains rate to dividends received with respect to ADSs or shares of common stock. Distributions in excess of our current and accumulated earnings and profits will be applied against and will reduce your tax basis in common stock or ADSs and, to the extent in excess of such tax basis, will be treated as gain from a sale or exchange of such common stock or ADSs. You should be aware that we do not intend to calculate our earnings and profits for United States federal income tax purposes and, unless we make such calculations, you should assume that any distributions with respect to common stock or ADSs generally will be treated as a dividend, even if that distribution would otherwise be treated as a return of capital or as capital gain pursuant to the rules described above. If you are a corporation, you will not be allowed a deduction for dividends received in respect of distributions on common stock or ADSs, which is generally available for dividends paid by U.S. corporations.

If a dividend distribution is paid in rubles, the amount includible in income will be the U.S. dollar value of the dividend, calculated using the exchange rate in effect on the date the dividend is includible in income by you, regardless of whether the payment is actually converted into U.S. dollars. Any gain or loss resulting from currency exchange rate fluctuations during the period from the date the dividend is includible in your income to the date the rubles are converted into U.S. dollars will be treated as ordinary income or loss. You may be required to recognize foreign currency gain or loss on the receipt of a refund of Russian withholding tax pursuant to the United States-Russia income tax treaty to the extent the United States dollar value of the refund differs from the dollar equivalent of that amount on the date of receipt of the underlying dividend.

Russian withholding tax at the rate applicable to you under the United States-Russia income tax treaty should be treated as a foreign income tax that, subject to generally applicable limitations and conditions, is eligible for credit against your U.S. federal income tax liability or, at your election, may be

deducted in computing taxable income. If, however, the holder of an ADS is not treated as the owner of the underlying common stock represented by the ADS for U.S. federal income tax purposes, then Russian withholding tax would not be treated as a foreign income tax eligible for credit as described in the preceding sentence. If Russian tax is withheld at a rate in excess of the rate applicable to you under the United States-Russia income tax treaty, you may not be entitled to credits for the excess amount, even though the procedures for claiming refunds and the practical likelihood that refunds will be made available in a timely fashion are uncertain.

For United States foreign tax credit purposes, a dividend distribution will be treated as foreign source income and will generally be classified as passive category income but could, in the case of certain U.S. holders, constitute general category income for taxable years beginning after December 31, 2006. The rules relating to the determination of the foreign tax credit, or deduction in lieu of the foreign tax credit, are complex and you should consult your own tax advisors with respect to those rules.

#### **Taxation on Sale or Exchange of Common Stock or ADSs**

The sale of common stock or ADSs will generally result in the recognition of gain or loss in an amount equal to the difference between the amount realized on the sale and your adjusted basis in such common stock or ADSs. That gain or loss will be capital gain or loss if the common stock or ADSs are capital assets in your hands and will be long-term capital gain or loss if the common stock or ADSs have been held for more than one year. If you are an individual, such realized long-term capital gain is generally subject to a reduced rate of United States federal income tax. Limitations may apply to your ability to offset capital losses against ordinary income.

Deposits and withdrawals of common stock by you in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes.

Gain realized on the sale of common stock or ADSs will generally be treated as U.S. source income and therefore the use of foreign tax credits relating to any Russian taxes imposed upon such sale may be limited. You are strongly urged to consult your own tax advisors as to the availability of tax credits for any Russian taxes withheld on the sale of common stock or ADSs.

#### **Information Reporting and Backup Withholding**

Dividends and proceeds from the sale or other disposition of common stock or ADSs that are paid in the United States or by a U.S.-related financial intermediary will be subject to U.S. information reporting rules and U.S. backup withholding tax, unless you are a corporation or other exempt recipient. In addition, you will not be subject to backup withholding if you provide your taxpayer identification number and certify that no loss of exemption from backup withholding has occurred. Holders that are not U.S. persons generally are not subject to information reporting or backup withholding, but such holders may be required to provide certification as to their non-U.S. status.

#### **F. Dividends and Paying Agents**

Not applicable.

#### **G. Statement by Experts**

Not applicable.

#### **H. Documents on Display**

The documents that are exhibits to or incorporated by reference in this document can be read at the U.S. Securities and Exchange Commission's public reference facilities at Room 1024,

450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330 or, from outside the United States, at 1-202-942-8090. Copies may also be obtained from the SEC website at www.sec.gov.

## I. Subsidiary Information

Not applicable.

### Item 11. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk from changes in both foreign currency exchange rates and interest rates. Foreign currency exchange risks exist to the extent that our revenues are primarily denominated in Russian rubles and our costs are denominated in currencies other than Russian rubles and our foreign currency denominated debt. We are subject to market risk deriving from changes in interest rates, which may affect the cost of our financing. We do not use financial instruments such as foreign exchange forward contracts, foreign currency options, interest rate swaps and forward rate agreements, to manage these market risks, because the market for these types of financial instruments in Russia is not well developed and the costs of these instruments is relatively high.

#### Interest Rate Risk

Our interest rate exposure results mainly from debt obligations. At December 31, 2006, we had debt amounting to \$ 443.0 million, which comprised variable-rate borrowings of \$ 83.8 million and fixed-rate borrowings of \$ 359.2 million. See also Item 5. Operating and Financial Review and Prospects E. Contractual Obligations.

The following tables present our variable and fixed-rate debt obligations as of December 31, 2006 by expected maturity dates and related weighted average interest rates.

|                                 | Expected Maturity Date as of December 31, 2006 |        |      |      |      | 2011 and thereafter | Total  | Fair value | Interest rates at December 31, 2006 |
|---------------------------------|--|--------|------|------|------|---------------------|--------|------------|-------------------------------------|
|                                 | Currency<br>(in thousands of U.S. dollars)     | 2007   | 2008 | 2009 | 2010 |                     |        |            |                                     |
| <b>Variable-rate loans(1)</b>   |  |        |      |      |      |                     |        |            |                                     |
|                                 | Euro   |        |      |      |      |                     |        |            |                                     |
|                                 | U.S. dollars                                   |        |      |      |      |                     |        |            |                                     |
|                                 | Rubles   | 83,753 |      |      |      |                     | 83,753 | 83,753     | 7.83 %                              |
| <b>Variable-rate notes</b>      | Rubles   |        |      |      |      |                     |        |            |                                     |
| <b>Total variable rate debt</b> |  | 83,753 |      |      |      |                     | 83,753 | 83,753     | 7.83 %                              |

(1) Our variable rate loans are linked to Mosprime rate

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Expected Maturity Date as of December 31, 2006

|                              | Currency<br>(in thousands of U.S. dollars) | 2007   | 2008    | 2009   | 2010    | 2011 and<br>thereafter | Total   | Fair<br>value | Interest<br>rates at<br>December 31,<br>2006 |
|------------------------------|--|--------|---------|--------|---------|------------------------|---------|---------------|--|
| <b>Fixed-rate loan</b>       |  |        |         |        |         |                        |         |               |  |
|                              | Rubles                                     | 43,276 | 5,306   | 5,117  | 7,941   | 6,149                  | 67,789  | 67,789        | 7.54 %                                       |
|                              | U.S. dollars                               | 8,129  | 6,254   | 5,243  | 962     | 155                    | 21,013  | 21,013        | 4.11 %                                       |
|                              | Euro                                       | 8,112  | 5,238   | 4,384  | 2,611   | 1,357                  | 21,702  | 21,702        | 5.4 %  |
| <b>Fixed-rate Notes</b>      |  |        |         |        |         |                        |         |               |  |
|                              | U.S. dollars                               |        | 150,000 |        |         |                        | 150,000 | 150,000       | 8.5 %  |
|                              | Rubles                                     |        |         |        | 98,742  |                        | 98,742  | 98,742        | 9.0 %  |
| <b>Total fixed rate debt</b> |  |        |         |        |         |                        |         |               |  |
|                              |  | 59,517 | 167,068 | 14,744 | 110,256 | 7,661                  | 359,246 | 359,246       | 8.1 %  |

Our fixed rate debt increased to \$359.2 million and our variable rate debt increased to \$83.6 million as a result of our incurrence of additional short-term and long-term debt. See Notes 15 and 16 to our Consolidated Financial Statements included under Item 18. Financial Statements.

The following tables present our variable and fixed-rate debt obligations as of December 31, 2005 by maturity dates and related weighted average interest rates.

Maturity Date as of December 31, 2005

|                                 | Currency<br>(in thousands of U.S. dollars) | 2006   | 2007 | 2008 | 2009 | 2010 and<br>thereafter | Total  | Fair<br>value | Interest<br>rates at<br>December 31,<br>2005 |
|---------------------------------|--|--------|------|------|------|------------------------|--------|---------------|--|
| <b>Variable-rate loans(1)</b>   |  |        |      |      |      |                        |        |               |  |
|                                 | Euro                                       | 2,703  |      |      |      |                        | 2,703  | 2,703         | 5.69 %                                       |
|                                 | U.S. dollars                               | 1,013  |      |      |      |                        | 1,013  | 1,013         | 6.06 %                                       |
|                                 | Rubles                                     |        |      |      |      |                        |        |               |  |
| <b>Variable-rate notes(2)</b>   |  |        |      |      |      |                        |        |               |  |
|                                 | Rubles                                     | 49,794 |      |      |      |                        | 49,794 | 49,794        | 11.24 %                                      |
| <b>Total variable rate debt</b> |  |        |      |      |      |                        |        |               |  |
|                                 |  | 53,510 |      |      |      |                        | 53,510 | 53,510        | 10.86 %                                      |

(1) Our variable rate loans are linked to LIBOR and EURIBOR.

(2) Our ruble notes are linked to the inflation index.

Expected Maturity Date as of December 31, 2005

|                              | Currency<br>(in thousands of U.S. dollars) | 2006   | 2007   | 2008    | 2009  | 2010 and<br>thereafter | Total   | Fair<br>value | Interest<br>rates at<br>December 31,<br>2005 |
|------------------------------|--|--------|--------|---------|-------|------------------------|---------|---------------|--|
| <b>Fixed-rate loan</b>       |  |        |        |         |       |                        |         |               |  |
|                              | Rubles                                     | 19,904 | 764    | 713     | 455   | 16                     | 21,852  | 21,852        | 5.85 %                                       |
|                              | U.S. dollars                               | 10,436 | 7,731  | 6,161   | 4,813 | 535                    | 29,676  | 29,676        | 4.11 %                                       |
|                              | Euro                                       | 5,090  | 5,025  | 1,179   | 904   | 180                    | 12,378  | 12,378        | 3.62 %                                       |
| <b>Fixed-rate Notes</b>      |  |        |        |         |       |                        |         |               |  |
|                              | U.S. dollars                               |        |        | 150,000 |       |                        | 150,000 | 150,000       | 8.5 %  |
| <b>Total fixed rate debt</b> |  |        |        |         |       |                        |         |               |  |
|                              |  | 35,430 | 13,520 | 158,053 | 6,172 | 104,230                | 318,136 | 318,136       | 7.89 %                                       |



Our fixed rate debt increased to \$318.1 million as a result of our issuance of ruble denominated notes in 2005 and our variable rate debt decreased to \$53.5 million. See Notes 15 and 16 to our Consolidated Financial Statements included under Item 18. Financial Statements.

### Foreign Currency Risk

Our foreign currency exchange risk exposure results from the fact that our revenues are primarily denominated in Russian rubles and a significant portion of our costs is denominated in currencies other than Russian rubles and net monetary liability position from our foreign currency denominated debt. Thus, we incur remeasurement gains as the Russian ruble appreciates against other currencies and losses as the ruble depreciates against other currencies. Management believes that monetary assets and liabilities denominated in foreign currencies, other than foreign currency-denominated debt, are not significant from a foreign currency risk perspective.

As of December 31, 2006, our U.S. dollar debt position amounted to \$171.0 million and our euro debt position amounted to \$21.7 million, compared to a U.S. dollar debt position of \$180.7 million and euro debt position of \$15.1 million as of December 31, 2005.

| Expected Maturity Date as of December 31, 2006 |              |         |         |        |         |                     |         |            |
|--|--------------|---------|---------|--------|---------|---------------------|---------|------------|
|  | Currency     | 2007    | 2008    | 2009   | 2010    | 2011 and thereafter | Total   | Fair value |
| (in thousands of U.S. dollars)                 |              |         |         |        |         |                     |         |            |
| <b>Debt</b>                                    | Rubles       | 127,029 | 5,306   | 5,117  | 106,683 | 6,149               | 250,284 | 250,284    |
|  | U.S. dollars | 8,129   | 156,524 | 5,243  | 962     | 155                 | 171,013 | 171,013    |
|  | Euro         | 8,112   | 5238    | 4,384  | 2,611   | 1,357               | 21,702  | 21,702     |
| <b>Total debt</b>                              |              | 143,270 | 167,068 | 14,744 | 110,256 | 7,661               | 442,999 | 442,999    |

| Expected Maturity Date as of December 31, 2005 |              |        |        |         |       |                     |         |            |
|--|--------------|--------|--------|---------|-------|---------------------|---------|------------|
|  | Currency     | 2006   | 2007   | 2008    | 2009  | 2010 and thereafter | Total   | Fair value |
| (in thousands of U.S. dollars)                 |              |        |        |         |       |                     |         |            |
| <b>Debt</b>                                    | Rubles       | 69,798 | 764    | 713     | 455   | 104,246             | 175,876 | 175,876    |
|  | U.S. dollars | 11,449 | 7,731  | 156,161 | 4,813 | 535                 | 180,689 | 180,689    |
|  | Euro         | 7,793  | 5,025  | 1,179   | 904   | 180                 | 15,081  | 15,081     |
| <b>Total debt</b>                              |              | 88,940 | 13,520 | 158,053 | 6,172 | 104,961             | 371,646 | 371,646    |

During 2006, the Russian ruble appreciated against the U.S. dollar and the euro. We incurred a currency remeasurement gain of \$10.3 million, which was comprised of gains and losses from euro- and U.S. dollar denominated obligations, respectively, as well as remeasurement gains from our U.S. dollar-denominated notes. For purposes of accounting for our U.S. dollar-denominated notes, we used the exchange rate as of December 31, 2006, which appreciated nominally by 8.5% against the December 31, 2005 exchange rate resulting in a currency remeasurement gain.

During 2005, the Russian ruble appreciated against the U.S. dollar and the euro. We incurred a currency remeasurement gain of \$1.2 million. In 2005, we incurred total currency remeasurement gains of \$1.2 million, which comprised of gains and losses from euro- and U.S. dollar denominated obligations, respectively, as well as remeasurement gains from our operations in Ukraine. For purposes of accounting for our U.S. dollar-denominated notes, we used the exchange rate as of December 31, 2005, which depreciated nominally by 3.7% against the December 31, 2004 exchange rate resulting in a currency remeasurement loss. On the other hand, as the value of the ruble increased against the euro, our euro-denominated obligations resulted in currency remeasurement gains. With respect to ruble-denominated liabilities of our Ukrainian subsidiary, we incurred currency remeasurement gains due to the depreciation of the ruble against the Ukrainian hryvna.

We believe that the carrying value of our long-term debt approximates its fair value. The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and short-term loans reported in the consolidated balance sheet approximate their fair values due to the short maturity of those instruments.

See also Item 3. Key Information A. Selected Financial Data Exchange Rates and Inflation.

**Item 12.** *Description of Securities Other than Equity Securities*

Not applicable.

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**PART II**

**Item 13.** *Defaults, Dividend Arrearages and Delinquencies*

None.

**Item 14.** *Material Modifications to the Rights of Security Holders and Use of Proceeds*

Not applicable.

**Item 15T.** *Controls and Procedures*

*(a) Disclosure Controls and Procedures.*

As required by Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, management has evaluated, with the participation of our chief executive officer and chief financial officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding its required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating and implementing possible controls and procedures.

As described below, two material weaknesses were identified in our internal control over financial reporting. The Public Company Accounting Oversight Board's Auditing Standard No. 2 defines a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As a result of the material weaknesses, our chief executive officer and chief financial officer have concluded that, as of December 31, 2006, the end of the period covered by this report, our disclosure controls and procedures and control over financial reporting were not effective at a reasonable assurance level.

*(b) Management's annual report on internal control over financial reporting.*

Management is responsible for establishing and maintaining adequate internal control over financial reporting.

Internal control over financial reporting refers to a process designed by, or under the supervision of, our chief executive officer and chief financial officer and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our

receipts and expenditures are being made only in accordance with authorizations of our management and members of our board of directors; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2006 using the framework set forth in the report of the Treadway Commission's Committee of Sponsoring Organizations (COSO), Internal Control Integrated Framework. The scope of management's evaluation excluded the acquisition of Ochakovo and Manros, two companies that we acquired in November/December 2006, as described in Frequently Asked Question No. 3 (Oct. 6, 2004) regarding Release No. 3447986, Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports (June 5, 2003). Accordingly, management's assessment of our internal control over financial reporting does not include internal control over financial reporting of Ochakovo and Manros, which together represented 8.9% of our total assets and 10.7% of our net assets at December 31, 2006, and generated 1.0% of our total revenue and (0.4)% of our net income during the year then ended.

As a result of evaluation of effectiveness of internal control over financial reporting as of December 31, 2006, management concluded that the following two material weaknesses in our internal control existed:

- Our financial statement closing process and the transformation of our statutory financial statements into U.S. GAAP consolidated financial statements has not reduced to an acceptably low level the risk that material errors may occur and may not be detected on a timely basis by management in the normal course of business; and
- Insufficient accounting resources and expertise in respect of the preparation of consolidated financial statements in accordance with U.S. GAAP.

As a result of the material weaknesses, management has concluded that our internal control over financial reporting was ineffective as of December 31, 2006.

*Additional Information Regarding the Material Weaknesses*

*Our financial statement closing process and the transformation of our statutory financial statements into U.S. GAAP consolidated financial statements has not reduced to an acceptably low level the risk that material errors may occur and may not be detected on a timely basis by management in the normal course of business.*

The first weakness results from the fact that there is no fully automated process in place to support the transformation of statutory financial statements of our subsidiaries to comply with U.S. GAAP or the preparation of the consolidated balance sheet, consolidated statements of income and cash flows, including the reconciliation and elimination of intragroup balances and transactions. We also lack a sufficiently detailed description of individual procedures, responsible persons and controls for the U.S. GAAP financial statements closing processes and documentation of their completion. Also, some of our processes

regarding accumulation and communication of detail information regarding non-routine transactions, commitments and contingencies did not operated effectively as designed.

*Insufficient accounting resources and expertise in respect of the preparation of consolidated financial statements in accordance with U.S. GAAP.*

The second weakness relates to our insufficient U.S. GAAP accounting resources and expertise. Our business consists of 36 operating subsidiaries, of which the 10 major subsidiaries are located across eight time zones in Russia and the Commonwealth of Independent States, each of which prepares stand-alone financial statements for statutory purposes under Russian accounting standards or other local country accounting standards. The preparation of our U.S. GAAP consolidated financial statements is a partly automated process which involves (1) the transformation of these statutory financial statements into U.S. GAAP consolidated financial statements through accounting adjustments and (2) a consolidation of all these stand-alone statutory financial statements. This process is complicated, time-consuming and requires significant attention and time from our senior accounting personnel at our subsidiaries and corporate headquarters. Moreover, U.S. GAAP accounting adjustments tend to result in large differences between our statutory and U.S. GAAP financial position and results of operations.

These difficult tasks require U.S. GAAP-experienced accounting personnel at each of our 10 major subsidiaries and at our Moscow corporate offices. While we have senior accounting personnel who are ACCA-qualified, Russia has available only a small number of accounting personnel with U.S. GAAP expertise. Moreover, there is an increasing demand for such personnel as more Russian companies are beginning to prepare financial statements on the basis of U.S. GAAP or other international standards. Such competition, combined with the locations of our major subsidiaries which such personnel may not find suitable in comparison to other opportunities, makes it difficult for us to hire and retain such personnel. Under these circumstances, we have had difficulty in remedying this material weakness.

Notwithstanding the steps we have taken and continue to take that are designed to remedy each material weakness identified above, we may not be successful in remediating these material weaknesses in the near or long term and we may not be able to prevent other material weaknesses in the future.

#### *Remediation Activities*

We have taken and continue to take several steps to correct the material weaknesses.

- Management developed a documentation of our statutory and U.S. GAAP financial statements closing process. We developed and introduced checklists for accounting personnel for documenting actual performance of procedures and controls. We have reviewed and communicated to proper personnel our processes on accumulation and communication regarding non-routine transactions, commitments and contingencies. Currently, management is in the process of improving internal guidelines of the statutory and U.S. GAAP financial statements closing process, including individual procedures and controls. This process is taking place under close supervision of our department of internal control. We expect these new procedures will be implemented by the end of September 2007.
- In December 2006, we hired a senior accounting professional with appropriate U.S. GAAP experience responsible for review of U.S. GAAP statements and dealing with complex issues. An individual professional development plan is currently being implemented for the key accounting specialists involved in the U.S. GAAP consolidated financial statements preparation process, which will be constantly monitored by management, to further strengthen our accounting function. Currently, four of our key financial staff are in the process of obtaining their ACCA certification, and one is ACCA- qualified. Remaining specialists are in the process of registering or obtaining

ACCA or DipIfr certificates. We also have added two additional accounting specialists to our U.S. GAAP accounting department.

- In April 2007, we arranged a training seminar for our key accounting staff provided by qualified external trainers on Financial Accounting Standard No. 109, *Accounting for Income Taxes* which enhanced the process of accounting for income tax in accordance with Financial Accounting Standard No. 109,. In 2007, we plan to continue arranging training seminars for our accounting staff. In particular, a U.S. GAAP update training will be held for our key accounting specialists, and a comprehensive U.S. GAAP training will be held for all U.S. GAAP accounting department during the year 2007.

Although we have undertaken the foregoing initiatives, the existence of a material weakness is an indication that there is more than a remote likelihood that a material misstatement of our financial statements will not be prevented or detected in a future period. In addition, we cannot assure you that we will not in the future identify further material weaknesses or significant deficiencies in our internal control over financial reporting that we have not discovered to date. We are taking steps to refine our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act, which will take effect beginning with the year ending December 31, 2006, and the efficacy of the steps we have taken to date and the steps we are still in the process of completing is subject to continued management review supported by confirmation and testing by management and by our internal auditors, as well as audit committee oversight. As a result, additional changes will be made to our internal control over financial reporting. See Item 3. Key Information D. Risk Factors There are material weaknesses in our internal control over financial reporting and we may not be able to remedy these material weaknesses or prevent future material weaknesses. If we fail to do so there is a more than remote likelihood that a material misstatement of the annual or interim statements will not be prevented or detected.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only management's report in this annual report.

(c) Changes in internal control over financial reporting.

Management has evaluated, with the participation of our chief executive officer and chief financial officer, whether any changes in our internal control over financial reporting that occurred during the period covered by this annual report have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on the evaluation we conducted, management has concluded that no such changes have occurred. However, management believes the measures that have been implemented to remediate the material weaknesses have had a material impact on our internal control over financial reporting since December 31, 2006, and anticipates that these measures and other ongoing enhancements will continue to have a material impact on our internal control over financial reporting in future periods.

**Item 16A.** *Audit Committee Financial Expert*

Our Board of Directors has determined that Guy de Selliers is an audit committee financial expert as defined in Item 16A of Form 20-F. Mr. de Selliers is independent in accordance with SEC Rule 10A-3.

**Item 16B.** *Code of Ethics*

In July 2005, our Board of Directors approved a Code of Ethics that applies to our employees, including our principal executive officer, principal financial officer and principal accounting officer or

controller, or persons performing similar functions, which is posted on our website at [http://www.wbd.com/f\\_reports/corp\\_govern/](http://www.wbd.com/f_reports/corp_govern/). No waivers of the Code of Ethics have been granted.

**Item 16C.** *Principal Accountant Fees and Services*

Ernst & Young LLC has served as our independent public accountants for the fiscal years ended December 31, 2006 and 2005, respectively, for which audited financial statements appear in this annual report on Form 20-F. The following table presents the aggregate fees for professional services and other services rendered by Ernst & Young in 2006 and 2005, respectively.

|                    | Year ended December 31, |              |
|--------------------|-------------------------|--------------|
|                    | 2006                    | 2005         |
|                    | (in U.S. dollars)       |              |
| Audit Fees         | \$ 827,096              | \$ 929,400   |
| Audit-Related Fees |                         | 30,000       |
| All Other Fees     | 80,423                  | 268,470      |
| Total              | \$ 907,519              | \$ 1,227,870 |

**Audit Fees**

Audit services consisted of the audit of the consolidated financial statements as of and for the years ended December 31, 2006 and 2005, the Russian statutory audit of stand-alone financial statements prepared in accordance with Russian accounting principles of Wimm-Bill-Dann Foods OJSC as of and for the years ended December 31, 2006 and 2005, reviews of the consolidated condensed financial statements for the three months ended March 31, 2006 and 2005, the six months ended June 30, 2006 and 2005 and the nine months ended September 30, 2006 and 2005 and services performed by our external auditors in connection with our Audit Committee meetings and related communications, as well as with their review of this annual report on Form 20-F.

**Audit-related Fees**

Audit-related services for the year ended December 31, 2005 consisted of services performed by our external auditors in connection with the issuance of a ruble bond.

**Other Fees**

Other services for the years ended December 31, 2006 and 2005 mainly consisted of advisory services regarding compliance with the Sarbanes-Oxley Act of 2002.

**Audit Committee Pre-Approval Policies and Procedures**

The Sarbanes-Oxley Act of 2002 required that we implement a pre-approval process for all engagements with our Independent Registered Public Accounting Firm. In compliance with these requirements, our Audit Committee pre-approves the engagement terms and fees of Ernst & Young for all audit and non-audit services. The Audit Committee pre-approved the engagement terms and fees of Ernst & Young for all audit and non-audit services for the fiscal years ended December 31, 2006 and 2005.

**Item 16D.** *Exemption from the Listing Standards for Audit Committees*

Not applicable.

**Item 16E.** *Purchases of Equity Securities by the Issuer and Affiliated Purchasers*

No purchases were made by or on behalf of us or any affiliated purchaser of shares or other units of any class of our equity securities during the period covered by this annual report.

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**PART III**

*Item 17. Financial Statements*

**See instead Item 18. Financial Statements.**

*Item 18. Financial Statements*

The following financial statements, together with the report of Ernst & Young LLC, are filed as part of this annual report on Form 20-F.

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| <u>Report of Independent Registered Public Accounting Firm</u>  | F-2         |
| <u>Consolidated Balance Sheets as of December 31, 2006 and 2005</u>   | F-3         |
| Consolidated Statements of Operations for the years ended December 31, 2006, 2005 and 2004                  | F-5         |
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| <u>Consolidated Statements of Shareholders' Equity for the years ended December 31, 2006, 2005 and 2004</u> | F-8         |
| <u>Notes to the Consolidated Financial Statements</u>   | F-9         |

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*Item 19. Exhibits*

- 1.1 Charter of Wimm-Bill-Dann Foods OJSC (English Translation) is incorporated by reference to Exhibit 1 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2002, on Form 20-F.
- 1.2 Amendments to the charter of Wimm-Bill-Dann Foods OJSC (English Translation), approved June 18, 2003 is incorporated herein by reference to Exhibit 1.2 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2003 on Form 20-F.
- 1.3 Amendment to the charter of Wimm-Bill-Dann Foods OJSC (English Translation), approved July 16, 2004 is incorporated herein by reference to Exhibit 1.3 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2004 on Form 20-F.
- 1.4 Amendment to the charter of Wimm-Bill-Dann Foods OJSC (English Translation), approved June 14, 2005 is incorporated herein by reference to Exhibit 1.4 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2004 on Form 20-F.
- 1.5 Amendment to the charter of Wimm-Bill-Dann Foods OJSC (English Translation), approved May 30, 2006
- 1.6 Amendment to the charter of Wimm-Bill-Dann Foods OJSC (English Translation), approved July 14, 2006
- 1.7 Amendment to the charter of Wimm-Bill-Dann Foods OJSC (English Translation), approved October 23, 2006
- 1.8 Amendment to the charter of Wimm-Bill-Dann Foods OJSC (English Translation), approved December 15, 2006
- 2.1 Deposit Agreement, dated January 17, 2002, by and among the Company, the Depositary, and the holders and beneficial owners from time to time of the ADSs is incorporated by reference to Exhibit 2.1 to the Annual Report filed pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934 for the fiscal year ended December 31, 2001 on Form 20-F/A.
- 4.1 U.S. \$150,000,000 Loan Agreement, dated as of 14 May 2003 between Open Joint Stock Company Wimm-Bill-Dann Foods as Borrower and UBS (Luxembourg) S.A. as Lender is incorporated herein by reference to Exhibit 4.1 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2002 on Form 20-F.
- 4.2 Deed of Guarantee, dated as of 14 May 2003 between OAO Lianozovsky Dairy Plant, OAO Tsaritsino Dairy Plant, ZAO Trade Company Wimm- Bill-Dann as Guarantors and UBS (Luxembourg) S.A. as Lender is incorporated herein by reference to Exhibit 4.2 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2002, on Form 20-F.
- 4.2.1 Side Letter and Deed of Accession dated 23 January 2004 is incorporated herein by reference to Exhibit 4.2.1 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2004 on Form 20-F.
- 4.2.2 Side Letter and Deed of Accession dated 27 January 2005 is incorporated herein by reference to Exhibit 4.2.2 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2004 on Form 20-F.

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- 4.2.3 Notice on termination of guarantee provided by OAO Tsaritsino Dairy Plant, OAO Baltic milk Dairy Plant, OAO Dairy Plant (Timashevsk) dated 10 July 2006
- 4.3 U.S. \$150,000,000 Loan Agreement, dated as of 06 February 2007 between Open Joint Stock Company Wimm-Bill-Dann Foods as Borrower and UBS (Luxembourg) S.A.
- 4.4 Contract No. P71028, dated January 1, 2007, by and between CJSC Tetra Pak and OAO wimm-Bill-Dann.\*
- 4.5 Contract No. P71039, dated January 1, 2007, by and between CJSC Tetra Pak and OAO Wimm-Bill-Dann Beverages.\*
- 4.6 Subsoil Use License No. 01948 issued to Rodniki Valdaya Limited Liability Company; License Agreement on the terms of subsoil use for the extraction of up to 500 m3/day of underground drinking water from exploitation wells No. 2537 and No. 2542 (English Translation) is incorporated herein by reference to Exhibit 4.5 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2002, on Form 20-F.
- 4.7 Exchange Agreement No. B-01, dated April 4, 2001, by and between Moscow Baby Food Plant and Mikhail Vishnyakov is incorporated herein by reference to Exhibit 10.2 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.8 Exchange Agreement No. B-02, dated April 4, 2001, by and between Lianozovsky Dairy Plant and Mikhail Vishnyakov is incorporated herein by reference to Exhibit 10.3 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.9 Exchange Agreement No. B-03, dated April 4, 2001, by and between Lianozovsky Dairy Plant and Mikhail Dubinin is incorporated herein by reference to Exhibit 10.4 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.10 Exchange Agreement No. B-04, dated April 4, 2001, by and between Lianozovsky Dairy Plant and Alexander Orlov is incorporated herein by reference to Exhibit 10.5 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.11 Exchange Agreement No. B-05, dated April 4, 2001, by and between Lianozovsky Dairy Plant and Sergei Plastinin is incorporated herein by reference to Exhibit 10.6 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.12 Exchange Agreement No. B-06, dated April 4, 2001, by and between Lianozovsky Dairy Plant and Gavril Yushvaev is incorporated herein by reference to Exhibit 10.7 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.13 Exchange Agreement No. B-07, dated April 4, 2001, by and between Lianozovsky Dairy Plant and Evgeny Yaroslavsky is incorporated herein by reference to Exhibit 10.8 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.14 Exchange Agreement No. TsK-01, dated April 5, 2001, by and between Lianozovsky Dairy Plant and Mikhail Vishnyakov is incorporated herein by reference to Exhibit 10.9 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.15 Exchange Agreement No. TsK-02, dated April 5, 2001, by and between Lianozovsky Dairy Plant and Mikhail Dubinin is incorporated herein by reference to Exhibit 10.10 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.16 Exchange Agreement No. TsK-03, dated April 5, 2001, by and between Lianozovsky Dairy Plant and Alexander Orlov is incorporated herein by reference to Exhibit 10.11 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).

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- 4.17 Exchange Agreement No. TsK-04, dated April 5, 2001, by and between Lianozovsky Dairy Plant and Sergei Plastinin is incorporated herein by reference to Exhibit 10.12 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.18 Exchange Agreement No. TsK-05, dated April 5, 2001, by and between Lianozovsky Dairy Plant and Aleksandrs Timohins is incorporated herein by reference to Exhibit 10.13 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.19 Exchange Agreement No. TsK-06, dated April 5, 2001, by and between Lianozovsky Dairy Plant and Gavril Yushvaev is incorporated herein by reference to Exhibit 10.14 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.20 Exchange Agreement No. TsK-07, dated April 5, 2001, by and between Lianozovsky Dairy Plant and Evgeny Yaroslavsky is incorporated herein by reference to Exhibit 10.15 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 4.21 Amended and Restated Partnership and Cooperation Agreement is incorporated herein by reference to Exhibit 99.1 to Amendment No. 2 to the Registration Statement on Form F-1 (Registration No. 333-14278).
- 8.1 List of Subsidiaries of Wimm-Bill-Dann Foods OJSC.
- 12.1 Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 12.2 Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 13.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 13.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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\* Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the Securities and Exchange Commission.

**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

WIMM-BILL-DANN FOODS OJSC

By: /s/ TONY D. MAHER  
Tony D. Maher  
Title: *Chief Executive Officer*

Date: June 25, 2007

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**Wimm-Bill-Dann Foods**  
**Consolidated Financial Statements**  
**Years ended December 31, 2006 and 2005**

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders  
Wimm-Bill-Dann Foods

We have audited the accompanying consolidated balance sheets of Wimm-Bill-Dann Foods, a Russian Open Joint Stock Company ( the Company ) as of December 31, 2006 and 2005, and the related consolidated statements of income and comprehensive income, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audits included 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Wimm-Bill-Dann Foods at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006 in conformity with U.S. generally accepted accounting principles.

/s/ ERNST & YOUNG LLC  
April 10, 2007  
Moscow, Russia

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**Wimm-Bill-Dann Foods**  
**Consolidated Balance Sheets**  
(Amounts in thousands of U.S. dollars)

|  | December 31,<br>2006 | 2005              |
|--|----------------------|-------------------|
| <b>ASSETS</b>  |                      |                   |
| <b>Current assets:</b>   |                      |                   |
| Cash and cash equivalents (Note 5)                                     | \$ 40,310            | \$ 93,103         |
| Short-term bank deposits   |                      | 32,164            |
| Trade receivables, net (Note 6)  | 89,932               | 59,968            |
| Inventory (Note 7)   | 174,074              | 130,597           |
| Taxes receivable   | 51,161               | 61,480            |
| Advances paid  | 30,695               | 9,715             |
| Net investment in direct financing leases (Note 8)                     | 2,095                | 2,335             |
| Deferred tax asset (Note 18)   | 12,749               | 8,750             |
| Other current assets (Note 9)  | 19,730               | 8,915             |
| <b>Total current assets</b>  | <b>420,746</b>       | <b>407,027</b>    |
| <b>Non-current assets:</b>   |                      |                   |
| Property, plant and equipment, net (Note 11)                           | 606,728              | 459,527           |
| Intangible assets, net (Note 10)                                       | 26,844               | 7,078             |
| Goodwill (Note 12)   | 105,990              | 32,008            |
| Net investment in direct financing leases non-current portion (Note 8) | 1,673                | 3,072             |
| Long-term investments  | 25                   | 138               |
| Deferred tax asset non-current portion (Note 18)                       | 8,737                | 5,554             |
| Other non-current assets (Note 13)                                     | 5,193                | 6,153             |
| <b>Total non-current assets</b>  | <b>755,190</b>       | <b>513,530</b>    |
| <b>Total assets</b>  | <b>\$ 1,175,936</b>  | <b>\$ 920,557</b> |

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

**Wimm-Bill-Dann Foods**  
**Consolidated Balance Sheets (continued)**  
(Amounts in thousands of U.S. dollars, except share data)

|  | December 31,<br>2006 | 2005              |
|--|----------------------|-------------------|
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                      |                   |
| <b>Current liabilities:</b>  |                      |                   |
| Trade accounts payable   | \$ 104,066           | \$ 65,780         |
| Advances received  | 13,230               | 5,291             |
| Short-term loans (Note 15)   | 123,849              | 19,554            |
| Long-term loans, current portion (Note 15)   | 4,137                | 3,823             |
| Short-term notes payable (Note 16)   |                      | 49,794            |
| Taxes payable  | 9,494                | 13,406            |
| Accrued liabilities (Note 14)  | 37,103               | 17,071            |
| Government grants - current portion (Note 19)  | 1,422                | 2,174             |
| Other payables (Note 17)   | 37,035               | 30,200            |
| <b>Total current liabilities</b>   | <b>330,336</b>       | <b>207,093</b>    |
| <b>Long-term liabilities:</b>  |                      |                   |
| Long-term loans (Note 15)  | 30,082               | 1,824             |
| Long-term notes payable (Note 16)  | 248,742              | 254,230           |
| Other long-term payables (Note 17)   | 20,905               | 26,893            |
| Government grants - long-term portion (Note 19)  | 1,125                | 3,219             |
| Deferred taxes - long-term portion (Note 18)   | 28,275               | 15,636            |
| <b>Total long-term liabilities</b>   | <b>329,129</b>       | <b>301,802</b>    |
| <b>Total liabilities</b>   | <b>659,465</b>       | <b>508,895</b>    |
| <b>Commitments and contingencies (Note 30)</b>   |                      |                   |
| <b>Minority interests (Note 21)</b>  | <b>18,977</b>        | <b>24,619</b>     |
| <b>Shareholders' equity (Note 20):</b>   |                      |                   |
| Common stock: 44,000,000 shares authorized, issued and outstanding with a par value of 20 rubles | 29,908               | 29,908            |
| Share premium account  | 164,132              | 164,132           |
| Retained earnings  | 234,285              | 163,237           |
| Accumulated other comprehensive income:  |                      |                   |
| Currency translation adjustment  | 69,169               | 29,766            |
| <b>Total shareholders' equity</b>  | <b>497,494</b>       | <b>387,043</b>    |
| <b>Total liabilities and shareholders' equity</b>  | <b>\$ 1,175,936</b>  | <b>\$ 920,557</b> |

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

## Wimm-Bill-Dann Foods

## Consolidated Statements of Income and Comprehensive Income

(Amounts in thousands of U.S. dollars, except share and per share data)

|   | Year ended December 31 |                     |                     |
|---|------------------------|---------------------|---------------------|
|   | 2006                   | 2005                | 2004                |
| <b>Sales (Note 27)</b>  | <b>\$ 1,762,127</b>    | <b>\$ 1,394,590</b> | <b>\$ 1,183,986</b> |
| <b>Cost of sales (Note 22)</b>  | <b>(1,194,159 )</b>    | <b>(999,006 )</b>   | <b>(858,767 )</b>   |
| <b>Gross profit</b>   | <b>567,968</b>         | <b>395,584</b>      | <b>325,219</b>      |
| Selling and distribution expenses (Note 23)                           | (246,054 )             | (191,990 )          | (173,433 )          |
| General and administrative expenses (Note 24)                         | (134,481 )             | (109,642 )          | (92,816 )           |
| Other operating expenses, net   | (31,812 )              | (6,457 )            | (6,047 )            |
| <b>Operating income</b>   | <b>155,621</b>         | <b>87,495</b>       | <b>52,923</b>       |
| Financial income and expenses, net (Note 25)                          | (15,480 )              | (22,868 )           | (14,618 )           |
| <b>Income before provision for income taxes and minority interest</b> | <b>140,141</b>         | <b>64,627</b>       | <b>38,305</b>       |
| Provision for income taxes (Note 18)                                  | (41,560 )              | (30,712 )           | (12,170 )           |
| Minority interest (Note 21)   | (3,197 )               | (3,649 )            | (3,161 )            |
| <b>Net Income</b>   | <b>\$ 95,384</b>       | <b>\$ 30,266</b>    | <b>\$ 22,974</b>    |
| <b>Other comprehensive income, net of tax</b>                         |                        |                     |                     |
| Currency translation adjustment                                       | 39,403                 | (14,139 )           | 23,324              |
| <b>Comprehensive income</b>   | <b>\$ 134,787</b>      | <b>\$ 16,127</b>    | <b>\$ 46,298</b>    |
| <b>Earnings per share basic and diluted</b>                           | <b>\$ 2.17</b>         | <b>\$ 0.69</b>      | <b>\$ 0.52</b>      |
| Weighted average number of shares outstanding, basic and diluted      | \$ 44,000,000          | \$ 44,000,000       | \$ 44,000,000       |

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



**Wimm-Bill-Dann Foods**

## Consolidated Statements of Cash Flows

(Amounts in thousands of U.S. dollars)

|  | Year ended December 31 |                |               |
|--|------------------------|----------------|---------------|
|  | 2006                   | 2005           | 2004          |
| <b>Cash flows from operating activities:</b>                                       |                        |                |               |
| Net Income   | \$ 95,384              | \$ 30,266      | \$ 22,974     |
| Adjustments to reconcile net income to net cash provided by operating activities:  |                        |                |               |
| Minority interest  | 3,197                  | 3,649          | 3,161         |
| Depreciation and amortisation  | 62,329                 | 53,435         | 44,003        |
| Currency remeasurement loss(gain) relating to bonds payable and long-term payables | (13,660 )              | 990            | (9,938 )      |
| Obsolescence and net realizable value expense                                      | 601                    | 1,077          | 3,482         |
| Provision for doubtful accounts  | 3,130                  | 3,908          | 3,722         |
| Loss on disposal of property, plant and equipment                                  | 2,340                  | 1,321          | 1,013         |
| Earned income on net investment in direct financing leases                         | (706 )                 | (402 )         | (639 )        |
| Deferred tax expense(benefit)  | (6,672 )               | 3,327          | (6,019 )      |
| Non-cash rental received   | 2,938                  | 2,496          | 1,957         |
| Provision (reversal) of tax contingent liability                                   | 1,028                  | (800 )         | (128 )        |
| Loss/(gain) from securities and disposal of long-term investments                  | 86                     | 1,786          | 190           |
| Impairment of tangible assets and intangible assets                                | 15,633                 |                |               |
| Impairment of goodwill   | 2,539                  |                |               |
| Write-off of unrecoverable investments in direct finance lease                     | 131                    |                |               |
| Write-off of unrecoverable VAT   | 588                    |                |               |
| Amortisation of bond issue expenses  | 1,197                  | 1,046          | 1,025         |
| Changes in operating assets and liabilities (net of impact of acquisitions):       |                        |                |               |
| Inventory  | (18,193 )              | (25,361 )      | (9,208 )      |
| Trade accounts receivable  | (20,023 )              | (2,636 )       | (4,883 )      |
| Advances paid  | (16,224 )              | 9,553          | 1,356         |
| Taxes receivable   | 8,187                  | 15,082         | 13,979        |
| Other current assets   | (5,549 )               | (1,062 )       | (3,346 )      |
| Other long-term assets   | 45                     |                |               |
| Trade accounts payable   | 21,713                 | 3,649          | 7,000         |
| Advances received  | 1,400                  | 1,880          | 719           |
| Taxes payable  | 906                    | 6,698          | 1,526         |
| Accrued liabilities  | 14,710                 | 2,816          | 2,913         |
| Other current payables   | 6,152                  | 678            | (3,148 )      |
| Other long-term payables   | 4,045                  | 541            | 9             |
| <b>Total cash provided by operating activities</b>                                 | <b>167,252</b>         | <b>113,937</b> | <b>71,720</b> |

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

**Wimm-Bill-Dann Foods**

## Consolidated Statements of Cash Flows (continued)

(Amounts in thousands of U.S. dollars)

|   | Year ended December 31 |                   |                  |
|---|------------------------|-------------------|------------------|
|   | 2006                   | 2005              | 2004             |
| <b>Cash flows from investing activities:</b>                      |                        |                   |                  |
| Cash paid for acquisition of subsidiaries, net of cash acquired   | \$ (134,367 )          | \$ (24,964 )      | \$ (6,697 )      |
| Cash paid for property, plant and equipment                       | (127,713 )             | (72,805 )         | (68,103 )        |
| Cash paid for acquisition of investments                          |                        | (71 )             |                  |
| Proceeds from disposal of investments                             |                        | 538               | 675              |
| Proceeds from disposal of property, plant and equipment           | 883                    | 5,944             | 2,081            |
| Cash paid for net investments in direct financing leases          | (1,496 )               | (1,982 )          | (1,764 )         |
| Cash received from other long-term assets                         | 1,429                  |                   |                  |
| Cash invested in short-term bank deposits                         | 33,106                 | (31,817 )         |                  |
| <b>Net cash used in investing activities</b>                      | <b>(228,158 )</b>      | <b>(125,157 )</b> | <b>(73,808 )</b> |
| <b>Cash flows from financing activities:</b>                      |                        |                   |                  |
| Short-term loans and notes, net                                   | 85,760                 | (3,795 )          | 7,967            |
| Repayment of long-term loans                                      | (21,414 )              | (4,099 )          | (2,481 )         |
| Proceeds from long-term loans                                     | 30,214                 | 1,636             | 343              |
| Repayment of long-term payables                                   | (19,416 )              | (17,123 )         | (19,727 )        |
| Repayment of long-term notes payable                              | (52,719 )              |                   | (2,261 )         |
| Proceeds from long-term notes payable, net of debt issuance costs |                        | 106,000           |                  |
| Dividends paid  | (21,066 )              |                   |                  |
| <b>Total cash provided by (used in) financing activities</b>      | <b>1,359</b>           | <b>82,619</b>     | <b>(16,159 )</b> |
| Impact of exchange rate differences on cash and cash equivalents  | 6,754                  | (2,087 )          | 1,774            |
| <b>Net increase(decrease) in cash and cash equivalents</b>        | <b>(52,793 )</b>       | <b>69,312</b>     | <b>(16,473 )</b> |
| <b>Cash and cash equivalents, at beginning of the year</b>        | <b>93,103</b>          | <b>23,791</b>     | <b>40,264</b>    |
| <b>Cash and cash equivalents, at the end of the year</b>          | <b>\$ 40,310</b>       | <b>\$ 93,103</b>  | <b>\$ 23,791</b> |

|   | 2006      | 2005      | 2004      |
|---|-----------|-----------|-----------|
| <b>SUPPLEMENTAL INFORMATION:</b>                              |           |           |           |
| Income taxes paid   | \$ 53,451 | \$ 27,123 | \$ 20,523 |
| Interest paid   | 3,238     | 22,871    | 14,615    |
| Income taxes offset with VAT receivables                      | 1,466     | 2,715     | 1,842     |
| Taxes other than income taxes offset with VAT receivables     | 7,929     | 3,896     | 6,390     |
| Vendor financed acquisitions of property, plant and equipment | 5,561     | 5,709     | 7,335     |

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

**Wimm-Bill-Dann Foods**

## Consolidated Statements of Shareholders' Equity

(Amounts in thousands of U.S. dollars, except share amounts)

|   | Common Stock<br>Shares | Amount           | Share<br>premium<br>account | Accumulated<br>other<br>comprehensive<br>income (loss) | Retained<br>earnings | Total             |
|---|------------------------|------------------|-----------------------------|--|----------------------|-------------------|
| Balances at December 31, 2003                                     | 44,000,000             | \$ 29,908        | \$ 164,132                  | \$ 20,581  | \$ 109,997           | \$ 324,618        |
| Net income  |                        |                  |                             |  | 22,974               | 22,974            |
| Currency translation adjustment                                   |                        |                  |                             | 23,324   |                      | 23,324            |
| <b>Balances at December 31,<br/>2004</b>                          | <b>44,000,000</b>      | <b>29,908</b>    | <b>164,132</b>              | <b>43,905</b>  | <b>132,971</b>       | <b>370,916</b>    |
| Net income  |                        |                  |                             |  | 30,266               | 30,266            |
| Currency translation adjustment                                   |                        |                  |                             | (14,139 )  |                      | (14,139 )         |
| <b>Balances at December 31,<br/>2005</b>                          | <b>44,000,000</b>      | <b>29,908</b>    | <b>164,132</b>              | <b>29,766</b>  | <b>163,237</b>       | <b>387,043</b>    |
| Net income  |                        |                  |                             |  | 95,384               | 95,384            |
| Currency translation adjustment                                   |                        |                  |                             | 39,403   |                      | 39,403            |
| Dividends on common stock<br>including income taxes of<br>\$3,270 |                        |                  |                             |  | (24,336 )            | (24,336 )         |
| <b>Balances at December 31,<br/>2006</b>                          | <b>44,000,000</b>      | <b>\$ 29,908</b> | <b>\$ 164,132</b>           | <b>\$ 69,169</b>                                       | <b>\$ 234,285</b>    | <b>\$ 497,494</b> |

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

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements**

**Years ended December 31, 2006, 2005 and 2004**

**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**1. The Company**

Wimm-Bill-Dann Foods ( WBD Foods or the Company ) is an open joint stock company registered in Russia. It is a holding company which, as of December 31, 2006, owned controlling interests in 36 manufacturing facilities in Russia and elsewhere in the Commonwealth of Independent States ( CIS ), as well as distribution branches in more than 25 cities in Russia and elsewhere in the CIS. WBD Foods has a strong and diversified brand portfolio with over 1,000 types of dairy products, and over 150 types of juice, nectars and still drinks.

**2. Operating Environment of the Company**

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

**3. Summary of Significant Accounting Policies**

*Accounting Principles*

The Company and its subsidiaries maintain their accounting books and records in domestic currency based on domestic accounting regulations. The consolidated financial statements have been prepared in order to present WBD Foods consolidated financial position, results of operations, and cash flows in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) and expressed in terms of U.S. dollars (see paragraph Translation Methodology on the following page).

*Principles of Consolidation*

The consolidated financial statements of the Company include the accounts of WBD Foods and its subsidiaries when the Company has operating and financial control. Results of subsidiaries acquired or disposed of during the year and accounted for by the purchase method have been included in operations from the relevant date of acquisition to the relevant date of disposal. Pro forma results of operations reflecting these acquisitions have not been presented because the results of operations of the acquired companies, either individually or collectively, are not material to consolidated results of operations. All inter-company accounts and transactions are eliminated upon consolidation. Minority interests in the net assets and net results of the Company s subsidiaries are shown under Minority interests in the accompanying consolidated balance sheets and statements of income.

*Comprehensive Income*

Comprehensive income is defined as the change in equity of a company during a period from non-owner sources. Comprehensive income of WBD Foods for the years ended December 31, 2006, 2005 and 2004 consists of net income and a currency translation adjustment in the amount of \$39,403, (\$14,139) and \$23,324, respectively.

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**3. Summary of Significant Accounting Policies (continued)**

*Translation Methodology*

Starting from January 1, 2003, Russia is no longer considered a hyperinflationary economy, therefore, the U.S. GAAP financial statements are prepared using the local currency, the Russian ruble, as the functional currency for WBD Foods' Russian subsidiaries. Subsequent translation to the reporting currency, the U.S. dollar, is made in accordance with Statement of Financial Accounting Standards (SFAS) No. 52. All assets and liabilities of the Company and its subsidiaries with functional currencies other than the U.S. dollar are translated into U.S. dollar equivalents at exchange rates as follows: (1) asset and liability accounts at the rate of exchange in effect on the balance sheet date, (2) revenues and expenses at the average exchange rates for the year, and (3) shareholders' equity accounts at historical exchange rates. Translation gains or losses are recorded as a separate component of shareholders' equity, and transaction gains and losses are reflected in net income.

In respect of Wimm-Bill-Dann Netherlands B.V., the U.S. dollar has been used to prepare the financial statements as this is its functional currency. The financial statements of Ukrainian, Kyrgyz, Usbekh and Kazakh subsidiaries have been prepared using the Ukrainian hryvnia, Kyrgyz som, Uzbek sum and Kazakh tenge, respectively, as the functional currency. Translation (remeasurement) of domestic currency denominated financial statements into U.S. dollars has been performed in accordance with the provisions of SFAS No. 52.

The ruble is not a fully convertible currency outside the territory of the Russian Federation. Within the Russian Federation, official exchange rates are determined daily by the Central Bank of Russia (CBR). Market rates may differ from the official rates but the differences are, generally, within narrow parameters monitored by the CBR. As of December 31, 2006 and 2005, the official rates of exchange were 26.33 rubles = 1 U.S. dollar and 28.78 rubles = 1 U.S. dollar, respectively. The translation of local currency denominated assets and liabilities into US dollars for the purposes of these financial statements does not indicate that the Company could realize or settle, in U.S. dollars, the reported values of these assets and liabilities. Likewise, it does not indicate that the Company could return or distribute the reported US dollar value of capital to its shareholders.

*Management Estimates*

The preparation of the consolidated financial statements in conformity with U.S. 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. Examples include estimates of provisions for bad and doubtful accounts, obsolete inventory, and valuation allowance for deferred tax assets. Actual results could differ from those estimates.

*Cash and Cash Equivalents*

Cash and cash equivalents represent cash on hand and in the Company's bank accounts and short-term investments having original maturities of three months or less.

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**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**3. Summary of Significant Accounting Policies (continued)**

*Short-Term Bank Deposits*

Short-term bank deposits have maturities of more than three months and less than one year. Short-term bank deposits are invested with banks and earn interest at the prevailing short-term deposit rates. Deposits are presented at their cost, including accrued interest. The short-term bank deposits are in rubles and bear an average annual interest of 6 % for 2005 and 2006.

*Trade Receivable and Allowance for Doubtful Accounts*

Accounts receivable are stated at their net realizable value which approximates their fair value. The Company provides an allowance for doubtful accounts based on management's periodic review of accounts, including the delinquency of account balances. Delinquency status is based on contractual terms. The Company evaluates the collectibility of its receivables at least quarterly, based upon various factors, including the financial condition and payment history of major customers, an overall review of collections experience of other accounts and economic factors or events expected to affect the Company's future collections.

Trade receivables are written-off when evidence exists that they will not be collectible. The Company generally does not require collateral from its credit customers.

*Inventory*

Inventories, including work-in-process, are valued at the lower of cost or market. 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 production fixed and variable overhead costs. Market 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 realizable value) at the maximum level, and net realizable value, less an allowance for normal profit at the minimum level. Net realizable value is the selling price in the ordinary course of business, less the costs of completion, marketing, and distribution. Unrealizable inventory is fully provided for in the accompanying consolidated financial statements.

*Value-Added Taxes*

Value-added taxes ( VAT ) related to sales are payable based upon invoices issued to the customer or collection of respective receivables. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales.

VAT related to purchase transactions that are subject to offset against VAT payable after the balance sheet dates are recognized in the balance sheets on a gross basis.

*Property, Plant and Equipment*

Property, plant and equipment are stated at historic acquisition cost, less accumulated depreciation.

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004****(Amounts in thousands of U.S. dollars, except where otherwise stated)****3. Summary of Significant Accounting Policies (continued)**

The acquisition cost of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the assets have been put into operation, such as repairs and maintenance costs, are normally expensed in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property, plant and equipment. When assets are sold or retired, their cost and accumulated depreciation are eliminated from the accounts and any gain or loss resulting from their disposal is included in other operating expenses of the consolidated statement of income.

The carrying value of property, plant and equipment, as determined above is depreciated on a straight-line basis over the estimated useful lives of the related assets. The following estimated useful lives have been applied:

|                         |             |
|-------------------------|-------------|
| Buildings               | 10-50 years |
| Machinery and equipment | 3-25 years  |
| Computer hardware       | 3-12 years  |
| Other                   | 2-15 years  |

Construction in progress comprises costs directly related to construction of property, plant and equipment plus an appropriate allocation of variable and fixed overheads that are incurred in construction. Construction in progress is depreciated once the property, plant and equipment are put into operation.

The Company capitalizes interest costs with respect to qualifying construction projects.

*Capital Leases Lessor Accounting*

The Company presents assets leased as a receivable equal to the net investment in the lease. Finance income is based on a pattern reflecting a constant periodic rate of return on the net investment outstanding and included in other operating expenses. Initial direct costs are deferred and expensed over the period in which the related revenue is recognized.

*Intangible Assets*

Intangible assets with determinable useful lives are amortized using the straight-line method over their estimated period of benefit, ranging from two to ten years. Indefinite-lived intangibles and intangible assets with determinable useful lives are evaluated annually for impairment or when indicators exist indicating such assets may be impaired, such determination of fair value being based on a valuation model that incorporates expected future cash flows and profitability projections.

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**3. Summary of Significant Accounting Policies (continued)**

*Goodwill*

Goodwill represents the purchase price for businesses acquired in excess of the fair value of identifiable net assets acquired. Goodwill is not amortized, but instead tested for impairment at least annually or whenever indicators of impairment arise.

In cases where the fair value of the net assets acquired exceeds the purchase price, that excess (negative goodwill) is allocated as a pro rata reduction of the amounts that otherwise would have been assigned to the identifiable assets acquired, excluding financial assets other than investments accounted for by the equity method, assets to be disposed of by sale, deferred tax assets and any current assets. If any excess remains after reducing to zero the amounts that otherwise would have been assigned to those assets, that remaining excess is recognized as an extraordinary gain in the period in which the business combination is completed.

*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 Company estimates the future undiscounted cash flows expected to derive 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 Company would then calculate the impairment as the excess of the carrying value of the asset (group) over the estimate of its fair market value. Impairment loss is included in other operating expenses in the consolidated statement of income.

*Revenue Recognition*

Sales are recognized, net of VAT and discounts, when goods are shipped to customers. At the time of shipment, in accordance with the Company's standard sales agreements, the title is transferred and the customer assumes the risk and rewards of ownership. This policy is consistent with the Russian Civil Code, which states that legal title transfers when a product is shipped to a customer unless specifically overridden by the sales agreement.

The Company offers sales volume discounts based on individual customer volumes acquired in a previous month. An accrual for such discounts is made at the end of each accounting period and is recognized as a reduction of revenue in the consolidated statements of income.

*Shipping and Handling Expenses*

Shipping and handling expenses incurred by the Company are reflected in sales and distribution expenses in the accompanying consolidated statements of income.

*Government Grants*

Government grants are recognized when the related cash or assets are received. Government grants are deferred and amortized over the period necessary to match them with the related costs that they are



**Wimm-Bill-Dann Foods**  
**Notes to Consolidated Financial Statements (continued)**  
**Years ended December 31, 2006, 2005 and 2004**  
**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**3. Summary of Significant Accounting Policies (continued)**

intended to compensate. Grants received are treated as deferred income in the accompanying consolidated financial statements. The amortization of government grants related to acquisition of property, plant and equipment is recognized as a reduction of cost of sales when depreciation expense of the related long-term assets is recognized. Interest expense incurred in government grant loan programs is recognized in financial income and expenses, net.

*Debt Issuance Costs*

Debt issuance costs are capitalized and amortized using the straight line method over the life of the related debt.

*Taxation*

Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and loss or tax credit carryforwards using enacted tax rates expected to be in effect at the time these differences are realized. Valuation allowances are recorded for deferred tax assets where it is more likely than not that such assets will not be realized. For financial reporting purposes, a valuation allowance has been recognized to reflect management's estimate of the realization of deferred tax assets. A valuation allowance is provided when it is more likely than not that some or all of the deferred tax assets will not be realized in the future. These evaluations are based on expectations of future taxable income and reversals of various taxable temporary differences.

*Advertising and Marketing Costs*

Advertising and marketing costs are expensed as incurred. Advertising costs for the years ended December 31, 2006, 2005 and 2004 were \$67,538, \$45,336 and \$46,106, respectively, and are reflected as a component of selling and distribution expenses in the accompanying consolidated statements of income (see Note 23).

*Stock Options*

The Company follows the provisions of Statement of Financial Accounting Standards No. 123 (revised) Share-Based Payment (SFAS No. 123R), which requires all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value. The fair value of share-based payment awards is estimated on the date of grant using an option-pricing model. The Company has chosen to use the Black-Sholes Model as the option-pricing model and the value of the portion of the award that is ultimately expected to vest is being recognized as expense on the straight-line method over the requisite service periods.

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**3. Summary of Significant Accounting Policies (continued)**

*Earnings per Share*

Earnings per common share have been determined based upon the weighted average number of shares outstanding during these periods.

*Concentration of Credit Risk*

Financial instruments which potentially expose the Company to concentrations of credit risk consist primarily of cash in banks, short-term bank deposits and trade accounts receivable. The Company deposits available cash with several financial institutions. The credit risk associated with trade accounts receivable is limited due to the Company's large domestic customer base. At December 31, 2006, 2005 and 2004, the Company had no other significant concentrations of credit risk. The Company does not usually require collateral from its customers.

*Fair Value of Financial Instruments*

The carrying amounts of cash and cash equivalents, short-term bank deposits, accounts receivable, accounts payable and short-term loans reported in the consolidated balance sheets approximate fair values due to the short maturity of those instruments. Management is of the opinion that the carrying value of the Company's long-term loans approximates fair value.

*Segment Reporting*

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, requires that a business enterprise reports financial and descriptive information about its reportable operating segments. WBD Foods currently manages its business as three major operating segments - dairy, beverages and baby food production and distribution, and accordingly, reports segment information on this basis.

*Reclassifications*

Where necessary, corresponding figures have been adjusted to conform with changes in the presentation of the current period.

Previously, the Company classified as sales revenue amounts from sales of non-milk inventory and services; related expenses were included in the cost of sales. Commencing 2006, the Company began classifying such items in other operating expenses. Prior net sales and cost of sales have been reclassified accordingly for comparative periods presented in the accompanying financial statements. This change in classification has no effect on previously reported net income.

*New Accounting Pronouncements*

*Accounting for Uncertainty in Income Taxes*

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109, Accounting for Income Taxes. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**3. Summary of Significant Accounting Policies (continued)**

meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 clearly scopes out income taxes from SFAS No. 5, Accounting for Contingencies .

FIN 48 is effective for fiscal years beginning after December 15, 2006; however, early adoption is allowed. The adoption of the provisions of FIN 48 did not have material impact on the Company's financial position and results of operations.

***Accounting for Certain Hybrid Financial Instruments***

In February 2006, the FASB issued SFAS No. 155 *Accounting for Certain Hybrid Financial Instruments*, which amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets*.

SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS No. 155 amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. These provisions of SFAS No. 155 are effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006.

The adoption of the provisions of SFAS No. 155 is not expected to have an impact on the Company's results of operations, financial position or cash flows.

***Accounting for Servicing of Financial Assets***

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets*, which amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

This Statement requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. These provisions of SFAS No. 156 are effective at the beginning of an entity's first fiscal year that begins after September 15, 2006.

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**3. Summary of Significant Accounting Policies (continued)**

The adoption of the provisions of SFAS No. 156 is not expected to have an impact on the Company's results of operations, financial position or cash flows.

*Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*.

This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements.

This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, which amends FASB Statements No. 87, 88, 106 and 132(R).

This Statement improves financial reporting by requiring an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization.

An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006.

The adoption of the provisions of SFAS No. 158 did not have an impact on the Company's results of operations, financial position or cash flows as the Company does not have a defined benefit postretirement plan.

*The Fair Value Option for Financial Assets and Financial Liabilities*

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*.

This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions.

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**3. Summary of Significant Accounting Policies (continued)**

This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007; however, early adoption is allowed.

The adoption of the provisions of SFAS No. 159 is not expected to have an impact on the Company's results of operations, financial position or cash flows.

**4. Businesses Acquired**

*Acquisition of Minority Interests*

In December 2006, WBD Foods acquired 0.26% of WBD OJSC, a subsidiary, from shareholders of WBD Foods for cash consideration of \$812. The purchase price in excess of fair value of net assets acquired of \$415 was recorded as goodwill.

In October 2006, WBD Foods acquired 30.35% of Nazarovskoe Milk OJSC, a subsidiary, from minority shareholders for cash consideration of \$1,982. The purchase price in excess of fair value of net assets acquired of \$771 was recorded as goodwill.

In January 2006, WBD Foods acquired 20% of Moscow Baby Food Plant OJSC, a subsidiary, from minority shareholders for cash consideration of \$6,955. The fair value of net assets acquired in excess of purchase price of \$4,192 was subsequently recorded as a reduction of the value of property, plant and equipment.

In January 2005, WBD Foods acquired 10% of Sibirskoe Moloko dairy plant OJSC, a subsidiary, from minority shareholders for cash consideration of \$1,050. The purchase price in excess of fair value of net assets acquired of \$355 was recorded as goodwill.

The changes in minority interests related to all acquisitions noted above are presented as Acquisitions by the Company of minority interests in subsidiaries in Note 21.

*Business Combinations*

*2006*

In September 2006, the Company acquired 100% of Surgut City Dairy Plant OJSC for cash consideration of \$4,536. The acquisition of Surgut Dairy Plant allows the Company to gain a leading position in a promising region and continue its expansion in the markets of the Urals and Siberia. By having its own enterprise in Surgut, the Company will be able to optimize its expenditure on logistics by reducing the need to transport products between regions.

The fair value of net assets acquired in excess of purchase price of \$617 was subsequently recorded as a reduction of the value of property, plant and equipment.

In November 2006, the Company acquired 93.74% of Ochakovo Dairy Plant OJSC for cash consideration of \$66,792. Ochakovo Dairy Plant is the fourth largest dairy producer in Russia and one of the largest dairy enterprises in Moscow. The plant produces milk, sour cream, yogurts, cheese curds and other dairy products under a strong brand portfolio (including brands such as 33 Cows, Pastushok, Kremlin

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

**(Amounts in thousands of U.S. dollars, except where otherwise stated)**

**4. Businesses Acquired (continued)**

Products and Actilife). The acquisition of Ochakovo Dairy Plant allows the Company to increase its share of the Moscow dairy market in volume and in value, to enrich brand portfolio and obtain a better cooperation with key retailers and suppliers in Moscow and the Moscow region. The cash consideration paid for this acquisition was allocated to property, plant and equipment \$32,479, intangible assets \$12,562, long-term investments \$11, goodwill \$30,501, current assets \$18,686, less liabilities \$27,447.

In December 2006, the Company acquired 83.36% of Angarsky Milk Plant OJSC (Molka OJSC) for cash consideration of \$4,908. The purchase of Molka OJSC allows the Company to strengthen its position in a strategically important region and continue its expansion in the Siberian market. By having its own enterprise in Irkutsk region, the Company gains the ability to optimize logistical expenditures by eliminating the need for long-distance transport of products between regions. The cash consideration paid for this acquisition was allocated to property, plant and equipment \$ 1,923, long-term investments \$2, goodwill \$3,722, current assets \$1,051, less liabilities \$1,790.

In December 2006, the Company acquired 100% of Manros Group for cash consideration of \$51,336. Manros Group comprises six companies of which four are dairy production plants. Manros produces milk, sour cream, yogurts, cottage cheese, kefir and other dairy products under Na zdorovie , Molochnaya Dolina and Vkusnika brands. The acquisition of Manros further strengthens the Company s market position in the fast-growing Siberian region, where continued economic growth is translating into ever growing demand across our proposition of healthy products aimed at the entire family. The cash consideration paid for this acquisition was allocated to property, plant and equipment \$25,191, intangible assets \$5,937, goodwill \$37,053, non-current assets \$240, current assets \$10,365, less liabilities \$27,450. The purchase price allocations are preliminary and may change as a result of changes in the fair value of assets and liabilities of acquired entities. Management expects to finalize purchase price allocations before December 31, 2007.

*2005*

In July 2005, the Company acquired 100% of Experimental Baby Food Plant LLC for cash consideration of \$3,527. Experimental Baby Food Plant LLC produces baby food from raw fruits. The acquisition of Experimental Baby Food Plant LLC allows the Company to increase its product portfolio in the baby food market segment and to keep up with anticipated growth in market demand. The fair value of net assets acquired in excess of purchase price of \$2,335 was subsequently recorded as a reduction of the value of property, plant and equipment.

In July 2005, the Company acquired 66.3% of Obninsk Dairy Plant OJSC for cash consideration of \$6,365. Obninsk Dairy Plant owns several milk product brands and a milk product manufacturing facility. The acquisition of Obninsk Dairy Plant allows the Company to increase its existing product and brand portfolio and establish its presence in Kaluga region to better meet anticipated growth in the local marketplace. The cash consideration paid for this acquisition was allocated to property, plant and equipment \$2,257, intangible assets \$903, goodwill \$1,091, current assets \$2,898, less liabilities \$784.

**Wimm-Bill-Dann Foods**

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2006, 2005 and 2004

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**4. Businesses Acquired (continued)**

In October 2005, the Company acquired 100% of Essentuki mineral water plant CMW (Caucasian Mineral Water) LLC for cash consideration of \$5,505. The acquisition of Essentuki mineral water plant CMW (Caucasian Mineral Water) LLC allows the Company to enhance its existing product and brand portfolio by developing mineral water brand Novoessentukskaya, expand production of mineral water Essentuki in plastic bottles and increase its market share in mineral water segment. Management has established the preliminary purchase price allocation taking into account all relevant information at the time of preparing these consolidated financial statements. The purchase price allocation was completed by the Company in 2006. The cash consideration paid for this acquisition was allocated to property, plant and equipment \$2,066, intangible assets \$358, goodwill \$3,171, current assets \$446 less liabilities \$536.

In December 2005, the Company acquired 63.53% of Nazarovskoe Milk OJSC for cash consideration of \$5,167. The acquired company is one of the major condensed milk producers in Siberian and Far East regions. The acquisition of Nazarovskoe Milk OJSC allows the Company to increase its existing product and brand portfolio and establish its presence in Krasnoyarsk region that possesses a high growth potential. The cash consideration paid for this acquisition was allocated to property, plant and equipment \$4,482, goodwill \$2,007, current assets \$1,798 less liabilities \$3,120.

In December 2005, the Company acquired 100% of Pervouralsk City Dairy for cash consideration of \$119. The purchase price allocation was completed by the Company in 2006. The purchase price in excess of fair value of net assets acquired was recorded as goodwill in amount of \$1,126.

In April, July and September 2005, the Company acquired 100%, 99.34% and 63.5% of Plemzavod Za Mir i Trud OJSC, Zaveti Iicha and Trud farms for cash considerations of \$1,689, \$344 and \$420, respectively. The acquired farms produce raw milk. The acquisitions of Plemzavod Za Mir I Trud OJSC, Zaveti Iicha and Trud farms allow the Company to reduce raw material expenses and become less dependable on raw milk suppliers, as well as to ensure a steady supply of raw milk to keep up with anticipated growth in production driven by anticipated increases in market demand. The fair values of net assets acquired in excess of purchase prices of \$3,894, \$2,761 and \$1,029 were subsequently recorded as a reduction of the values of property, plant and equipment.

**5. Cash and Cash Equivalents**

Cash and cash equivalents as of December 31, 2006 and 2005 were comprised as follows:

|  | 2006             | 2005             |
|--|------------------|------------------|
| Rubles and other CIS currencies        | \$ 39,153        | \$ 91,813        |
| Hard currencies                        | 1,104            | 1,235            |
| Cash equivalents                       | 53               | 55               |
| <b>Total cash and cash equivalents</b> | <b>\$ 40,310</b> | <b>\$ 93,103</b> |

**Wimm-Bill-Dann Foods**

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2006, 2005 and 2004

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**6. Trade Receivables, Net**

Trade receivables as of December 31, 2006 and 2005 were comprised as follows:

|                                     | 2006             | 2005             |
|-------------------------------------|------------------|------------------|
| Trade receivables                   | \$ 97,010        | \$ 65,094        |
| Allowance for doubtful accounts     | (7,078 )         | (5,126 )         |
| <b>Total trade receivables, net</b> | <b>\$ 89,932</b> | <b>\$ 59,968</b> |

The movement in the allowance for doubtful accounts for the years ended December 31, 2006, 2005 and 2004 was as follows:

|                                 | 2006            | 2005            | 2004             |
|---------------------------------|-----------------|-----------------|------------------|
| Balance, beginning of period    | \$ 5,126        | \$ 13,931       | \$ 11,455        |
| Provision for doubtful accounts | 3,130           | 3,908           | 3,722            |
| Write off of trade receivables  | (2,027 )        | (12,358 )       | (1,938 )         |
| Currency translation adjustment | 849             | (355 )          | 692              |
| <b>Balance, end of period</b>   | <b>\$ 7,078</b> | <b>\$ 5,126</b> | <b>\$ 13,931</b> |

**7. Inventory**

Inventory as of December 31, 2006 and 2005 was comprised as follows:

|                        | 2006              | 2005              |
|------------------------|-------------------|-------------------|
| Raw materials          | \$ 101,274        | \$ 83,635         |
| Work in progress       | 16,581            | 10,749            |
| Finished goods         | 56,219            | 36,213            |
| <b>Total inventory</b> | <b>\$ 174,074</b> | <b>\$ 130,597</b> |

Obsolescence and net realizable value expense during 2006, 2005 and 2004 amounted to \$602, \$1,077 and \$3,482, respectively, and was included in cost of sales in the accompanying consolidated statements of income.

**8. Net Investment in Direct Financing Leases**

Commencing from 1999, the Company announced a program called Dairy Rivers of Russia with the purpose of ensuring a steady and reliable source of milk. Under this program the Company acquired agricultural equipment and leased such equipment to several farms. These transactions were classified as direct financing leases. The lease agreements vary from one to five years and provide a free of charge equipment transfer option at the end of the lease term. The lease receivables are denominated in EURO, U.S. dollars and Russian rubles. The lessees have the option to settle the receivable through the delivery of milk supplies to the Company based on a predetermined schedule. The settlement is based on milk prices which are variable dependent upon prevailing market prices.



**Wimm-Bill-Dann Foods**

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2006, 2005 and 2004

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**8. Net Investment in Direct Financing Leases (continued)**

The following lists the components of the net investment in direct financing leases at December 31, 2006 and 2005:

|  | <b>2006</b>     | <b>2005</b>     |
|--|-----------------|-----------------|
| Total future minimum lease payments            | \$ 4,808        | \$ 6,375        |
| Less: Unearned income                          | (1,040 )        | (968 )          |
| <b>Net investment in direct finance leases</b> | <b>\$ 3,768</b> | <b>\$ 5,407</b> |
| Current portion                                | \$ 2,095        | \$ 2,335        |
| Long-term portion                              | 1,673           | 3,072           |

At December 31, 2006, total future minimum lease payments to be received for each of the five succeeding fiscal years are as follows:

|      | <b>Years ended<br/>December 31</b> |
|------|------------------------------------|
| 2007 | \$ 2,706                           |
| 2008 | 1,371                              |
| 2009 | 656                                |
| 2010 | 75                                 |
| 2011 |                                    |

**9. Other Current Assets**

Other current assets as of December 31, 2006 and 2005 were comprised as follows:

|                           | <b>2006</b>      | <b>2005</b>     |
|---------------------------|------------------|-----------------|
| Assets held for sale      | \$ 4,007         | \$ 3,324        |
| Restricted cash           | 9,467            |                 |
| Other debtors, net        | 3,929            | 3,584           |
| Deferred expenses         | 1,750            | 1,649           |
| Other                     | 577              | 358             |
| <b>Total other assets</b> | <b>\$ 19,730</b> | <b>\$ 8,915</b> |

**Wimm-Bill-Dann Foods**

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2006, 2005 and 2004

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**10. Intangible Assets, Net**

Identifiable intangible assets as of December 31, 2006 and 2005 were comprised as follows:

|  | <b>2006</b>           |                     | <b>2005</b>           |                     |
|--|-----------------------|---------------------|-----------------------|---------------------|
|  | <b>Gross carrying</b> | <b>Accumulated</b>  | <b>Gross carrying</b> | <b>Accumulated</b>  |
|  | <b>amount</b>         | <b>amortization</b> | <b>amount</b>         | <b>amortization</b> |
| Intangible assets with determinable lives: |                       |                     |                       |                     |
| Financial accounting software              | \$ 5,025              | \$ (1,172 )         | \$ 3,302              | \$ (228 )           |
| Trademarks                                 | 3,489                 | (1,324 )            | 2,369                 | (456 )              |
| Supplier contracts                         | 907                   | (752 )              | 1,602                 | (1,079 )            |
| Others                                     | 750                   | (65 )               | 825                   | (21 )               |
| Intangible assets with indefinite lives:   |                       |                     |                       |                     |
| Trademarks                                 | 19,986                |                     | 764                   |                     |
| <b>Total intangible assets</b>             | <b>\$ 30,157</b>      | <b>\$ (3,313 )</b>  | <b>\$ 8,862</b>       | <b>\$ (1,784 )</b>  |

Financial accounting software and supplier contracts have a weighted average useful life of five years, and trademarks with determinable lives have a useful life of two to ten years.

Amortization expense during the years ended December 31, 2006, 2005 and 2004 amounted to \$1,564, \$752 and \$445, respectively.

Amortization expense relating to the net carrying amount of intangible assets at December 31, 2006 is estimated to be \$1,412 in 2007, \$1,401 in 2008, \$1,357 in 2009, \$1,275 in 2010 and \$1,244 in 2011.

**11. Property, Plant and Equipment, Net**

The net book value of property, plant and equipment at December 31, 2006 and 2005 was comprised as follows:

|   | <b>2006</b>       | <b>2005</b>       |
|---|-------------------|-------------------|
| Buildings   | \$ 233,166        | \$ 157,823        |
| Machinery and equipment                                 | 511,905           | 446,945           |
| Computer hardware                                       | 22,973            | 15,597            |
| Other   | 49,636            | 36,761            |
| Gross book value of property, plant and equipment       | 817,680           | 657,126           |
| Accumulated depreciation                                | (296,332 )        | (239,305 )        |
| Advances paid for property, plant and equipment         | 32,484            | 10,898            |
| Construction in progress and equipment for installation | 52,896            | 30,808            |
| <b>Total property, plant and equipment, net</b>         | <b>\$ 606,728</b> | <b>\$ 459,527</b> |

The Company capitalized interest costs of \$519, \$410, and \$972 during the years ended December 31, 2006, 2005 and 2004, respectively, with respect to qualified construction projects.

**Wimm-Bill-Dann Foods**

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2006, 2005 and 2004

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**11. Property, Plant and Equipment, Net (continued)**

Depreciation expense during the years ended December 31, 2006, 2005 and 2004 amounted to \$60,765, \$52,683, and \$43,558, respectively.

The assets transferred to the Company upon privatisation do not include the land on which the Company's factories and buildings, comprising the Company's principal manufacturing facilities, are located. The Company has the option to purchase this land upon application to the state registrar body or to continue occupying this land under rental agreements. Russian legislation does not specify an expiry date to this option. As at December 31, 2006 the Company has not filed any application to exercise the purchase option.

**12. Goodwill**

The movement of goodwill for the years ended December 31, 2006 and 2005 comprised:

|                                     |                   |
|-------------------------------------|-------------------|
| Balance at December 31, 2003        | \$ 24,695         |
| Acquisitions                        | 78                |
| Currency translation adjustment     | 1,518             |
| Balance at December 31, 2004        | 26,291            |
| Acquisitions                        | 7,188             |
| Currency translation adjustment     | (1,471 )          |
| Balance at December 31, 2005        | 32,008            |
| Acquisitions                        | 72,462            |
| Impairment loss                     | (2,539 )          |
| Currency translation adjustment     | 4,059             |
| <b>Balance at December 31, 2006</b> | <b>\$ 105,990</b> |

**13. Other Non-Current Assets**

Other non-current assets at December 31, 2006 and 2005 were comprised as follows:

|   | 2006            | 2005            |
|---|-----------------|-----------------|
| Notes issuance expenses, net of amortisation                            | \$ 1,448        | \$ 2,456        |
| Advances for further step acquisition of minority interest in: WBD OJSC | 2,306           |                 |
| Moscow Baby Food Plant ( ZDMP )   | 386             | 1,566           |
| Tsaritsyno Dairy Plant ( TsMK )   | 384             |                 |
| Obninsk Dairy Plant   |                 | 1,350           |
| Sibirskoe Moloko dairy plant  | 146             | 133             |
| Other   | 523             | 648             |
| <b>Total other assets</b>   | <b>\$ 5,193</b> | <b>\$ 6,153</b> |

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**14. Accrued Liabilities**

Accrued liabilities at December 31, 2006 and 2005 were comprised as follows:

|                                  | 2006             | 2005             |
|----------------------------------|------------------|------------------|
| Payroll related accruals         | \$ 26,243        | \$ 11,200        |
| Interest accruals                | 2,281            | 3,154            |
| Other accruals                   | 8,579            | 2,717            |
| <b>Total accrued liabilities</b> | <b>\$ 37,103</b> | <b>\$ 17,071</b> |

**15. Short-Term and Long-Term Loans**

Short-term loans at December 31, 2006 and 2005 comprised the following:

|                               | 2006            |                   |                                      | 2005            |                  |                                      |
|-------------------------------|-----------------|-------------------|--------------------------------------|-----------------|------------------|--------------------------------------|
|                               | No. of<br>loans | Amount            | Weighted<br>average<br>interest rate | No. of<br>loans | Amount           | Weighted<br>average<br>interest rate |
| Ruble denominated             | 24              | \$ 123,849        | 8.09 %                               | 22              | \$ 19,219        | 10.29 %                              |
| U.S. dollar denominated       |                 |                   |                                      | 3               | 335              | 7.92 %                               |
| <b>Total short-term loans</b> |                 | <b>\$ 123,849</b> |                                      |                 | <b>\$ 19,554</b> |                                      |

Long-term loans at December 31, 2006 and 2005 comprised the following:

|   | 2006            |                  |                                      | 2005            |                 |                                      |
|---|-----------------|------------------|--------------------------------------|-----------------|-----------------|--------------------------------------|
|   | No. of<br>loans | Amount           | Weighted<br>average<br>interest rate | No. of<br>loans | Amount          | Weighted<br>average<br>interest rate |
| U.S. dollar denominated                 |                 | \$               |                                      | 1               | \$ 677          | 6.59 %                               |
| EURO denominated                        | 2               | 7,698            | 1.89 %                               | 2               | 3,144           | 4.86 %                               |
| Ruble denominated                       | 22              | 26,521           | 5.41 %                               | 5               | 1,826           | 14.50 %                              |
| Total amount of long-term borrowings    |                 | 34,219           |                                      |                 | 5,647           |                                      |
| Less current portion of long-term loans |                 | (4,137 )         |                                      |                 | (3,823 )        |                                      |
| <b>Total long-term loans</b>            |                 | <b>\$ 30,082</b> |                                      |                 | <b>\$ 1,824</b> |                                      |

*Guarantees*

At December 31, 2006 and 2005, WBD Foods and certain other major subsidiaries guaranteed certain short-term and long-term bank loans received by other subsidiaries of WBD Foods. The aggregate amount of such guarantees equaled the carrying amount of the respective short-term and long-term loans.

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**15. Short-Term and Long-Term Loans (continued)***Unused lines of Credit*

At December 31, 2006 the Company had \$6,940 of unused borrowings under its long-term lines of credit.

*Maturity of Long-Term Loans*

The maturities of long-term loans outstanding at December 31, 2006 was as follows:

|                              | <b>Years ended<br/>December 31,</b> |
|------------------------------|-------------------------------------|
| 2007                         | \$ 4,137                            |
| 2008                         | 6,488                               |
| 2009                         | 6,749                               |
| 2010                         | 9,577                               |
| 2011                         | 7,268                               |
| <b>Total long-term loans</b> | <b>\$ 34,219</b>                    |

*Collateral*

Certain of the Company's inventory, property, plant and equipment served as collateral for the short-term and long-term loans from International Moscow Bank, Rosselkhozbankbank, Gazprombank, Uralsib Bank Nomos-Bank and Sberbank.

At December 31, 2006 and 2005 the assets that served as collateral consisted of the following:

- Inventory in the amounts of \$12,063 and \$3,433, respectively;
- Property, plant and equipment with a net book value of \$34,804 and \$9,381, respectively.

**16. Short-Term and Long-Term Notes Payable**

Notes payable issued by WBD Foods at December 31, 2006 and 2005 comprised the following:

| <b>Maturity</b>              | <b>Currency</b> | <b>2006</b>       | <b>2005</b>       |
|------------------------------|-----------------|-------------------|-------------------|
| Short-term notes             | Ruble           | \$                | \$ 49,794         |
|                              |                 |                   | 49,794            |
| Long-term notes              | U.S. dollar     | \$ 150,000        | \$ 150,000        |
|                              | Ruble           | 98,742            | 104,230           |
| <b>Total long-term notes</b> |                 | <b>\$ 248,742</b> | <b>\$ 254,230</b> |

*WBD Foods U.S. dollar Notes*

On May 21, 2003, UBS (Luxembourg) S.A. issued 8.5% Loan Participation Notes due 2008 for the sole purpose of funding a \$150,000 loan (the Loan) to WBD Foods. The Loan will mature on May 21,



**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**16. Short-Term and Long-Term Notes Payable (continued)**

2008 and bears interest at an annual rate of 8.5%, payable semi-annually in arrears on May 21 and November 21 of each year.

Two of WBD Foods subsidiaries unconditionally, irrevocably, jointly and severally guarantee its obligation under the Loan. The loan agreement contains a number of covenants including requirements to maintain certain financial ratios.

*WBD Foods Ruble Notes*

On April 15, 2003, WBD Foods issued 1,500,000 non-convertible ruble denominated notes at a face value of 1,000 rubles each. The offering raised a total of 1,500,000 thousand rubles. The notes were redeemed by WBD Foods on April 11, 2006. The interest rate for the years ending December 31, 2006 and December 31, 2005 was 11.24% and 10.78%, respectively.

On December 21, 2005, WBD Foods issued 3,000,000 non-convertible ruble denominated notes at a face value of 1,000 rubles each. The offering raised a total of 3,000,000 thousand rubles (\$113,934 at the exchange rate as of December 31 2006 of which \$15,192 have been repaid as of December 31, 2006). The notes are redeemable by WBD Foods on December 15, 2010. The interest rate of the coupon is 9%. Interest is payable semi-annually in arrears commencing on June 21, 2006.

**17. Other Payables**

Other payables primarily represent payables for property, plant and equipment and were comprised as follows as of December 31, 2006 and 2005:

|   | 2006             | 2005             |
|---|------------------|------------------|
| Other payables for property, plant and equipment: |                  |                  |
| Current payables                                  | \$ 9,800         | \$ 5,493         |
| Vendors financing obligations, including          |                  |                  |
| current portion                                   | 15,284           | 15,769           |
| long-term portion                                 | 20,905           | 26,652           |
|   | 45,989           | 47,914           |
| Other payables:                                   |                  |                  |
| Current payables                                  | 11,951           | 8,938            |
| Long-term payables, including                     |                  |                  |
| current portion                                   |                  |                  |
| long-term portion                                 |                  | 241              |
|   | 11,951           | 9,179            |
| <b>Total other payables</b>                       | <b>57,940</b>    | <b>57,093</b>    |
| Less current liabilities                          | (37,035 )        | (30,200 )        |
| <b>Total other long-term payables</b>             | <b>\$ 20,905</b> | <b>\$ 26,893</b> |

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**17. Other Payables (continued)**

The Company has agreements with suppliers of equipment which provide financing for the periods ranging from 1 to 9 years. As of December 31, 2006 and 2005, vendor financing obligations were \$21,013 and \$29,677, respectively, EURO 10,628 thousand and EURO 10,050 thousand (equivalent to \$14,004 and \$11,937 as of December 31, 2006 and 2005, respectively) 30,858 thousand rubles and 23,225 thousand rubles (equivalent to \$1,172 and \$807 as of December 31, 2006 and 2005, respectively). This financing is provided at interest rates of LIBOR plus 1.5%, EURIBOR plus 1.5% and 14.0% for U.S. dollar, EURO and ruble denominated contracts, respectively. The majority of equipment financing is provided by one supplier. At December 31, 2006 and 2005, property, plant and equipment amounting to \$33,141 and \$47,728, respectively, served as collateral under these financing agreements.

The maturity of vendors financing obligations and other long-term payables outstanding at December 31, 2006 was as follows:

|  | <b>Years ended<br/>December 31,</b> |
|--|-------------------------------------|
| 2007   | \$ 15,284                           |
| 2008   | 10,580                              |
| 2009   | 7,995                               |
| 2010   | 1,937                               |
| 2011   | 393                                 |
| Total maturity of other long-term payables       | 36,189                              |
| Less current portion of other long-term payables | (15,284 )                           |
| <b>Total other long-term payables</b>            | <b>\$ 20,905</b>                    |

**18. Income Tax**

WBD Foods provision for income taxes for the years ended December 31, 2006, 2005 and 2004 was as follows:

|   | <b>2006</b>      | <b>2005</b>      | <b>2004</b>      |
|---|------------------|------------------|------------------|
| Current income tax provision            | \$ 48,232        | \$ 27,385        | \$ 18,189        |
| Deferred income tax charge/(benefit)    | (6,672 )         | 3,327            | (6,019 )         |
| <b>Total provision for income taxes</b> | <b>\$ 41,560</b> | <b>\$ 30,712</b> | <b>\$ 12,170</b> |

WBD Foods statutory income tax rate was 24% for the periods presented above.

Foreign current income tax provisions for the years ended December 31, 2006, 2005 and 2004 were \$2,372, \$700 and \$534, respectively. Foreign deferred income tax charge/(benefit) for the years ended December 31, 2006, 2005 and 2004 were \$(258), \$637 and \$(1,255), respectively.



**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004****(Amounts in thousands of U.S. dollars, except where otherwise stated)****18. Income Tax (continued)**

The actual provision for income taxes reconciled to WBD Foods' theoretical tax provision at statutory rate was as follows for the respective periods ended:

|  | 2006      |               | 2005      |               | 2004      |               |
|--|-----------|---------------|-----------|---------------|-----------|---------------|
| Income before provision for income taxes   | \$        | 140,141       | \$        | 64,627        | \$        | 38,305        |
| Russian statutory tax rate   |           | 24            | %         | 24            | %         | 24            |
| Theoretical tax provision at statutory rate  |           | 33,634        |           | 15,510        |           | 9,193         |
| Tax effect of expenses not deductible for national statutory taxation purposes     |           | 10,829        |           | 12,341        |           | 6,232         |
| Tax effect of income not taxable for national statutory taxation purposes          |           | (2,172)       |           | (974)         |           | (248)         |
| Tax effect of income tax privileges relating to small business enterprises benefit |           |               |           | (275)         |           | (1,278)       |
| Tax effect of income tax at different rates  |           | (849)         |           | 470           |           | 550           |
| Increase (decrease) in valuation allowance   |           | (370)         |           | 2,609         |           | (2,258)       |
| Tax effect of other  |           | 488           |           | 1,031         |           | (21)          |
| <b>Actual provision for income taxes</b>   | <b>\$</b> | <b>41,560</b> | <b>\$</b> | <b>30,712</b> | <b>\$</b> | <b>12,170</b> |

The income tax benefit for small enterprises was abolished as of January 1, 2002 and continued to be available to enterprises that were established before July 1, 2001. Such enterprises were exempt from income taxes for the first two years of operations and in the third and fourth years income taxes were levied at a rate of 25% and 50% of the income tax rate, respectively. Starting from January 1, 2002 the Company's juice production primarily concentrated in two small enterprises, Fruit Rivers and Nectarin, which were registered in March and April 2001, respectively. These WBD Foods subsidiaries utilized small business enterprises income tax benefits until March 31, 2005.

Unused credits, such as profit tax privileges, may not usually be carried forward under Russian tax legislation. Accordingly, tax credits are reflected in the Company's consolidated financial statements only to the extent and in the year in which the credits are utilized.

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004****(Amounts in thousands of U.S. dollars, except where otherwise stated)****18. Income Tax (continued)**

Temporary differences between the tax bases of assets and liabilities and the respective carrying amounts in these consolidated financial statements give rise to the following deferred tax assets and liabilities at December 31, 2006 and 2005:

|   | 2006               | 2005               |
|---|--------------------|--------------------|
| Deferred tax assets/(liabilities) arising from tax effect of:                           |                    |                    |
| Losses carried forward  | \$ 8,541           | \$ 10,486          |
| Intangible assets   | 867                | 1,058              |
| Property, plant and equipment   | 8,646              | 4,359              |
| Net investments in direct financing leases  |                    | 1,297              |
| Allowance for doubtful accounts   | 4,883              | 3,557              |
| Obsolescence and net realizable value inventory write off and other accrued liabilities | 2,448              | 1,729              |
| Payroll related accruals  | 4,265              | 907                |
| Other   | 1,188              | 896                |
| Gross deferred tax asset  | 30,838             | 24,289             |
| Less valuation allowance for deferred tax asset   | (7,097 )           | (7,467 )           |
| Deferred tax asset net of valuation allowance   | 23,741             | 16,822             |
| Intangible assets   | (5,035 )           | (1,451 )           |
| Property, plant and equipment   | (22,183 )          | (14,357 )          |
| Net investments in direct financing leases  | (2,896 )           | (1,114 )           |
| Bonds issuance costs  | (348 )             | (589 )             |
| Other   | (68 )              | (643 )             |
| Gross deferred tax liability  | (30,530 )          | (18,154 )          |
| <b>Net deferred tax (liability)/asset</b>   | <b>\$ (6,789 )</b> | <b>\$ (1,332 )</b> |
| Analyzed as to:   |                    |                    |
| Current deferred tax asset  | 12,749             | 8,750              |
| Long-term deferred tax asset  | 8,737              | 5,554              |
| Long-term deferred tax liability  | (28,275 )          | (15,636 )          |

In the context of the Company's current structure, tax losses and current tax assets of the different subsidiaries may not be set off against current tax liabilities and taxable profits of other subsidiaries and, accordingly, taxes may accrue even where there is a net consolidated tax loss. Therefore, deferred tax assets of one subsidiary of the Company are not offset against deferred tax liabilities of another subsidiary. As at December 31, 2006 and 2005, a valuation allowance has been recorded for deferred tax assets in the amounts of \$7,097 and \$7,467, respectively, as it is not more likely than not that sufficient taxable profit will be available to offset the deductible temporary differences to which these assets relate.

For statutory income tax purposes, WBD Foods and its subsidiaries had accumulated tax losses of \$34,797 which may be carried forward for use against future taxable income, of which \$4,041, \$12,783,

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004****(Amounts in thousands of U.S. dollars, except where otherwise stated)****18. Income Tax (continued)**

\$10,283 and \$7,690 expire in the period 2008-2013, 2014, 2015 and 2016 respectively. The use of accumulated tax losses of the Russian subsidiaries is fully usable starting from the year 2007.

As of December 31, 2006, Fruktopak had deferred tax asset of \$1,387 as related to net taxable loss carried forward. Management believes that the loss will be realized in full against the future taxable income of Ramenskiy Plant, to which it merged on May 16, 2006, during the year ended December 31, 2007.

**19. Government Grants**

In 1993-1999 ZDMP received capital grants from the Russian and Moscow Governments. These grants related to the acquisition of property, plant and equipment for baby food production and are recognized in the consolidated statements of income in the period in which the depreciation expense on the related property, plant and equipment is incurred. The conditions of the grants are that ZDMP must continue to use the related property, plant and equipment for baby food production. Management believes that it has complied with this condition and will continue to comply in the future.

The movement in capital government grants during the years ended December 31, 2006 and 2005 comprised:

|   |                 |
|---|-----------------|
| Balance at December 31, 2004                      | \$ 7,485        |
| Amortization                                      | (2,107 )        |
| Currency translation adjustment                   | 15              |
| Balance at December 31, 2005                      | 5,393           |
| Amortization                                      | (2,507 )        |
| Decrease related to minority interest acquisition | (646 )          |
| Currency translation adjustment                   | 307             |
| <b>Balance at December 31, 2006</b>               | <b>\$ 2,547</b> |

Grants are amortized once the related property, plant and equipment are put into operation. Amortization is reported as a reduction in the depreciation expense of the related property, plant and equipment.

During the year ended December 31, 2006 and 2005, WBD Foods received operating grants from the Russian Government and Moscow City Government in the amount of \$0 and \$276, respectively. These grants related to interest rates on loans used for acquisition of milk and other raw materials, and are recognized in the consolidated statements of income in the period in which the related interest expense is incurred. The grants were provided at the lower of two-thirds of the Central Bank of Russia interest rate (equating to 11% at December 31, 2006) or actual amount of the interest expense. The conditions of the grants are that WBD Foods must use the related loans received from Russian banks for the acquisition of milk and other raw materials.

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004****(Amounts in thousands of U.S. dollars, except where otherwise stated)****20. Shareholders Equity**

In accordance with Russian corporate laws, earnings available for dividends are limited to profits, denominated in domestic currency, after certain deductions. At December 31, 2006 retained earnings of WBD Foods which are distributable under statutory legislation totaled 737 million rubles (\$28,005 at the exchange rate as of December 31, 2006).

**21. Minority Interest**

The movement in minority interest during the years ended December 31, 2006 and 2005 comprised:

|   |                  |
|---|------------------|
| <b>Balance at December 31, 2004</b>                               | <b>\$ 17,327</b> |
| Acquisitions by the Company of minority interests in subsidiaries | (1,081 )         |
| Acquisition of subsidiaries                                       | 5,312            |
| Minority interest share in net income                             | 3,649            |
| Currency translation adjustment                                   | (588 )           |
| <b>Balance at December 31, 2005</b>                               | <b>\$ 24,619</b> |
| Acquisitions by the Company of minority interests in subsidiaries | (12,906 )        |
| Acquisition of subsidiaries                                       | 2,446            |
| Minority interest share in net income                             | 3,197            |
| Currency translation adjustment                                   | 1,621            |
| <b>Balance at December 31, 2006</b>                               | <b>\$ 18,977</b> |

**22. Cost of Sales**

Cost of sales for 2006, 2005, and 2004 were comprised of the following:

|                               | <b>2006</b>         | <b>2005</b>       | <b>2004</b>       |
|-------------------------------|---------------------|-------------------|-------------------|
| Raw materials                 | \$ 986,477          | \$ 836,404        | \$ 726,934        |
| Personnel                     | 68,464              | 50,030            | 44,283            |
| Depreciation and amortization | 50,136              | 41,921            | 34,577            |
| Utilities                     | 29,240              | 21,222            | 17,378            |
| Goods for resale              | 22,556              | 16,724            | 6,663             |
| Other                         | 37,286              | 32,705            | 28,932            |
| <b>Total cost of sales</b>    | <b>\$ 1,194,159</b> | <b>\$ 999,006</b> | <b>\$ 858,767</b> |

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004****(Amounts in thousands of U.S. dollars, except where otherwise stated)****23. Selling and Distribution Expenses**

Selling and distribution expenses for 2006, 2005, and 2004 were comprised of the following:

|  | 2006              | 2005              | 2004              |
|--|-------------------|-------------------|-------------------|
| Advertising and marketing                      | \$ 76,194         | \$ 57,936         | \$ 54,298         |
| Personnel                                      | 55,955            | 47,665            | 43,831            |
| Shipping and handling                          | 73,565            | 52,995            | 45,938            |
| Bad debt expense                               | 3,130             | 3,908             | 3,722             |
| Materials and supplies                         | 9,369             | 10,446            | 8,447             |
| Warehouse                                      | 10,986            | 9,525             | 8,937             |
| Other  | 16,855            | 9,515             | 8,260             |
| <b>Total selling and distribution expenses</b> | <b>\$ 246,054</b> | <b>\$ 191,990</b> | <b>\$ 173,433</b> |

**24. General and Administrative Expenses**

General and administrative expenses for 2006, 2005, and 2004 were comprised of the following:

|  | 2006              | 2005              | 2004             |
|--|-------------------|-------------------|------------------|
| Personnel  | \$ 78,227         | \$ 61,830         | \$ 53,250        |
| Taxes other than income tax                      | 12,789            | 13,194            | 11,782           |
| Audit, consulting and legal fees                 | 10,506            | 5,567             | 4,655            |
| Depreciation                                     | 7,215             | 5,711             | 4,576            |
| Materials and supplies                           | 2,462             | 3,268             | 3,226            |
| Communication costs                              | 2,731             | 2,880             | 2,331            |
| Rent   | 2,670             | 2,177             | 2,268            |
| Security expenses                                | 1,441             | 1,638             | 469              |
| Insurance  | 2,031             | 1,561             | 1,367            |
| Other  | 14,409            | 11,816            | 8,892            |
| <b>Total general and administrative expenses</b> | <b>\$ 134,481</b> | <b>\$ 109,642</b> | <b>\$ 92,816</b> |

**25. Financial Income and Expenses, Net**

Financial income and expense, net for 2006, 2005, and 2004 were comprised of the following:

|  | 2006             | 2005             | 2004             |
|--|------------------|------------------|------------------|
| Interest expense                               | \$ 27,898        | \$ 23,388        | \$ 22,348        |
| Interest income                                | (4,372)          | (1,569)          | (1,421)          |
| Currency remeasurement (gains), net            | (10,288)         | (1,231)          | (7,673)          |
| Bank charges                                   | 2,070            | 1,983            | 1,857            |
| Other financial expense /(income), net         | 172              | 297              | (493)            |
| <b>Total financial income and expense, net</b> | <b>\$ 15,480</b> | <b>\$ 22,868</b> | <b>\$ 14,618</b> |

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**26. Pension Costs**

In the normal course of business, WBD Foods and its subsidiaries contribute to the Russian Federation state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred. Governmental pension contributions are included in personnel costs in the consolidated statements of income. Pension costs amounted to \$26,270, \$20,282 and \$20,557 in 2006, 2005 and 2004, respectively. WBD Foods has no other pension obligations.

**27. Segment Information**

The Company's major reportable business segments are dairy, beverages and baby food. These segments are strategic business units that produce and offer distinctive products, i.e. sterilized and pasteurized milk, yogurts, dairy desserts, and other dairy products in the dairy segment; fruit juices, nectars, juice based drinks and bottled mineral water in the beverages segment and milk and juice based baby food products in the baby food segment.

WBD Foods' accounting policy for segments is the same as that described in the summary of significant accounting policies. Management evaluates segment performance based on segment profit or loss before minority interests and deferred taxes. Transfers between segments are made at values that approximate market values.

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**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**27. Segment Information (continued)****Operating Segments 2006**

|  | <b>Dairy</b>      | <b>Beverages</b>  | <b>Baby food</b> | <b>Common and corporate assets/expenses</b> | <b>Intersegment receivables</b> | <b>Consolidated</b> |
|--|-------------------|-------------------|------------------|---|---------------------------------|---------------------|
| Total sales  | \$ 1,339,621      | \$ 324,074        | \$ 117,152       | \$  |                                 | \$ 1,780,847        |
| Inter segment sales  | (18,720 )         |                   |                  |   |                                 | (18,720 )           |
| Sales to external customers  | 1,320,901         | 324,074           | 117,152          |   |                                 | 1,762,127           |
| Cost of sales  | (917,813 )        | (209,630 )        | (66,716 )        |   |                                 | (1,194,159 )        |
| Gross profit   | 403,088           | 114,444           | 50,436           |   |                                 | 567,968             |
| Operating expenses   | (243,943 )        | (105,712 )        | (18,116 )        | (44,576 )                                   |                                 | (412,347 )          |
| Operating income (loss)  | 159,145           | 8,732             | 32,320           | (44,576 )                                   |                                 | 155,621             |
| Financial income and expense, net and current provision for income taxes | (39,809 )         | (3,900 )          | (8,688 )         | (11,315 )                                   |                                 | (63,712 )           |
| Net segment profit (loss)  | \$ 119,336        | \$ 4,832          | \$ 23,632        | \$ (55,891 )                                |                                 | \$ 91,909           |
| Deferred tax (charge)/benefit  |                   |                   |                  |   |                                 | 6,672               |
| Minority interest  |                   |                   |                  |   |                                 | (3,197 )            |
| Net income (loss)  |                   |                   |                  |   |                                 | \$ 95,384           |
| <b>Total assets</b>  | <b>\$ 915,244</b> | <b>\$ 214,706</b> | <b>\$ 90,122</b> | <b>\$ 128,683</b>                           | <b>\$ (172,819 )</b>            | <b>\$ 1,175,936</b> |
| <b>Expenditure for property, plant and equipment</b>                     | <b>\$ 93,322</b>  | <b>\$ 13,474</b>  | <b>\$ 19,356</b> | <b>\$ 3,811</b>                             |                                 | <b>\$ 129,963</b>   |
| <b>Depreciation and amortization</b>                                     | <b>\$ 46,849</b>  | <b>\$ 11,515</b>  | <b>\$ 3,010</b>  | <b>\$ 955</b>                               |                                 | <b>\$ 62,329</b>    |

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**27. Segment Information (continued)***Operating Segments 2005*

|  | <b>Dairy</b>      | <b>Beverages</b>  | <b>Baby<br/>food</b> | <b>Common and<br/>corporate<br/>assets/expenses</b> | <b>Intersegment<br/>receivables</b> | <b>Consolidated</b> |
|--|-------------------|-------------------|----------------------|---|-------------------------------------|---------------------|
| Total sales  | \$ 1,005,774      | \$ 303,147        | \$ 87,839            | \$ 3  |                                     | \$ 1,396,763        |
| Inter segment sales  | (2,173 )          |                   |                      |   |                                     | (2,173 )            |
| Sales to external customers  | 1,003,601         | 303,147           | 87,839               | 3   |                                     | 1,394,590           |
| Cost of sales  | (750,663 )        | (193,846 )        | (54,480 )            | (17 )   |                                     | (999,006 )          |
| Gross profit   | 252,938           | 109,301           | 33,359               | (14 )   |                                     | 395,584             |
| Operating expenses   | (177,672 )        | (88,078 )         | (11,593 )            | (30,746 )   |                                     | (308,089 )          |
| Operating income (loss)  | 75,266            | 21,223            | 21,766               | (30,760 )   |                                     | 87,495              |
| Financial income and expense, net and current provision for income taxes | (14,663 )         | (6,433 )          | (5,050 )             | (24,107 )   |                                     | (50,253 )           |
| <b>Net segment profit (loss)</b>   | <b>\$ 60,603</b>  | <b>\$ 14,790</b>  | <b>\$ 16,716</b>     | <b>\$ (54,867 )</b>                                 |                                     | <b>\$ 37,242</b>    |
| Deferred tax (charge)/benefit  |                   |                   |                      |   |                                     | (3,327 )            |
| Minority interest  |                   |                   |                      |   |                                     | (3,649 )            |
| Net income (loss)  |                   |                   |                      |   |                                     | <b>\$ 30,266</b>    |
| <b>Total assets</b>  | <b>\$ 572,981</b> | <b>\$ 213,009</b> | <b>\$ 70,638</b>     | <b>\$ 131,964</b>                                   | <b>\$ (68,035 )</b>                 | <b>\$ 920,557</b>   |
| <b>Expenditure for property, plant and equipment</b>                     | <b>\$ 59,922</b>  | <b>\$ 12,962</b>  | <b>\$ 1,754</b>      | <b>\$ 472</b>                                       |                                     | <b>\$ 75,110</b>    |
| <b>Depreciation and amortization</b>                                     | <b>\$ 41,209</b>  | <b>\$ 8,565</b>   | <b>\$ 2,993</b>      | <b>\$ 668</b>                                       |                                     | <b>\$ 53,435</b>    |



**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**27. Segment Information (continued)****Operating Segments 2004**

|  | <b>Dairy</b>      | <b>Beverages</b>  | <b>Baby food</b> | <b>Common and corporate assets/expenses</b> | <b>Intersegment receivables</b> | <b>Consolidated</b> |
|--|-------------------|-------------------|------------------|---|---------------------------------|---------------------|
| Total sales  | \$ 824,509        | \$ 301,050        | \$ 64,657        | \$  |                                 | \$ 1,190,216        |
| Inter segment sales  | (6,230 )          |                   |                  |   |                                 | (6,230 )            |
| Sales to external customers  | 818,279           | 301,050           | 64,657           |   |                                 | 1,183,986           |
| Cost of sales  | (618,918 )        | (199,232 )        | (40,611 )        | (6 )  |                                 | (858,767 )          |
| Gross profit   | 199,361           | 101,818           | 24,046           | (6 )  |                                 | 325,219             |
| Operating expenses   | (151,623 )        | (86,919 )         | (7,266 )         | (26,488 )                                   |                                 | (272,296 )          |
| Operating income (loss)  | 47,738            | 14,899            | 16,780           | (26,494 )                                   |                                 | 52,923              |
| Financial income and expense, net and current provision for income taxes | (14,472 )         | (3,348 )          | (3,862 )         | (11,125 )                                   |                                 | (32,807 )           |
| Net segment profit (loss)  | \$ 33,266         | \$ 11,551         | \$ 12,918        | \$ (37,619 )                                |                                 | \$ 20,116           |
| Deferred tax (charge)/benefit  |                   |                   |                  |   |                                 | 6,019               |
| Minority interest  |                   |                   |                  |   |                                 | (3,161 )            |
| Net income (loss)  |                   |                   |                  |   |                                 | \$ 22,974           |
| <b>Total assets</b>  | <b>\$ 544,592</b> | <b>\$ 226,084</b> | <b>\$ 56,230</b> | <b>\$ 24,671</b>                            | <b>\$ (55,489 )</b>             | <b>\$ 796,088</b>   |
| <b>Expenditure for property, plant and equipment</b>                     | <b>\$ 57,161</b>  | <b>\$ 8,817</b>   | <b>\$ 5,092</b>  | <b>\$ 1,569</b>                             |                                 | <b>\$ 72,639</b>    |
| <b>Depreciation and amortization</b>                                     | <b>\$ 29,856</b>  | <b>\$ 11,009</b>  | <b>\$ 2,234</b>  | <b>\$ 904</b>                               |                                 | <b>\$ 44,003</b>    |

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**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**27. Segment Information (continued)**

The changes in the carrying amount of goodwill for each segment for the years ended December 31, 2006, 2005 and 2004 were as follows:

|                                     | Dairy            | Beverages       | Baby food | Total             |
|-------------------------------------|------------------|-----------------|-----------|-------------------|
| Balance at December 31, 2004        | \$ 22,398        | \$ 3,893        | \$        | \$ 26,291         |
| Acquisitions                        | 3,765            | 3,423           |           | 7,188             |
| Write-off                           |                  |                 |           |                   |
| Currency translation adjustment     | (805 )           | (666 )          |           | (1,471 )          |
| Balance at December 31, 2005        | 25,358           | 6,650           |           | 32,008            |
| Acquisitions                        | 72,462           |                 |           | 72,462            |
| Write-off                           | (2,539 )         |                 |           | (2,539 )          |
| Currency translation adjustment     | 3,734            | 325             |           | 4,059             |
| <b>Balance at December 31, 2006</b> | <b>\$ 99,015</b> | <b>\$ 6,975</b> | <b>\$</b> | <b>\$ 105,990</b> |

For the years ended December 31, 2006, 2005, and 2004, approximately 93%, 92%, and 94% of sales were generated in and sold to customers in Russia. As of December 31, 2006, 2005 and 2004, the long-lived assets of the Company were primarily located in Russia.

The majority of the Company's packaging materials is purchased from one supplier. There can be no assurance that, in the event of a loss of this supplier or unfavourable developments in the business practices of this supplier, substantially all of the current levels of packaging materials could be purchased at comparable, or nearly comparable, prices on the international market.

**28. Dividends**

At the annual shareholders' meeting on June 30, 2006, dividends per common share were declared in the amount of 6.87 Russian rubles per common share (of which 4.60 Russian rubles are attributable for the period of 2002-2004 and 2.27 Russian rubles are attributable for the first quarter of 2006) which at the date of the meeting was equivalent to \$0.25. The dividends were paid to shareholders in August 2006.

At the shareholders' meeting on December 5, 2006 dividends per common share for nine months ended September 30, 2006 were declared in the amount of 7.86 Russian rubles per common share which at the date of the meeting was equivalent to \$0.30. The dividends were paid to shareholders in December 2006.

**29. Share-based Awards**

In 2006 the Company entered into share-based award agreements with a number of its executives. The arrangements include annual awards of 225,000 share options in each of the three years beginning in 2006 and 200,000 share options in both 2009 and 2010. The exercise price of the options equals the average sales price of the stock over the 90 days period preceding each annual grant. Each tranche vests one-third annually over a three year period and can be settled in cash. The contractual terms of options is from three to five years from grant date.

**Wimm-Bill-Dann Foods****Notes to Consolidated Financial Statements (continued)****Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**29. Share-based Awards (continued)**

In accordance with SFAS No. 123R the awards have been accounted for as a liability and, as such, the awards' fair value will be remeasured at each reporting date until the date of settlement.

Compensation cost for each period until settlement is based on recording the change, dependant on the percentage of the requisite service period that has been rendered at the reporting date, in the fair value of the award for each reporting period.

In 2006, 200,000 share options were granted at an exercise price of \$25.32 per share, and 25,000 share options were granted at an exercise price of \$39.29 per share. As of the grant date, the Company expected that all of the shares will vest. The Company expensed \$2,136 for all share-based awards for the period from the respective grant dates to December 31, 2006.

During 2006, none of the share options were canceled, forfeited or exercised and, as of December 31, 2006, none of the share options outstanding are vested or exercisable.

The aggregate intrinsic value of share options that are currently outstanding as of December 31, 2006 and that are expected to be exercised in the future is \$8,927. The estimated weighted average fair value of the individual share options as of December 31, 2006 was \$41.23.

The determination of fair value of share-based awards on the date of grant and each subsequent reporting date, using an option-pricing model, is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards and projected employee stock options exercise behaviors.

A summary of the assumptions used in the application of the Black-Sholes option valuation model as of the grant dates in 2006 were as follows:

|                            |              |   |
|----------------------------|--------------|---|
| Volatility(1)              | 32.28%-36.55 | % |
| Risk-free interest rate(2) | 6.10%-6.18   | % |
| Dividend yield(3)          | 0.77%-1.53   | % |
| Expected life (years)(4)   | 3 years      |   |

(1) The volatility is based on historical volatility of the Company's common stock over the same term as the expected term of the award.

(2) The risk-free rate is based on the Russian Federation Government Bond with expected term similar to the expected term of the award.

(3) The dividend yield is based on expected annual dividends per share and the share price as of the grant date.

(4) The expected life is based on the contractual term of the share options and assumption that the options will be exercised after the vesting period but before end of contractual term.

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**30. Related Parties**

*Wimm-Bill-Dann Trans*

During 2006, 2005 and 2004 the Company received transportation services from Wimm-Bill-Dann Trans ( WBD Trans ), a closed joint stock company, which is a WBD Foods investee, amounting to approximately \$11,713, \$11,687 and \$11,149, respectively. As of December 31, 2006, 2005 and 2004 advances paid to WBD Trans in respect of transportation services amounted to \$233, \$176 and \$247, respectively.

*Milk Suppliers*

During 2006, 2005 and 2004 the Company purchased milk from certain milk supplying companies, which are controlled by members of the control group of shareholders, amounting to \$12,175, \$4,493 and \$2,614, respectively. As of December 31, 2006 and 2005 accounts payable to these milk supplying companies in respect of milk received amounted to \$373 and \$134, respectively.

*AlfaStrahovanie*

In 2006 one of the members of WBD Foods Board of Directors was also a member of the Board of Directors in insurance company AlfaStrahovanie. Insurance services received from AlfaStrahovanie in 2006 amounted approximately to \$660. As of December 31, 2006 accounts payable to AlfaStrahovanie in respect to these services amounted to \$284.

*Echo of Moscow*

Through 2006 one of the members of WBD Foods Board of Directors was also a member of the Board of Directors in broadcasting company Echo of Moscow. Advertising services received from Echo of Moscow in 2006 amounted approximately to \$116. As of December 31, 2006 advances paid to Echo of Moscow in respect to these services amounted to \$1.

*Current Shareholders*

During 2006, WBD Foods acquired 0.26% interest in WBD OJSC from current shareholders for \$812 (see Note 4).

During 2004, WBD Foods acquired 6.2% interest in TsMK from current shareholders for \$3,406 (see Note 4).

During 2004 the Company paid for legal services, in the amount of \$507 respectively, on behalf of certain shareholders. As of December 31, 2004 all these amounts were fully repaid by the shareholders.

**31. Commitments and Contingencies**

*Property, Plant and Equipment Purchase Commitments*

As of December 31, 2006, contracted expenditures for the purchase of property, plant and equipment in the period subsequent to December 31, 2006 were \$10,078, payable in 2007.

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**31. Commitments and Contingencies (continued)**

*Insurance*

As of December 31, 2006, the Company had insurance coverage of \$485,178 in respect of property, plant and equipment at 20 major legal entities. The Company had insurance for business interruption at 14 major manufacture facilities with total coverage of \$421,732. At 26 legal entities the Company had product liability insurance with \$1,000 liability coverage per insurance case within the territory of Russia and CIS countries, \$2,500 liability coverage per insurance case worldwide except for territory of Russia and CIS countries with the cumulative coverage of \$5,000. Until the Company obtains insurance coverage for an amount exceeding the carrying value of property, plant and equipment, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Company's operations and financial position.

*Taxation*

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged 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 its 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. As such, significant additional taxes, penalties and interest may be assessed. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavorable outcome. 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.

Overall, management believes that the Group has paid or accrued all taxes that are applicable as at December 31, 2006. Where uncertainty exists, the Group has accrued tax liabilities based on management's best estimate of the probable outflow of resources embodying economic benefits, which will be required to settle these liabilities. Possible liabilities which were identified by management at the balance sheet date as those that can be subject to different interpretations of the tax laws and regulations are not accrued in the consolidated financial statements.

*Taxation*

During the period 2003 to March 31, 2005 certain subsidiaries of WBD Foods utilized small business enterprises income tax benefits which were available under Russian income tax legislation being in force before January 1, 2002. The Company believes that the tax savings to the Company for the period 2003 to March 31, 2005 in respect of these income tax benefits amounted to approximately \$5,349. Should the Russian tax authorities question the appropriate use of these benefits by WBD Foods' subsidiaries for the years 2003, 2004, and January-March 2005, issue a claim and prove successful in the court, they would be entitled to recover the amount claimed, together with penalties amounting to 20% of such amount and interest at the rate of 1/300th of the Central Bank of Russia rate, equating to 0.036% as of December 31, 2006, for each day of delay for late payment of such amounts. In any case, WBD Foods' management

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**31. Commitments and Contingencies (continued)**

believes that it has strong grounds on which to oppose any such claim and will vigorously defend its position.

*Transfer Pricing*

Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to control prices for transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions or transactions with significant price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and arbitration courts and their use in politically motivated investigations and prosecutions. We believe that the prices used by our group are market prices and, therefore, comply with the requirements of Russian tax law on transfer pricing. However, due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and propose adjustments. If such price adjustments are upheld by the Russian arbitration courts and implemented, our results of operations could be materially adversely affected. In addition, we could face significant losses associated with the assessed amount of prior tax underpaid and related interest and penalties, which would have a material adverse effect on our financial condition and results of operations.

**32. Impairment of Tangible Assets and Goodwill**

The Company performs asset impairment analyses on its facilities on an ongoing basis. During 2006 a review of all non-current assets was performed in relation to a future company strategy which was altered with the change in top management. The assessment considered the potential recoverability of the carrying amounts of fixed assets and positive goodwill.

As a result of this review the Company has recognized an impairment loss of \$18,172 in the year ended December 31, 2006, including \$15,633 related to fixed assets and intangible assets and \$2,539 related to positive goodwill (Novokuibyshevsk plant). The related deferred tax benefit amounted to \$3,153.

The impairment loss charge was included in *Other Operating Expenses* line of Income Statement for the year ended December 31, 2006. This amount is attributable to operational segments as follows: Dairy \$7,196, Beverages \$10,976.

The impairment was recognized based on the standards promulgated by the Financial Accounting Standard Board. Such standards require the recognition of an impairment charge when the cash flows resulting from the operation of an asset are expected to be less than its book value.

**33. Restructuring Costs**

In 2006 the company has undergone certain restructuring changes targeted at optimization of personnel headcount and decrease of personnel expenses in Dairy, Beverage and Holding operational segments. The optimization was carried out through the liquidation of duplicated functions and excessive labour force. According to these changes, a number of employees have been laid-off and compensated for it.

**Wimm-Bill-Dann Foods**

**Notes to Consolidated Financial Statements (continued)**

**Years ended December 31, 2006, 2005 and 2004**

(Amounts in thousands of U.S. dollars, except where otherwise stated)

**33. Restructuring Costs (continued)**

The restructuring charges mainly relate to redundancy costs, which for the year ended December 31, 2006 totaled \$4,605. This amount is attributable to operating segments as follows: Dairy \$1,867, Beverages \$2,412, Holding \$326. The restructuring costs were included in Other Operating Expenses line of Income Statement. Of the total, \$2,090 is accrued as Accrued liabilities as of December 31, 2006.

**34. Subsequent Events**

On February 6, 2007, UBS (Luxembourg) S.A. issued 7.5% Loan Participation Notes due 2008 for the sole purpose of funding a \$150,000 loan (the Loan ) to WBD Foods. The Loan will mature on May 14, 2008 and bears interest at an annual rate of 7.5%, payable in two installments on November 14, 2007 and May 14, 2008. The loan agreement contains a number of covenants including requirements to maintain certain financial ratios.

On March 5, 2007, the Company disposed of its interest in Novokuibyshevsk plant. As at December 31, 2006 Novokuibyshevsk plant complied with the provisions of SFAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets to be classified as a Long-lived asset to be disposed of by sale . All of its assets in the amount of \$1,574 are included in Other current assets ; all liabilities in the amount of \$414 are included in Other current liabilities in balance sheet for the year ended December 31, 2006. Net income and cash flows of Novokuibyshevsk plant in years of 2004-2006 were not significant and not disclosed separately.

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