



INTERREGIONAL  
SCIENTIFIC AND PRODUCTION  
ASSOCIATION

**Polymetal**

Annual report  
**2004**

## 2004 ANNUAL REPORT CONTENTS

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Financial highlights

Mission and strategy

2004 Key events

CEO's statement

Project management and corporate structure

Mineral reserve base

Production results

Financial results

Activities at production facilities:

■ *Dukat deposit*

■ *Lunnoye deposit*

■ *Vorontsovskoye deposit*

■ *Khakanjinskoye deposit*

Geological surveys and exploration

Engineering services: Polymetal Engineering

Global positioning

Corporate governance

Environmental policy and health and safety

Human resources

Board of Directors

Management

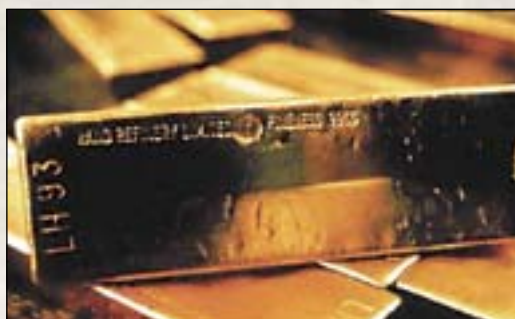
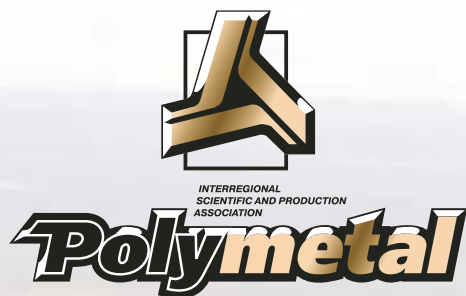
Appendix #1

■ *Consolidated financial statements and report of independent auditors  
for the years ended December 31, 2004 and 2003*

Appendix #2

■ *Production costs by Gold Institute Standards*

Contact information



# Annual Report 2004

St. Petersburg





## Financial highlight

Indicator	Meas. unit	2004	2003	2004/2003
Au production	th. oz.	212	137	54,7% ▲
Ag production	th. oz.	17 287	11 762	47,0% ▲
Au sales	th. oz.	213	129	65,6% ▲
Ag sales	th. oz.	17 301	9 839	75,8% ▲
Au sales revenue	th. USD	85 959	45 921	87,2% ▲
Ag sales revenue	th. USD	117 965	45 609	158,6% ▲
Total sales revenue	th. USD	204 487	92 357	121,4% ▲
Income from mining operations	th. USD	111 637	36 557	205,4% ▲
Operating profit	th. USD	95 560	26 759	257,1% ▲
EBITDA	th. USD	100 523	30 453	230,1% ▲
EBIT	th. USD	88 014	23 567	273,5% ▲
Profit before taxation and minority interests *	th. USD	61 975	17 250	259,3% ▲
Net profit	th. USD	83 583	13 468	520,6% ▲
Capital expenditures	th. USD	29 595	46 660	(36,6%) ▼
Total assets	th. USD	541 250	364 460	48,5% ▲

\* from continuing operations

### Source:

Consolidated financial statements according to US GAAP standards for 2004 and 2003; auditor: PricewaterhouseCoopers

### ▣ **Mission:**

To be a renowned leader in precious metals' production, by combining Western managerial strategies with state-of-the-art Russian technology and professional staff.

### ▣ **Strategy:**

#### **Expand the mineral reserve base:**

- additional surveys of flanks and deeper horizons at existing deposits;
- intensive additional surveys and transfer of mineral resources to reserves at the following deposits: Fevnalskoe, Kuzeevskoe, Aprelkovsko-Peshkovskiy ore knot;
- long-term, wide-scale programs for geological surveys of the Dukat ore knot and the Okhotsk Region.

#### **Efficient and dynamic development of existing companies:**

- comprehensive and strict control over production expenses;
- implementation of advanced technologies;
- modernization and expansion of production facilities through capital expenditures.

#### **Responsibility toward society, business partners and employees:**

- intensive focus on protecting the environment and individuals' health;
- complete transparency and accountability;
- steady, long-term development of staff potential.

### February

new management team hired for processing companies;

### March

for the first time in Russia, the company obtained licenses for direct export of gold and silver and began exporting precious metals;

### March

an agreement was signed between Polymetal Engineering and Copper Technology LLP for developing a project at the 50 Year Oktyabrya copper pyrite deposit (Kazakhstan);

### April

company reorganization - managerial and engineering companies were formed as part of Polymetal Group - improving overall efficiency;

### May

a 23 million USD syndicated short-term, pre-export loan, organized by Standard Bank London (GB);

### July

stage I of the ore mining and processing plant at the Khakanjinskoye deposit reached its project capacity;

### August

an agreement was signed between Polymetal Engineering and Mikhailovsky GOK for designing a concentrating mill;

### November

stage II of the processing plant at the Vorontsovskoye deposit was launched (for primary ore processing);

### November

20% of the shares of Magadan Silver (the Dukat deposit) was acquired from Pan American Silver, thus increasing our ownership share to 100%;

### December

a long-term 105 million USD syndicated financing was received. The financing was organized by Standard Bank London (GB), Hypo- und Vereinsbank (Germany) and Soci t  G n rale (France);

### December

finalized unified organizational structure for all subsidiaries. Polymetal Management Company became the sole managerial company for all mining and exploration companies.



## Chief Executive Officer's Statement



### ***To: shareholders, colleagues and partners***

2004 was an outstanding year for Polymetal, marked by numerous significant achievements in production and finance. Our management system underwent qualitative changes. We received international financing and introduced numerous technological innovations, and we continued to build our highly professional management team.

One of the most significant achievements of the past year was the creation of a new organizational structure, operating from a single corporate hub. This new structure increases production facilities' efficiency and contributes to the company's transparency. Our long-term, strategic goal is to create the leading mining company in Russia by combining Western managerial strategies with cutting-edge Russian technology and professional local staff.

Last year marked a key period in our company's development. Polymetal completed constructing the last large, first generation project on-schedule and on-budget. Successfully launching Stage II at the Vorontsovskoye deposit and reaching the project capacity at Stage I of the Khakanjinskoye deposit allowed our company to enter a new stage in its development.

The principal goals for Polymetal over the coming three years are expanding our mineral reserve base, increasing production efficiency and strengthening our staff's potential. Successfully meeting these targets will provide a strong foundation for the next stage of the company's development, including our mid-term goal of doubling precious metals production by 2010 (compared to reported figures for 2004).

Last year, the company demonstrated significant achievements in production, finance and organizational restructuring. As a result, the company demonstrated the best growth dynamics in the industry for 2004. Gold production rose by 55% and silver production increased 47%, compared with 2003. The company occupies a strong position as one of the world's leading silver producers and a top Russian gold producer.

Despite the high level of inflation in Russia and a nominal increase in the ruble exchange rate, the company succeeded in increasing its production and decreasing its total cash costs below the global average. Total cash costs decreased from \$2.30/oz Ag in 2003 to \$1.77/oz Ag in 2004 at the silver mines (Dukat and Lunnoye), and fell to \$201/oz Au at the Khakanjinskoye gold mine. The only facility that experienced an increase in total cash costs (up to \$257/oz) was the Vorontsovs



koye gold mine. This cost increase can be attributed to expedited stripping works. However, the total cash costs at all of the mining assets of the company remained below the global average. In 2005, we see additional possibilities for lowering cash costs even further.

In 2004, Polymetal was the first company in Russia to launch its own export of precious metals, which allowed us to effectively brand ourselves on the market and develop an international credit history. The high level of trust from international financial institutions was illustrated when a pool of foreign banks headed by Standard Bank London (GB) arranged a large-scale, long-term syndicated loan facility for our company. This arrangement was recognized by Trade Finance magazine as the Deal of the Year.

Comprehensive reorganization during the previous period allowed us to create a transparent and mobile managerial structure - better able to effectively address the needs of the company and changing conditions in the global precious metals market. Vertical integration, with a unified and centralized managerial and technological center, allows for highly efficient project management and results in a well-run organization.

By separating the research and scientific center into a subsidiary, we were able to quickly create

Russia's leading engineering company focused in the area of practical and fundamental project design at the deposits. In 2004, the engineering company successfully completed projects with several large third-party mining and metallurgy companies.

We have already set a number of highly ambitious goals for 2005: to increase gold production to 9 tons and silver production to 550 tons - allowing us to strengthen our position on the Russian gold market and become one of the five top silver producers in the world. At the same time, through efficient use of new technologies, we are planning to continue decreasing cash costs.

Another no less important goal for us is to increase the company's long-term mineral reserve base. In 2005, we expect reserves to increase by 12 tons of gold and 500 tons of silver (these increases will cover the following year's production).

In 2005, we will continue to take comprehensive steps to optimize the debt portfolio of the company and to attract long-term financing from international capital markets - effectively lowering interest rates and extending credit periods.

In the next year, Polymetal will continue to work to ensure that all of our operations comply with international standards. We are plan-

ning to complete recalculating and auditing our mineral reserve base in accordance with JORC international standards. In addition, we are upgrading our environmental practices, industrial security and labor, health and safety to meet international standards, in particular those set by the World Bank.

Achieving these ambitious, global goals is only possible because of Polymetal's professional employees. We have formed a dedicated team capable of efficiently implementing the most complex projects in the mining industry. Maintaining and developing this team is a key to the company's future success.

On behalf of the company's management, I express my gratitude to all of the employees of Polymetal for their high-quality work and to our shareholders and partners for their support of us throughout our development. It is my utmost belief that through the combined efforts of the entire team, we will continue to strengthen our position as the most efficient company in the precious metals market.



V. Nesis,  
CEO

MINPO Polymetal OJSC

## Project management and Corporate Structure

ICT (Investments. Construction. Technologies) Group is the main stockholder of MNPO (Interregional Scientific and Production Association) Polymetal OJSC. As of January 1, 2005, ICT OJSC owns 99.999% of MNPO Polymetal OJSC's capital stock (549,994 shares).

As of December 31, 2004, the capital stock of MNPO Polymetal OJSC was 55 million rubles represented by 550,000 shares of common stock.

MNPO Polymetal OJSC is a vertically integrated holding company, with the strategic goal of efficiently managing projects for developing Russian gold and silver ore de-

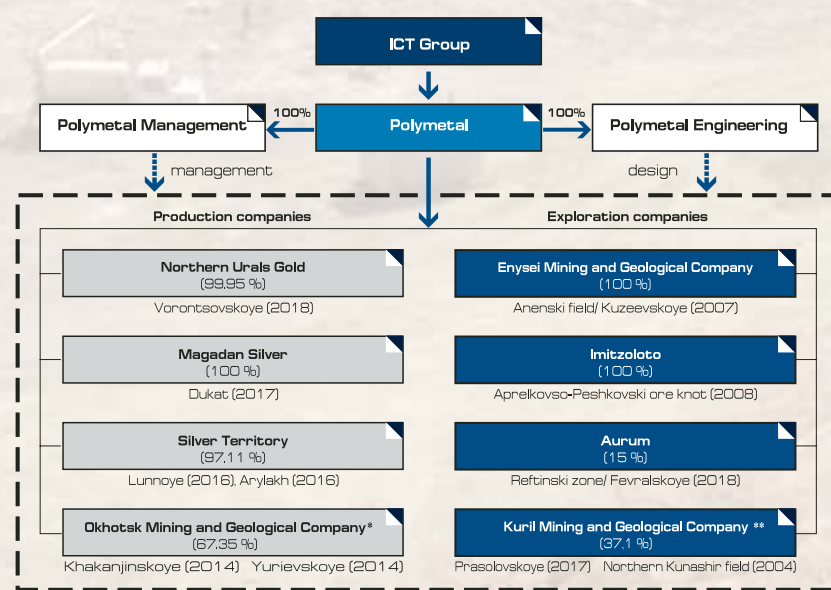
posits. The company is comprised of MNPO Polymetal OJSC which operates as the fundholder for mining and exploration companies in six Russian regions, Polymetal Management Company which manages projects and Polymetal Engineering Company which provides engineering services to affiliate and third-party companies. In addition, the holding includes service, logistics, transport and trading companies.

Polymetal Management Company manages four mining and four exploration companies. The company also holds nine licenses for exploring and producing gold, silver and additional co-product metals in the Sverdlovsk, Magadan, Sakhalin and Chita regions, and the Khabarovsk and Krasnoyarsk territories.

The corporate structure of the holding allows for transparent operations and maximizes produc-

tion efficiency. The structure also offers the flexibility to create joint venture projects within a single affiliate. In addition, the corporate model also enables structural assets to be bought and sold without changing the overall structure of the holding.

The diversity of geographical operations enables the company to accumulate valuable experience in exploring deposits in different climatic zones and to utilize various methods of geological surveys, mining and processing of ore. The extensive area of exploration and survey leads to continuous growth in the mineral reserve base, which will ensure steady production growth and positive key financials in the coming decades.



**Note:**

\* Repurchase rights of up to 97%, \*\* placed up for sale in 2005

## Mineral Resources



Vladimir T. Ryabukhin,  
Deputy CEO for Mineral Resources

Polymetal holds nine licenses for producing precious metals and engaging in geological surveys and exploration of gold and silver deposits in various Russian regions.

Based on our current production capacity and our mineral reserve base, we will be able to continue production at all deposits for at least the next 15 years. The quality of our mineral reserve base will

allow for production volumes to be significantly increased. We also anticipate - based on geological surveys and estimates - that our mineral reserve base will continue to expand.

### Mineral Base under JORC Code classification standards

	Tonnage (Kt)	Grade		Content	
		Au (g/t)	Ag (g/t)	Au (Koz)	Ag (Koz)
<b>Ore Reserves</b>					
<b>Proved</b>					
Dukat	1 763	1,3	679,6	74	38 530
Lunnoye	-	-	-	-	-
Arylakh	-	-	-	-	-
Vorontsovskoye	-	-	-	-	-
Khakanjinskoye	-	-	-	-	-
Yurievskoye	-	-	-	-	-
Subtotal	1 763	1,3	679,6	74	38 530
<b>Probable</b>					
Dukat	13 802	1,0	511,9	456	227 135
Lunnoye	853	2,6	373,8	70	10 256
Arylakh	1 366	0,9	524,8	41	23 040
Vorontsovskoye	8 558	5,1	7,1	1 402	1 964
Khakanjinskoye	6 118	5,2	229,1	1 016	45 060
Yurievskoye	235	18,0	13,0	137	98
Subtotal	30 932	3,1	309,3	3 122	307 553
Total Ore Reserves	32 695	3,0	329,2	3 196	346 083
<b>Mineral Resources</b>					
<b>Measured</b>					
Dukat	1 594	1,6	835,8	83	42 823
Lunnoye	-	-	-	-	-
Arylakh	-	-	-	-	-
Vorontsovskoye	-	-	-	-	-
Khakanjinskoye	-	-	-	-	-
Yurievskoye	-	-	-	-	-
Subtotal	1 594	1,6	835,8	83	42 823
<b>Indicated</b>					
Dukat	13 093	1,2	617,7	522	260 027
Lunnoye	755	3,1	453,6	75	11 004
Arylakh	1 459	1,3	673,8	59	31 605
Vorontsovskoye	15 021	4,1	6,7	2 003	3 224
Khakanjinskoye	5 165	6,8	298,8	1 121	49 610
Yurievskoye	241	19,4	14,1	151	109
Subtotal	35 734	3,4	309,5	3 932	355 580
Total	37 327	3,3	332,0	4 014	398 402
<b>Inferred</b>					
Dukat	2 200	1,2	517,9	82	36 636
Lunnoye	3 760	1,8	460,0	216	55 613
Arylakh	138	1,2	804,8	5	3 567
Vorontsovskoye	4 728	4,4	5,9	665	904
Khakanjinskoye	-	-	-	-	-
Yurievskoye	103	11,5	13,7	38	46
Subtotal	10 930	2,9	275,4	1 006	96 766
Total Mineral Resources	48 257	3,2	319,2	5 021	495 168

#### Note:

- calculations are based on the following cut-off grades: Dukat - 50 g/t Ag for open-pit and 125 g/t Ag for underground operations; Lunnoye - 125 g/t Ag for open-pit and 162,5 g/t Ag for underground operations; Arylakh - 200 g/t Ag for open-pit and 250 g/t Ag for underground operations; Khakanjinskoye - 2 g/t Au eq; Yurievskoye - 3,5 g/t Au eq; Vorontsovskoye - 1,4 g/t Au for oxidized ore, 2,3 g/t Au for primary ore.
- calculations are based on the following precious metals prices: Au - 350 \$US/oz., Ag - 6 \$US/oz.
- total figures in the table may differ from summary calculated figures as a result of numbers being rounded.



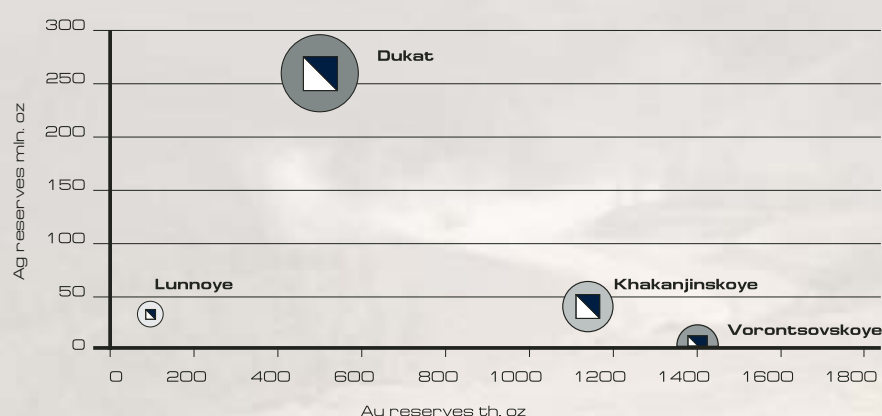
Resources at most deposits (except for Arylakh and Yurievskoye) were calculated based on conditions reflecting economic and cost indicators from the Soviet period (1970s-1990s) and will be

revised in the near future to account for current conditions.

Currently, underground mining is taking place at the Dukat deposit. The company plans to begin un-

derground mining at the Lunnoye and Khakanjinskoye deposits.

### Au and Ag reserves



**Note:**

figures for Lunnoye include its satellite deposit Arylakh and for Khakanjinskoye the Yurievskoye deposit is included

### Resources in exploration fields

Exploration company	Area	Au Resources (tons)
Imitzoloto	Aprelkovsko-Peshkovski ore knot	120
Yenisey Mining and Geological Company	Annenski field/Kuzeevskoye	100
Aurum	Reftinskaya zone/Fevnalskoye	60
Okhotsk Mining and Geological Company	Khakanjinskoye	10

**Note:**

Resources at these fields are estimated based on Russian standards

During the past year, together with SRK Consulting (a leading international company), an international geological audit was completed for all assets under the

management of Polymetal. Based on this report, a comprehensive, long-term economic model for developing the company's assets was designed.

In 2005, Polymetal reevaluated its mineral reserve base in accordance with the JORC International Code.

## Production Review

In 2004, the company demonstrated significant production growth.



Igor V. Venatovsky,  
First Deputy CEO



Yury E. Malakh,  
Deputy CEO for  
Material  
and Technical Supplies

The reported period marked a key chapter in the company's development. Existing plants reached their project capacities. An ore mining and metallurgy plant was opened at the Khakanjinskoye deposit and Stage II of the Vorontsovskoye depos-

it was launched. As a result, Polymetal achieved its production targets for 2004. Next year will be the first year that all the main production plants will operate at their project capacities.

### Polymetal production assets

Company	Region	Deposit	Ore	Production method
Magadan Silver	Magadan Region	Dukat	vein zones and veins of quartz sulfide, quartz chloride adularia, and quartz rodonite	open-pit and underground mining
Silver Territory	Magadan Region	Lunnoye	vein zones and veins of quartz carbonate and rodonite	open-pit mining and underground mining from 2007
Okhotsk Mining and Geological Company	Khabarovsk District	Khakanjinskoye	quartz gold and silver ores with manganese	open-pit mining and underground mining from 2009
Northern Urals Gold	Sverdlovsk Region	Vorontsovskoye	oxidized (loose) ores and primary gold sulfide vein impregnated ores	open-pit mining

Ore production rose by 57% compared to 2003 and reached 2,688,000 tons. Ore processing was 2,142,000 tons, a 30% increase from 2003. The ratio of ore produced by open-pit and underground mining in 2004 was relatively unchanged from 2003

figures (85 and 87% respectively). However, in coming years, with the start of underground mining at the Lunnoye and Khakanjinskoye deposits, ore production from underground mining will increase.

The launch of the Khakanjinskoye

deposit helped increase gold production by 55% compared to 2003. Production reached 212,000 oz. Silver production grew by 47% compared to 2003 and was 17,300,000 oz, primarily because of the Dukat and Lunnoye deposits.

Indicator	Meas. unit	2004	2003	2004/2003
Total rock mined	m <sup>3</sup>	7 883 880	6 070 892	29,9%
including stripping	m <sup>3</sup>	6 536 454	5 244 559	24,6%
Ore mined	m <sup>3</sup>	1 262 588	826 333	52,8%
	th. tons	2 687 823	1 716 425	56,6%
Open-pit mining	m <sup>3</sup>	1 114 636	742 186	50,2%
	th. tons	2 296 114	1 492 255	53,9%
Underground mining	m <sup>3</sup>	147 952	84 147	75,8%
	th. tons	391 709	224 170	74,7%
Ore processed	th. tons	2 141 635	1 653 813	29,5%
Au production	th. oz.	212	137	54,7%
Ag production	th. oz.	17 287	11 762	47,0%
Au sold	th. oz.	213	129	65,6%
Ag sold	th. oz.	17 301	9 839	75,8%

#### Note:

2003 production takes into account the Barun-Kholba deposit (sold in 2004).

<sup>2</sup> shipment of finished products (cement, gold and silver and in Dore bars) from production facilities to refineries



Vitaly V. Savchenko,  
Head of Production  
and Technology  
Department

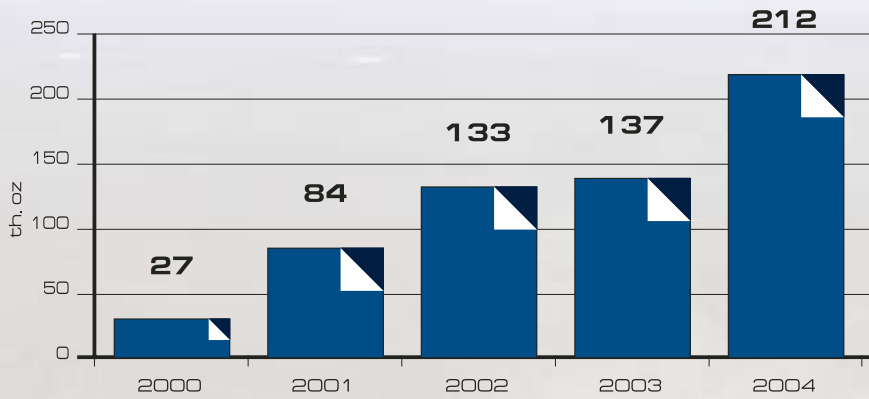


Igor O. Shnel,  
Head of Technological  
Department



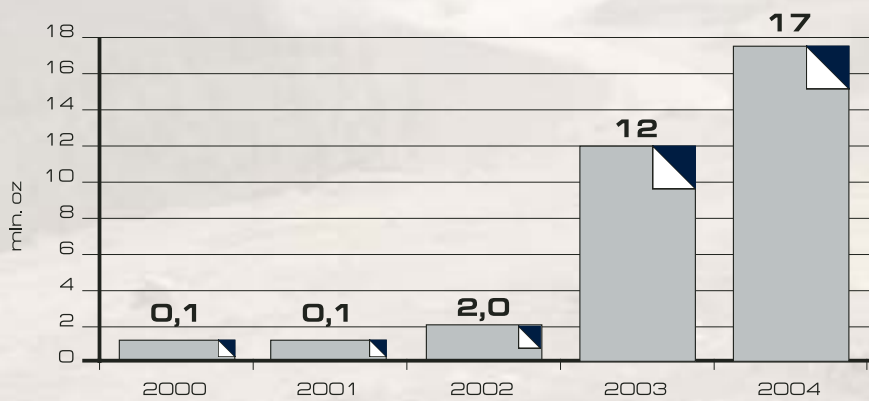
Gennady A. Filianin,  
Head of Analytical Control  
Department

### Au production



Yury A. Motorny,  
Head of Infrastructure  
Construction Department

### Ag production



Vladislav A. Kolosov,  
Chief Surveyor

Further growth will be ensured by increasing production at the Vorontsovskoye deposit (Stage II) and the Khakanjinskoye deposit.





## Financial Review



Sergey A. Cherkashin,  
CFO

### Sales

In 2004, Polymetal demonstrated rapid growth of key financials and production figures. Gold sales grew by 66% - from 129,000 oz. to 213,000 oz.; silver sales increased by 76% - from 9,800,000 oz. to 17,300,000 oz. In 2005, the company anticipates further growth in sales volume.

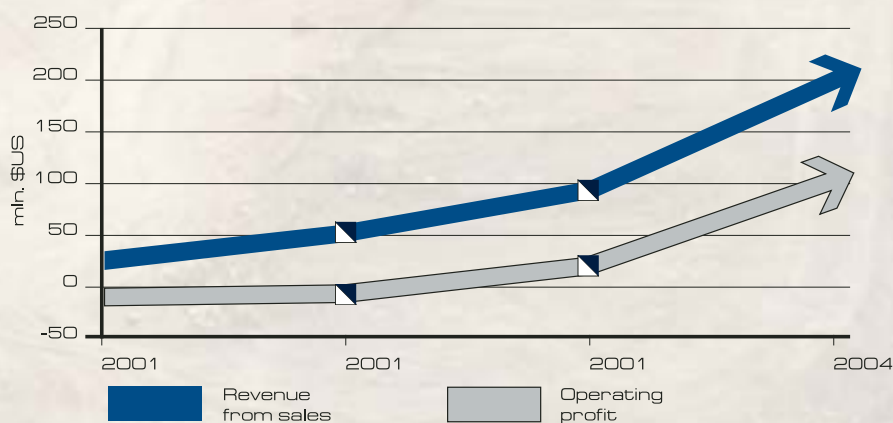
Total sales revenue for 2004 was \$204.5 million, which marked a 121% increase compared with 2003. This increase was due to both an increase in precious metals sales and a rapid rise in the average sale price. Revenue from gold sales was \$86 million (an 87% increase compared with 2003), silver revenue reached \$118 million - a 159% increase. Other sales (for co-product metals) accounted for \$800,000.

The company's income from mining operations grew by 205% and reached \$111.6 million. Because

of this dramatic growth, operating profit showed a 257% increase from \$24.1 million to \$95.6 million (the best dynamics in the Russian industry).

In 2004, EBITDA figures grew by 230% and reached \$100.5 million. The profit before taxation and minority interests grew by 259% and reached \$62 million. And according to last year's results, Polymetal's net income rose to \$83.6 million - a 520% increase.

### Revenue from sales and operating profit



Throughout its history, Polymetal's sales have shown a consistent upward trend due to continued expansion of the company's production plants. In 2003, the launch of a plant at the Khakanjinskoye deposit contributed to greater gold sales and increased production at

the Dukat and Lunnoye deposits helped raise increase silver sales.

The high growth dynamic is also due to favorable conditions in the global precious metals market. The average London PMI gold Fix in 2004 increased from \$363.4/ (\$/

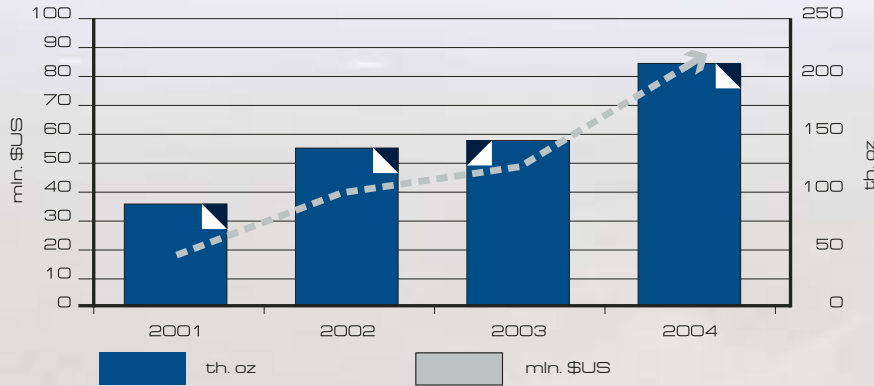
oz. to \$409.7/oz. - a 12.8% rise. The London PM silver Fix demonstrated a 36.7% increase, growing from \$4.88/oz. to \$6.67/oz.

<sup>3</sup> shipment of metal from refineries to banks and direct export.



Pavel D. Onta,  
Head of Precious Metals  
Sales Department

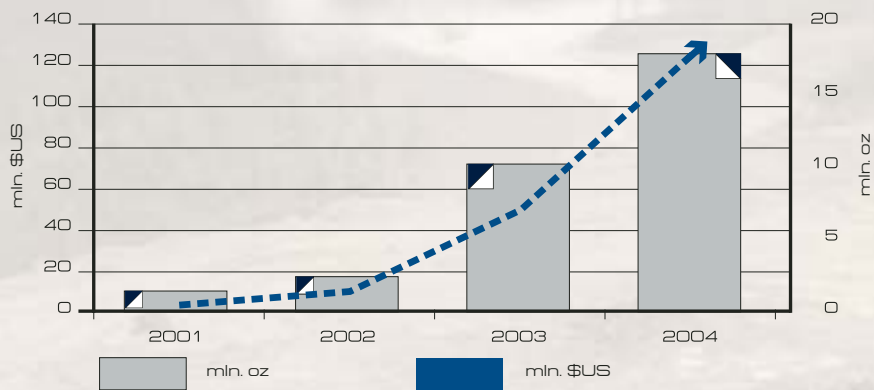
### Au sales



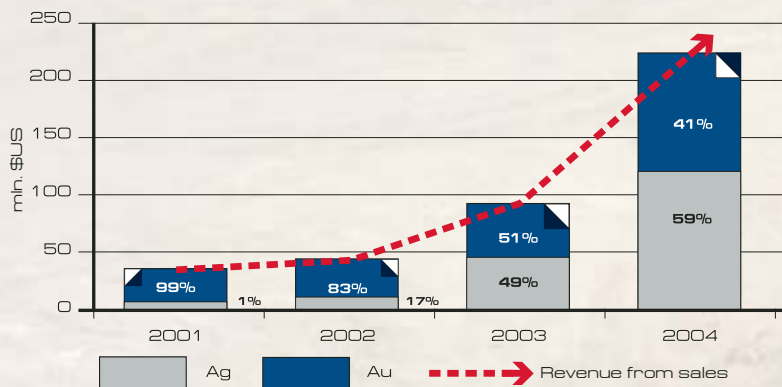
In 2004, the company's average sales price for gold grew from \$356/oz. to \$403.6/oz. (an 11% increase) and from \$4.6/oz. to \$6.6/oz. (a 48% increase) for silver, compared with 2003.

Since the growth in silver production outpaces that of gold, the company's sales breakdown is changing as well. In 2004, 59% of the total sales volume was from silver (compared to 49% in 2003). As a result of the dynamic growth in silver production and the sharp increase in silver prices, the percentage of total revenues from gold fell from 49% in 2003 to 41% in 2004.

### Ag sales



### Revenue from sales structure



In earlier periods, a larger volume of gold than silver was sold. In 2005, when the Khakanjinskoye deposit and Stage II of the mining and metallurgy facility at the Vrontsovskoye deposit reach their project capacities, the volume of silver and gold sales will be approximately equal.

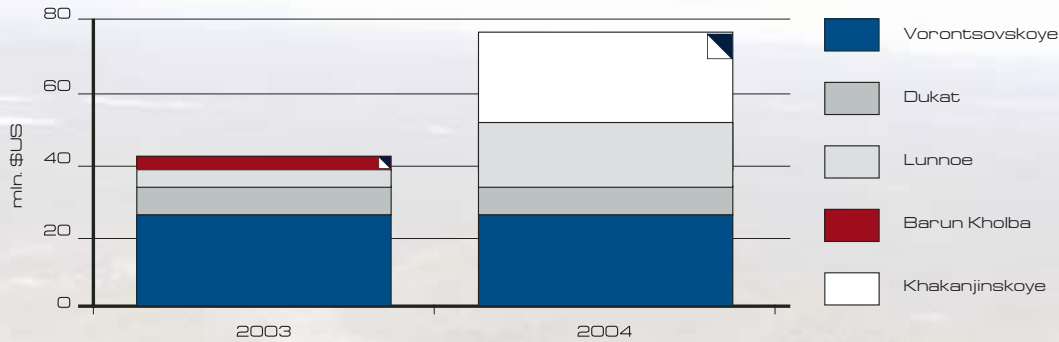


Denis G. Pavlov,  
Head of Treasury  
Department



Stanislav Y. Kalaidin,  
Head of Planning  
& Budgeting  
Department

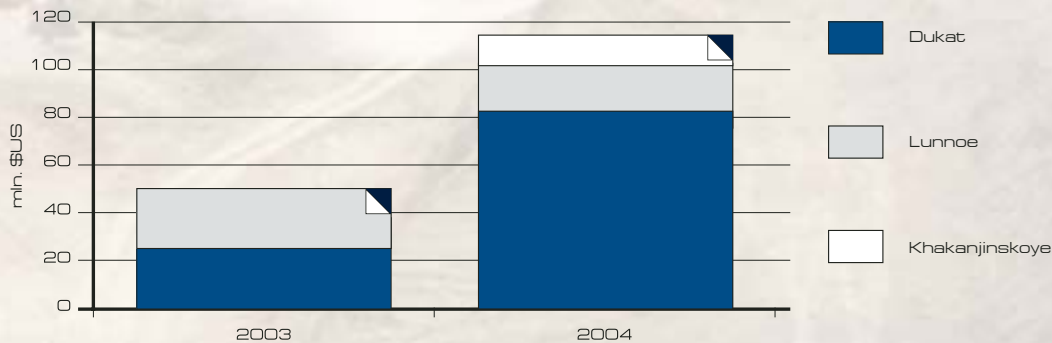
### ■ Au sales structure



**Note:**

The Borun - Holba deposit sold in 2004

### ■ Ag sales structure



In 2003, Polymetal obtained a license from the Russian Ministry of Economic Development and Trade to directly export gold (and in March 2004, the company obtained a license for direct silver exports). Prior to receiving these licenses, all sales of precious metals were limited to the local Russian market. Since then, the company has exported gold and silver directly to Switzerland, the United Kingdom and the United Arab Emirates (beginning in December of 2003). Polymetal is currently working on expanding the number of countries that it exports to. According to 2004 results, exports accounted for 7% of gold sales and 25.2% of silver sales.

### ■ Production costs

As a result of significant growth in 2004 production, production costs also increased from \$55.8 million to \$92.9 million. This 66% growth was in line with the 69% increase in equivalent gold production. Cost increases were uneven.

Tax payments (excluding profit tax) grew by 56% and amortization costs increased by 92%, (due to the launch of new production plants). Costs of raw and other materials were up 33% compared to 2003 figures. In 2003, several facilities were put into operation and at that stage production lagged behind monetary expenditures. However, in 2004 produc-

tion increased more rapidly than material expenditures. Thus, per unit costs declined. Total operating costs (excluding personnel costs) grew by 67% and reached \$64.5 million.

Personnel costs (salaries) grew by 33%. This can be attributed to two factors - the launch of the Khakanjinskoye deposit and the system of directly linking salaries to production volumes at the facilities.

As a result, the expenditure breakdown at Polymetal changed. The proportion spent on materials and spare parts decreased from 49% in 2003 to 38% in 2004, and the portion for





Alexander I. Kazarinov,  
Chief Accountant

services decreased from 18 to 11%, primarily because of the transfer of some auxiliary functions to subcontractors. At the same time, amortization costs increased from 9 to 17% of total costs and total taxation grew from 3 to 13% compared to the

figures for 2003. The percentage of salaries as a share of total costs was constant at 21%.

These changes - both in total costs and in the breakdown of costs - are a result of production plants reaching their project

capacities. Since precious metals mining is a material- and cost-intensive industry, most costs are fixed-cost expenditures. Thus, increasing production leads to lower per unit production costs.

### Operating costs

In 2004, the company actively took steps to decrease the cost

of producing precious metals. Because all of Polymetal's production facilities are either focused on gold or silver production (with

the other precious metal as a co-product), total cash costs were calculated based on Gold Institute Standards.

Company	Deposit	Unit	Total cash costs		
			2004	2003	2004/2003
Northern Urals Gold	Vorontsovskoye	\$US/oz Au	221	130	70,1%
Okhotsk Mining and Geological Company	Khakanjinskoye	\$US/oz Au	114	-	-
Magadan Silver, Silver Territory	Dukat, Lunnoye	\$US/oz Ag	1,68	2,55	(34,1%)

#### Notes:

- for the Vorontsovskoye and Khakanjinskoye deposits, silver is a co-product;
- for the Dukat and Lunnoye deposits, gold is a co-product;
- production of precious metals at the Dukat and Lunnoye deposits is a single technological process. The above figures are calculated for both deposits together;
- in 2003, only mining took place at the Khakanjinskoye deposit, no metal was produced.

<sup>4</sup> In 2004, the Russian inflation rate was 11.7%, the US dollar grew 5.6% compared to the ruble exchange rate; the average annual London PM Fix price for gold was \$409.7/oz. (up 13%), and the average annual London PM Fix price for silver increased 37% to \$6.67/oz.

<sup>5</sup> See full calculations and methodology in Appendix 1

The company was able to maintain cash costs at or below the global average at all of its production plants. In 2004, the average global cash costs grew by 13% and reached \$253/oz. During this same period, the average gold price grew from \$363/oz. to \$409/oz. It should be highlighted that Polymetal has significantly decreased production costs over a several year period when the global trend has been toward rising costs.

Total cash costs at the Vorontsovskoye deposit in 2004 grew by 154% (compared to 2003) and reached \$257/oz. Au. This significant increase in cash costs is due to rising operating costs at the deposit, because of intensive stripping and explosive work for obtaining primary ore for the new plant. In addition, during 2004, gold production declined at the deposit. Polymetal plans to reduce its cash costs at this deposit during the coming year.

In 2004, total cash costs at the Khakanjinskoye deposit totaled \$201/oz. Au. Gold production began in 2004, and the company plans to reach its target project capacity by the end of the first half of 2005. At the same time, we estimate significantly lowering total cash costs by decreasing production processing costs and increasing production efficiency (through improved recovery rates and metal production volumes).

At the Dukat and Lunnoye deposits - the key silver production facilities of the company - total cash costs fell to \$1.77/oz. Ag, a 23% decrease compared to 2003 results. At the same time, average global cash costs for silver increased by 11% and reached \$2.36/oz. The impressive results

at Dukat and Lunnoye can be attributed to technological innovations that optimized the production process and lowered metal losses during production. Based on results from the reported period, Polymetal's silver production facilities were among the most profitable primary silver mines in

the world.

The company sees further possibilities to lower production costs, for example, by optimizing technological processes (through minimizing the use of reagents) and by decreasing metal lost during processing and shipping.

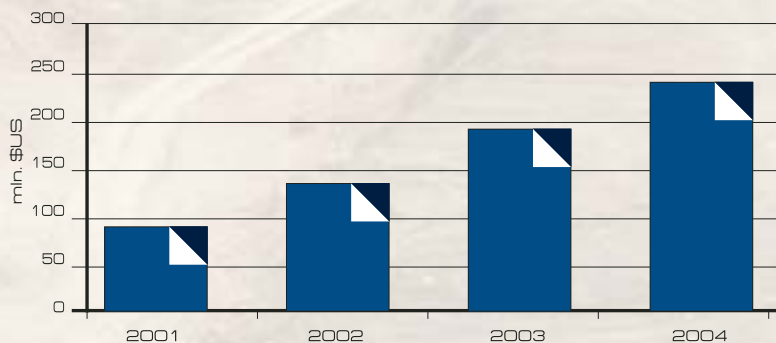
### Capital expenditures

In 2004, Polymetal continued to invest in developing its production plants. The total value of property, plants and equipment was \$256.7

million, a 25.7% increase compared to 2003. The period from 2003 to 2004 can be characterized as a period of active investment in construction. The value of buildings and additional struc-

tures grew 2.2 times due to the launch of new production plants. The number of facilities under construction declined as different projects were launched.

### Property, plants and equipment value

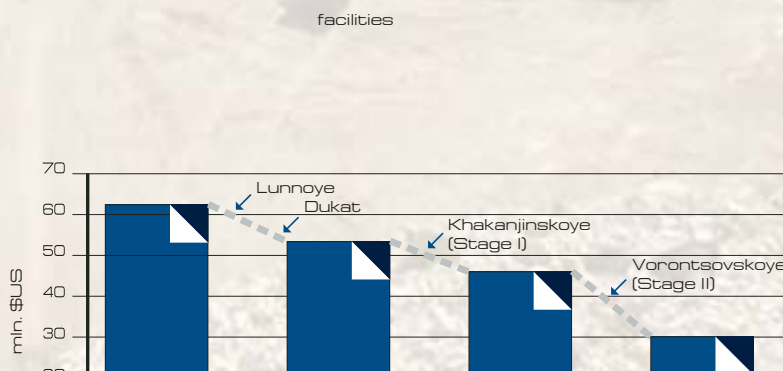


In 2003, the Khakanjinskoye deposit was launched and the Dukat deposit reached its project capacity. In 2004, the Dukat deposit increased its production capacity. Polymetal continued financing the

final stages of construction at the Khakanjinskoye deposit. However, the greatest percentage of capital expenditures was devoted to the construction and launch of Stage II at the Vorontsovskoye

deposit. 2004 capital expenditures were \$29.6 million (a 37% decrease compared to 2003 figures) - a result of the company passing the peak of expenditures.

### Capital Expenditures





Sergey L. Roslyakov,  
Head of Corporate  
Finance Department

Beginning in 2005, capital expenditures will primarily be focused on maintaining and expanding existing

production plants. In addition, there will be expenditures targeted at increasing production efficiency. In

2005, capital expenditures will decrease by at least two times compared to the reported period.

### Debt profile

Polymetal is actively restructuring its debts, focusing on extending loan periods and lowering effective interest rates.

In April 2004, the company entered the international financial market - attracting a seven month, pre-export loan from Standard Bank London (GB). The \$23 million credit was insured by precious metals exports.

At the end of 2004, Polymetal received a \$105 million long-term syndicated financing from a pool of international financial institutions, including Standard Bank London (GB), Hypo und Vereinsbank (Germa-

ny) and Societe Generale (France). This arrangement was awarded Deal of the Year by Trade Finance magazine (GB).

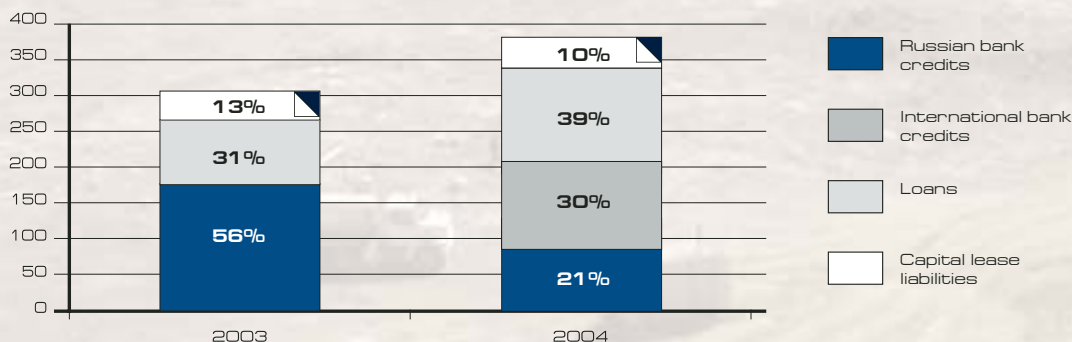
Attracting syndicated funds allowed us to continue to develop our primary silver production facilities - Lunnoye and Dukat. 20% of the funds were focused on this project. The remainder of the credit (80%) was used to restructure our current loan obligations. In addition, this international financing was the key to increasing loan periods for the company. In 2003, only 47% of debt (including capital lease liabilities) was long-term. In 2004, because of the international credits, long-term loans accounted for

74% of the total debt.

In 2004, 44% of capital lease liabilities were long-term. In general, the company's capital lease liabilities decreased by 8% to \$35 million, compared to 2003. The company's long-term financial liabilities are primarily three-year credits and five-year loans.

During the reported period, the portion of capital lease liabilities and loans (bonds and inter-group loan arrangements) were virtually unchanged compared with 2003. The portion of credits from Russian banks, however, decreased significantly from 56% to 21%, and debts to international creditors appeared on the books.

### Net debt structure



In 2005, Polymetal will continue to actively work to change the structure, loan period[s,]] and effective interest rates of its obligations. We are planning to increase the volume of long-term liabilities to international creditors and lower the volume of short-term liabilities to Russian creditors. This shift in the debt portfolio will lower the cost of debt. In 2005, Polymetal plans to place \$100 million in Credit Link Notes

(CLN) with international investors at an estimated annual interest rate of 9%. The money from the emission of the CLNs will be used to transfer relatively expensive, short-term debt to longer-term debt and to pay back the company's three-year bonds. As a result, almost 100% of Polymetal's debt will be long-term and 50% of its funds will be from the international financial market.

Increasing debt during 2004 was[were] due to continued investment in production development. In 2004, total liabilities to creditors and bond holders (including capital lease liabilities) grew by 16% and reached \$354 million compared to 2003 figures. Credits account for the largest portion of total liabilities (51%), which is approximately equal to the figure for 2003.



Production  
facilities  
overview





## Dukat deposit

The Dukat deposit is Polymetal's largest production facility. In 2004, both open-pit and underground mining took place at the deposit.

Gold production at the Dukat deposit grew by 9.6% in 2004 and reached 24,300 oz.[.] During the same period, silver production increased by 39.7% to 12,100,000 oz. Ore mined using open-pit and underground mining was up 39.1% and reached 839,500 tons, compared with 2003; and ore processing increased to 762,800 tons (39% growth).

Technological and business innovations allowed us to dramatically decrease total cash costs to \$1.77/oz. Ag (a 23% drop). According to 2004 results, the Dukat and Lunnoye deposits were among the largest primary silver mines in the world (holding 3rd and 10th place, respectively). In addition, these two deposits had the

lowest production costs among leading global silver mines.

In 2004, capital expenditures remained high, due to ongoing modernization efforts. In 2005, we plan to substantially reduce capital expenditures and to target these expenditures at maintaining and expanding existing facilities. Future periods, however, will again require significant expenditures directed at constructing Stage II of the plant.

During 2004, the company reached its project capacity (processing 750,000 tpa of ore) using both open-pit and underground mining. The company also upgraded its operations through implementing the following projects:

- completion of 980 m. level for underground mining operations, including all main structures and service systems;
- reserves of ore zones XVI, XV, and VIII at floor level were prepared and mining of these zones began;

- construction and stripping of new 930 m level began in underground mines to prepare for future ore mining;
- reconstruction and preparation of 860 m concentration floor to be used for locomotive haulage;
- stripping and open-pit mining work began at ore zone XIII in pit [quarry] #1;
- creation of a transitional one month ore supply at the ore storage facility of the plant.

In 2004, Polymetal engaged in intensive research and collaboration with VNIMI (All-Russian Scientific and Research Surveying Institute) to optimize production systems, stabilize pit [quarry] walls and address a range of other relevant mining issues.

The company steadily increased production and improved the reliability of operations at the plant. To increase the capacity of the concentrate filtering facility, a vacuum filter was installed[,] and





Victor R. Wulfert,  
Managing Director



Victor M. Ivanov,  
Chief Geologist



Gennady V. Kachaev,  
Head of the Plant

to ensure stability, a set of pumps was reconstructed. Utilizing new reagents at the flotation facility decreased the total cost of reagents and increased the recovery rate. The company estimates that the recovery rate will continue to increase, as we implement new technological innovations, such as[,] intercycle sand flotation and gravitational impregnation at the plant.

In 2005, open-pit mining in pits[quarries] #1 and #4 and underground mining at the 980 m, 930 m and 860 m floors will take place. During the following years, we plan to complete the construction and launch of the new 930 m floor level. We will also continue

to reconstruct the Tsentralnaya adit, adit #10, and the 860 m floor. In addition, open-pit mining will begin at the Eeeastern zone of the deposit in pit [quarry] #4.

In 2005, the company will design and implement measures aimed at increasing production capacity to 850,000 tpa of ore in the short-term and to 950,000 tpa of ore in the longer-term. We also plan to thoroughly modernize the underground mining facilities and the plant, using state-of-the-art technology.

In 2005, the company plans to begin a project to construct a second parallel ore grinding facility. One step in this process is to

acquire an additional wet grinding mill, which will increase output and stabilize operations at the plant.

To expand the company's mineral reserve base, Polymetal will engage in active geological surveying of nearby ore manifestations and small deposits. In addition, the company is planning to acquire several mining facilities in the vicinity of Dukat. We are also considering the possibility of constructing Stage II of the plant for processing ore from satellite deposits and sorted spoil piles of lean ore left by the state enterprise "Dukat GOK" (the company formerly operating at the Dukat deposit).

Indicator	Unit	2004	2003	2004/2003
Total rock mined	m <sup>3</sup>	1 486 686	871 573	70,6%
including stripping	m <sup>3</sup>	1 080 387	642 054	68,3%
Ore mined	m <sup>3</sup>	321 506	229 519	40,1%
	th. Tons	839 543	603 367	39,1%
Au ave. head grade	g/ton	1,4	1,5	(9,0%)
Ag ave. head grade	g/ton	601,6	738,9	(18,6%)
including open-pit operations	m <sup>3</sup>	173 554	145 372	19,4%
	th. Tons	447 834	379 197	18,1%
Au ave. head grade	g/ton	1,34	1,1	19,9%
Ag ave. head grade	g/ton	490,7	483,3	1,5%
including underground mining	m <sup>3</sup>	147 952	84 147	75,8%
	th. Tons	391 709	224 170	74,7%
Au ave. head grade	g/ton	1,4	2,2	(35,1%)
Ag ave. head grade	g/ton	728,5	1 171,2	(37,8%)
Ore processed	th. Tons	762 798	548 385	39,1%
Au ave. head grade	g/ton	1,5	1,6	(10,6%)
Ag ave. head grade	g/ton	608,0	782,7	(22,3%)
Au recovery rate	%	68%	70%	(2,8%)
Ag recovery rate	%	73%	69%	5,8%
Au produced	th. oz.	24,3	22,2	9,6%
Ag produced	th. oz.	12 076	8 646	39,7%
Au sales	th. oz.	22,1	20,2	8,9%
Ag sales	th. oz.	12 864	6 593	95,1%
Total cash costs *	\$US/oz. Ag	1,68	2,55	34,1%

**Note:**

\* Precious metals production at the Dukat and Lunnoye deposits is a single technological process. The above figures are calculated for both deposits together. Silver is a co-product at the deposit. [This was into account during] Calculations were based on Gold Institute Standards





## Lunnoye deposit

Lunnoye deposit grew 84.1% reaching 31,300 oz. Silver production increased 20.8% to 3,700,000 oz., compared with 2003. These production increases occurred despite a slight decrease in mined ore (down 7.1% to 284,000 tons). The volume of ore processed at the plant grew by 4.5% and reached 257,000 tons. Based on 2004 results, the Lunnoye deposit was the 10th leading silver mine in the world.

In 2004, extensive geological surveys of underexplored ore zones and depths took place at the deposit. Polymetal considers the Lunnoye deposit to be a facility with a high potential for increasing gold and silver reserves.

As mentioned above, total cash costs at the Lunnoye and Dukat deposits - which are part of a single technological process - decreased by 23% to \$1.77/oz. Ag in 2004, compared with 2003 results. By optimizing technological processes, the company plans to

lower cash costs even further in 2005.

A small-scale increase in the plant's production capacity is planned for 2005, in addition to modernization aimed at improving the recovery rate of precious metals. Capital expenditures will increase in 2005. And beginning in 2006, there will be a significant increase in capital expenditures to finance future projects, such as the start of underground mining at the deposit.

In 2004, open-pit mining operations took place at the Lunnoye deposit, using the southwestern and northeastern parts of the pit. A transportation scheme was used to strip and mine the northeastern part. The stripped ore was transported to the western spoil heap. Some of the stripped ore was used to construct a tailing impoundment. Difficult mining and geological conditions, coupled with unstable operation of equipment (such as drills and shovels) because of severe climatic conditions, prevented us from completing exploration of the pit in 2004.

In 2005, the company intends to continue mining at two independent flanks - the high southwestern flank and the low northeastern flank.

In 2004, numerous measures were instituted at the plant to improve technology, stabilize the plant's operations, and improve technological indicators:

- the construction and launch of a facility to deliver Dukat deposit's float concentrate to the technological process was finished;
- the plant's production capacity for processing raw materials was increased to 40,300 tons/hour by modernizing the pumping facility and utilizing more powerful engines;

The company implemented a highly efficient scheme for the joint processing of concentrates from the Dukat deposit and the ore from Lunnoye deposit at Lunnoye's facilities. This process resulted in a significant increase in the recovery rate. In 2005, the volume of silver refined at the Kolyma Refinery



Victor R. Wulfert,  
Managing Director



Anatoly G. Staheev,  
Executive Director



Vyacheslav I. Zaitsev,  
Chief Geologist

In 2004, gold production at the will increase significantly, which will allow us to create a complete and economically efficient cycle of production of precious metals from geological surveys to gold bars in one geographic region.

During the next period, the company plans to maintain the rate of mining operations it achieved in 2004, which will allow us to steadily deplete the hilly part of the pit, provide the plant with ore with the necessary head grade and meet the planning parameters of stripped and prepared reserves by the beginning of 2006. The company will also analyze the possibility of increasing the capacity of the plant to process concentrate from the Dukat deposit and ore from the Lunnoye deposit.

In 2005, Polymetal Engineering intends to finish preparing a feasibility study of the conditions for processing mineral resources

produced by underground mining and to design a project to process these minerals.

In addition, measures for decreasing losses of precious metals and increasing production capacity at the plant are planned for 2005, including:

- implementing a computerized, automated information retrieval system of the entire production process. This system will have numerous positive effects, including: allowing us to improve control and speed of managing the ore processing, to minimize precious metals losses to waste tailings, to lower human error in the production process and to reduce the number of technical personnel;
- industrial field testing and implementation of new mill linings to increase the plant's ore processing capacity and stabilize

grinding parameters ;

- reconstructing the Merrill Crow zone.

The most significant step for Polymetal in regard to its silver production projects is to begin exploring the Arylakh deposit (which is in the proximity of the Lunnoye deposit). The Arylakh deposit has a relatively low capacity with a high average head grade of silver. Using this deposit for mining and the existing infrastructure at Lunnoye will have a dramatic synergistic effect on the development of these two projects. In 2005, to begin developing the Arylakh deposit, the company will start constructing a roadway and preparing the production area of the mine. The company will also engage in further geological surveys of near and far flanks at the Lunnoye deposit.

Indicator	Unit	2004	2003	2004/2003
Total rock mined	m <sup>3</sup>	917 390	833 581	10,1%
including stripping	m <sup>3</sup>	802 365	709 849	13,0%
Ore mined	m <sup>3</sup>	114 980	123 732	(7,1%)
	th. tons	263 999	305 615	(7,1%)
Au ave. head grade	g/ton	32	3,3	(3,8%)
Ag ave. head grade	g/ton	431,5	450,5	(4,2%)
Ore processed	th. tons	257 368	246 385	4,5%
Au ave. head grade	g/ton	3,7	3,2	15,6%
Ag ave. head grade	g/ton	499,3	453,4	10,1%
Au recovery rate	%	91%	92%	(1,1%)
Ag recovery rate	%	90	89	1,1%
Au produced	th. Oz.	31,3	17,0	84,1%
Ag produced	th. Oz.	3 689	3 053	20,8%
Au sales	th. Oz.	32,8	13,4	144,8%
Ag sales	th. Oz.	3 247	3 172	2,4%
Total cash costs *	\$/US/oz. Ag	1,68	2,55	34,1%

**Note:**

\* Precious metals production at the Dukat and Lunnoye deposits is a single technological process. The above figures are calculated for both deposits together. Gold is a co-product at this deposit. [This fact was taken into account during] Calculations are based on Gold Institute Standards.





### Vorontsovskoye deposit

2004 was a key year in the development of the Vorontsovskoye deposit. The company is steadily transitioning from mining oxidized ore to mining primary ore. This transition required constructing a primary ore processing plant (Stage II at the deposit). As a result, the Vorontsovskoye deposit became one of Russia's leading deposits that simultaneously mines and processes two types of ore using different technologies.

Plant #2 began operating at the beginning of 2005. A significant share of capital expenditures in 2004 was due to the construction of Stage II of the deposit, which will reach its project capacity in 2005 and the purchase of necessary equipment. The company plans to reduce capital expenditures by more than four times in the following year.

According to 2004 results, gold production fell 15.2% to 78,000 oz.; and silver production dropped by 10.3% to 56,700 oz. These

production declines occurred despite a 10% increase in ore processing (to 909,000 tons). The production decline was primarily due to a 7% decrease in the average head grade of gold. In 2005, the company estimates that gold production will increase by 58% and that silver production will rise by 75%.

In 2004, the deposit had the highest production cost among all of the company's processing facilities - \$257/oz Au. This indicator, however, was within the range of average global production costs. The substantial 154% increase in total cash costs (from \$101/oz. Au in 2003) was due to expedited stripping to provide ore for the new processing plant to use in the future. Total cash costs also increased because the company needed to use drilling and explosives methods in the pit when it reached deeper rock bases. In 2005, the company plans to lower operating costs by 10 to 20%.

In 2004, mining of oxidized ore at the deposit continued; and in Q3-

Q4, mining of primary ore started. Over the course of 2004, steady growth in mining rock and ore was achieved and the productivity of the mining equipment grew significantly. It is important to note that the volume of rock mined using drilling and explosives grew sharply (a more than five times increase compared to 2003). Further lowering of the mine floor level will require increased use of these methods.

In 2005, the company will address a range of issues including how to increase the amount of drilling and explosives work, the launch of the Ulba mix loader and another Atlas Kopko drill and the construction and opening of storage facilities. In addition, the fleet of pit dump trucks and loading equipment will be updated in 2005.

In 2004, the company - based on a request by the Administration of the Krasnoturyinsk Municipal District - completed the recultivation of technogenic lakes in the mining areas near the Severny mine and the Severopeschanskaya mine





Andrey V. Novikov,  
Managing Director



Sergey N. Markov,  
Chief Engineer



Victor V. Kozlov,  
Chief Geologist

by the Vorontsovka settlement. The mined area was covered with stripped ore. We plan to complete biological recultivation in 2005 and return the land to the Administration of the Krasnoturyinsk Municipal District.

In 2004, two methods of ore processing were used: oxidized ore was processed using heap leaching and primary ore was processed at the plant using the carbon-in-pulp method.

The plant for processing primary ore was launched in November 2004 and was designed and equipped using the world's most advanced technologies. Most of the machinery in the plant is imported. During the current, initial period of operation, set-up and launch work is occurring. However, ore processing will grow and by mid-2005, it is estimated that

the plant will reach its project capacity of 600,000 tpa of ore with a 81% gold recovery rate and a 46% silver recovery rate.

2005 targets for the plant include: reaching project capacity, stabilizing the main production processes and addressing the issue of semi-dry storage of tailings.

Improving the technology for preparing pile foundations for heap leaching and ore pelletizing in 2004 contributed to reductions in production costs. Since 2003, the company has been pouring ore using a new stacker designed by our subsidiary engineering company. There has been a yearly increase in the volume of ore poured in pile. In 2005, we plan to maintain ore pouring levels and process 800,000 tons of ore through the heap leaching

methods. Actual recovery rates for precious metals closely match the expected rates and thus, allow for efficient processing of oxidized ore. Recovery rates for gold and silver are 80% and 36%, respectively. In addition, low production costs allow for processing off-balance oxidized ore. This processing will begin in 2005. The Vorontsovskoye deposit is one of the few deposits in the world that utilizes the heap leaching method year-round.

The company intends to develop a program for active geological surveys at the near and far flanks of the Vorontsovskoye deposit. The mineral reserve base will also be increased by reviewing the cut-off grades and by mining reserves below the current mining contour of the pit.

Indicator	Unit	2004	2003	2004/2003
Total rock mined	m <sup>3</sup>	4 283 518	3 633 358	17.9%
including stripping	m <sup>3</sup>	3 725 920	3 183 738	17.0%
Ore mined	m <sup>3</sup>	557 598	449 620	24.0%
	th. Tons	953 728	752 660	26.7%
Au ave. head grade	g/ton	3.7	3.7	0.6%
Ag ave. head grade	g/ton	9.0	6.0	49.6%
Ore processed	th. Tons	908 749	827 144	9.9%
Au ave. head grade	g/ton	3.6	3.9	(6.9%)
Ag ave. head grade	g/ton	8.9	6.7	34.0%
Au recovery rate	%	80%	80%	0%
Ag recovery rate	%	35%	35%	0%
Au produced	th. oz.	77.6	91.5	(15.2%)
Ag produced	th. oz.	56.7	63.2	(10.3%)
Au sales	th. oz.	82.7	95.3	(13.2%)
Ag sales	th. oz.	63.3	73.5	(13.9%)
Total cash costs *	\$/oz. Au	221	130	70%

**Note:**

\* The calculations take into account that silver is a co-product at the Vorontsovskoye deposit (according to Gold Institute Standards).



### Khakanjinskoye deposit

The Khakanjinskoye deposit began operating in October 2003. And at the start of 2004, the first metal from this deposit was sent to the refinery. Results from 2004 show, that gold production was 79,000 oz. and silver production was 1,500,000 oz. Ore mined reached 610,000 tons and ore processed at the plant was 212,000 tons, which is less than half of the plant's project capacity. The company plans to reach project capacity by mid-2005.

Total cash costs in 2004 were \$201/oz. Au. We anticipate that in 2005 the Khakanjinskoye deposit will become our lowest cost production facility. Economic analysis indicates that after the plant reaches its project capacity, operating costs will decrease.

The high level of capital expenditures in 2004 was due to modernization projects at the plant.

The company plans to significantly reduce its capital expenditures in 2005. However, future projects -- including the launch of the satellite Yurievskoye deposit and the start of underground mining -- will require significant additional capital expenditures.

2004 was the first full year of operation for the Khakanjinskoye deposit (after its launch in October 2003). In 2004, open-pit mining took place at the Central Zone (pit #1). During 2004, significant development - primarily of infrastructure - occurred at the deposit, including completing the main mining work at pit #1 and building a grid of service roads. And significantly, mining volume grew substantially.

By utilizing new, highly efficient imported machinery for shoveling and drilling, the mine was able to reach its project capacity in 2004. Additionally, the mine was fully prepared for inspection by the Russian National Inspection Committee.

According to preliminary data, the pit's [quarry's] monthly production capacity in 2005 will reach 150,000 m<sup>3</sup> of rock. Primary mining tasks at Khakanjinskoye in 2005 will include upgrading the efficiency of equipment used for drilling and explosives work, conducting detailed testing on the stability of the deposit's sides and increasing the final slope angle of ledges.

During the first half of 2004, operations at the deposit focused on startup and tuning work. These operations allowed us to stabilize the grinding facility and increase output at the first grinding stage using the new Outokumpu mill. These measures helped increase the production capacity of the gold extraction plant to up to 30,000 tons of ore per month.

To increase the plant's production capacity even further in 2005, the company plans to reconstruct the ore preparation facility and the plant (crushing and grinding processes). These steps





Sergey G. Antipin,  
Managing Director



Sergey A. Egorov,  
Chief Geologist



Vladimir I. Fedorov,  
Head of the Plant

will allow us to process more than 500,000 tpa of ore. And in the following year - with the introduction of a third grinding stage - we plan to increase production capacity to 600,000 tpa of ore. As part of the continuing process of improving production and ensuring that

the deposit is a world leader, the company plans to design a facility for the filtering and semidry storage of filter cakes from waste tailings.

The company is also planning to increase its mineral reserve base

by engaging in active geological surveys in the near and far flanks of the Khakanjinskoye deposit and the Okhotsk Region in general.

Indicator	Unit	2004	2003
Total rock mined	m <sup>3</sup>	1 196 286	732 380
including striping	m <sup>3</sup>	927 782	708 918
Ore mined	m <sup>3</sup>	268 504	23 462
	th tons	610 553	54 783
Au ave. head grade	g/ton	7.2	6.3
Ag ave. head grade	g/ton	228.0	239.2
Ore processed	th. tons	212 720	31 899
Au ave. head grade	g/ton	13.3	10.6
Ag ave. head grade	g/ton	425.3	366.7
Au recovery rate	%	94%	-
Ag recovery rate	%	49%	-
Au produced	th. oz.	79.0	-
Ag produced	th. oz.	1 465	-
Au sales	th. oz.	75.8	-
Ag sales	th. oz.	1 127	-
Total cash costs *	\$/oz. Au	114	-

**Note:**

\* The calculations take into account that silver is a co-product at the Khakanjinskoye deposit (according to Gold Institute Standards). In 2003, only mining operations took place at the Khakanjinskoye deposit; no metal production occurred.



## Geological survey and exploration

Geological survey and exploration in 2004 focused on preparing reserves for mining at existing deposits, expanding the mineral reserve base at operating mining facilities in flanks and at deep levels and discovering new precious metals deposits. Successfully completing these tasks involved using geological methods, such as route surveys, deep geochemical

exploration, hole boring and additional probing techniques.

In 2004, Polymetal carried out 76,368,000 m of drilling for geological survey and exploration utilizing high quality imported machinery. Approximately 30% of the drilling was targeted at finding new deposits.

Preparing the reserves for mining at the existing mining facilities

is carried out using the exploration services of the subsidiaries. This allows Polymetal to manage the quality of ore. Our success is illustrated by balanced results at the different processing plants.

### Comparison of qualitative indicators for ore at the plants

Deposit	Ore mined			Ore processed		
	Ore (th. tons)	Au ave. head grade (g/ton)	Ag ave. head grade (g/ton)	Ore (th. tons)	Au ave. head grade (g/ton)	Ag ave. head grade (g/ton)
Dukat	8395	1,38	601,4	7628	1,45	607,9
Lunnoye	283,9	3,15	431,4	257,3	3,74	491,0
Khakanjinskoye	610,5	7,15	227,9	212,7*	13,32	425,3
Vorontsovskoye	953,7	3,71	9,04	905,9	3,61	8,91

**Note:**

\* processing higher quality ore

In 2004, additional exploration aimed at transferring Polymetal's C2 category reserves to the industrial C1 category took place at the company's operating deposits. As a result of these activities, 261,000 oz. of gold and 9,000,000 oz. of silver were transferred to the C1 category. The reimbursement coefficient was 1.2 for gold and 0.52 for silver. These figures were the highest in the industry in Russia.

In 2004, increasing the mineral reserve base at mining facilities was accomplished by engaging in estimation and exploratory drilling at the flanks and deep floor levels of operating deposits. According to 2004 results, 232,000 oz. of gold and 4,983,250 oz. of silver were added to the C2 category.

In 2004, Polymetal had the lowest cost figures for reserve growth - \$25.5/oz. Au equivalent. (including

exploration costs). Taking into account reserves transferred to the C1 category through geological surveys, this figure was as low as \$11.1/oz. of Au equivalent.

Listed below are summary results for geological surveys that occurred at Polymetal's subsidiaries in 2004.

### ■ Vorontsovskoye (Northern Urals Gold, Sverdlovsk Region)

In 2004, Polymetal continued exploring resources at the Vorontsovskoye deposit in the contours of the operating pit. Over the course of the year, by increasing the density of the exploration grid, approximately 192,000 oz. of gold was transferred from the C2 category to the industrial C1 category. Results from detailed drilling support earlier estimates

of the amount of ore and qualitative characteristics of the gold mineralization in the C2 category blocks.

In 2004, drilling exploration in the near and far flanks (folds) of the deposit of ore leads was completed, and the resources were entered into the P1 category. According to preliminary data, balance reserves/resources are estimated at 1,200-1,300 thousand tons of ore (approximately [around] 208,975 oz. of gold). Most of these

resources (85%) are oxidized ore. Processing of this ore will be used to replenish ore for future heap leaching. Significant resources of low-grade ore (approximately 1.9 million tons) with an average gold head grade of 0.8 g/ton were found in the southern flanks of the deposit. The feasibility of processing these resources using heap leaching will be determined after a feasibility study and governmental inspection, which are scheduled for the end of 2005.

### ■ Khakanjinskoye (Okhotsk Mining and Geological Company, Khabarovsk Territory)

At the same time that Polymetal engaged in open-pit mining operations at the Khakanjinskoye deposit, the company began drilling work aimed at estimating the deposit's deeper levels to pre-

pare reserves for Stage II of underground mining at the deposit. Exploration drilling revealed two new ore leads in the contours of which single highly productive mine intersections of up to 10-12 m with an average gold head grade of up to 40 g/ton. Polymetal estimates that through contour drilling C2 category reserves will increase by 317,000 tons of ore,

129,147 oz. of gold (with an average head grade of 12.7 g/ton) and 4,848,220 oz. of silver (with an average head grade of 475 g/ton).

Next year, the company intends to continue estimating deeper levels at the Khakanjinskoye deposit and its far and near flanks (folds). We estimate that these operations will yield approximately 321,500 oz. of gold resources.

### ■ Lunnoye and Arylakh (Silver Territory, Magadan Region)

In 2004, Polymetal explored the operating pit at the Lunnoye deposit and conducted additional surveys of resources in one zone

IX (under the pit) to prepare them for future mining. The exploration allowed for mining ore of planned quality for a one year period. Additional surveys of deeper levels by drilling angled mines allowed 673,000 tons of ore, 56,809 oz. of gold and 7,812,450 oz. of silver

to be transferred to the C1 category of resources. Detailed exploration of C2 category blocks led to the discovery of ore columns with higher quality mineral resources. These ore columns will become the primary areas for future underground mining operations.

### ■ Dukat (Magadan Silver, Magadan Region)

In 2004, geological surveys at the Dukat silver deposit were in the organizational stage. Limited drilling targeted local exploration for

open-pit and underground mining.

## ■ Other exploration and prospecting projects

### ■ Kuzeevskoye (Yenisey Mining and Geological Company, Krasnoyarsk Territory)

Prospecting work - focused on discovering gold deposits in the Archean Greenstone Belt of the southern part of the Yenisey Mountain Ridge - began in 2004. In the licensed area of 11.2 km<sup>2</sup>, deep geochemical prospecting was carried out (1,300 probes), 56,000 m<sup>3</sup> of trenches were bulldozed, and 380 m of prospecting boreholes were drilled.

In 2004, Polymetal carried out exploration aimed at finding new ore deposits in other regions of the Russian Federation. Exploration was carried out by the company's

These activities have yielded promising geological results. Trenches in one of the zones of the licensed area revealed and tracked down two adjacent gold leads with horizontal lengths of 250 and 450 m, respectively. The capacities of the rock bodies range from 1 to 7.0 m with average gold head grade of 2-25 g/ton. One of the ore bodies was estimated based on a five deep borehole profile. A contiguous 250 m gold mineralization was found with the following parameters: capacity of 2.5 m and average head grade of approximately 10 g/ton.

subsidiaries: Yenisey Mining and Geological Company, Aurum and Imitzoloto.

2004 prospecting work indicates resources in the area of approximately 643,000 oz. of gold.

Deep geochemical exploration of the contours of the licensed area show four more ore bearing zones. Trenching and drilling of these zones is scheduled for 2005. If the estimates are correct, the licensed area should contain a medium-large gold deposit (approximately 1,607,500 - 3,215,000 oz.).

### ■ Aprelkovsko-Peshkovski ore knot (Imitzoloto, Chita Region)

Prospecting in the licensed area (Aprelkovsko-Peshkovski ore knot, 161 km<sup>2</sup>) is [are] focused on discovering gold porphyry type deposits. Currently, geochemical prospecting, geophysical explora-

tion and cartographic drilling at the most promising zone -- Taly -- have been carried out. The Zabajkalsky Research Institute estimated 10,931,000 oz. of gold resources at the Taly zone. Prospecting has revealed stockwork type contours in the area of the gold with a length of 1.5 km and a width of over 500 m. The average head grade of gold in the stock-

work is between 1-2 g/ton; and the gold is distributed unevenly. The gold stockwork has not been contoured either horizontally or vertically. At present - based on prospecting in the Taly zone - Imitzoloto estimates its mineral resource base at 3,858,000 oz. of gold. Prospecting work will continue in the future.

### ■ Fevral'skoye (Aurum, Sverdlovsk Region)

At the end of 2003, the company began prospecting work in the area of the Reftinski zone. The Fevral'skoye deposit, which had been mined using claim sluicing methods during the late 19th century

to a depth of up to 20-40 m (the level of underground streams), is located in the licensed area. Prior to 2003, deep floor levels of the deposit had not been explored. As a result, Aurum undertook detailed drilling using a 50x30-50 m grid on a 200x150 m piece to determine prospecting possibili-

ties. This work allowed us to determine industrial parameters and to obtain structural lithological listings of the gold lead. Gold resources in the detailed area are 96,450 oz. with an average head grade of 10 g/ton. Resources of the entire deposit are estimated at 1,929,000 oz. of gold.





Alexander V. Bulavin,  
Head of Licensing  
Department

## ▣ Other geological survey projects

In 2004, the company continued geological surveying and exploration at promising sites in various Russian regions. At the same time, the company continuously monitors mineral resource conditions in Russia to single out potentially viable resource deposits.

In 2005, Polymetal plans to continue exploring and prospecting

at drilling levels of 99,500 m and trenching at 50,000 m<sup>3</sup>. Additionally, the company will engage in geochemical prospecting. As a result of these activities, we expect to increase the gold stock in C1+C2 categories by 385,800 oz. and silver (in the same categories) by 16,075,000 oz.



## Engineering services: Polymetal Engineering

A key operating principle for Polymetal is to carry out the complete range of work at ore deposits - from geological surveys to gold bar production. The company utilizes its own resources at all stages. As a result of the company's reorganization in 2004, the scientific and research institute that had been a division of Polymetal became a separate, specialized engineering company - Polymetal Engineering. In a relatively short period, Polymetal Engineering has established itself as a market leader dealing with scientific and engineering issues at ore deposits throughout Russia.

Polymetal Engineering specializes in turnkey design of deposit developing projects that allow investment schemes to be quickly implemented. During the past six years, Polymetal Engineering has designed eight mining facilities in various regions of Russia - the largest of which were the Dukat deposit and the mining and metallurgy operations at the Khakanjinskoye, Vorontsovskoye and Lunnoye deposits. With the exception of the Dukat deposit (brown field with massive reconstruction), all other investment projects have been green field.

Polymetal Engineering carries out cutting-edge scientific research. Based on results of this research, it develops standards and regulations, which are used to [[develop]] design specifications



Valery N. Tsyplakov,  
Managing Director

for constructing ore enrichment facilities (at all stages of investment projects).

In 2004, Polymetal Engineering successfully fulfilled over 250 orders for comprehensive design at main and auxiliary mining facilities, ore enrichment and mining and metallurgy works. In addition, the company conducted over 90 studies aimed at developing technologies, expanding mineral reserve bases at companies, improving existing technologies and finding new reagents and processes.

Developed computer networks, advanced CAD technologies, state-of-the-art 3D graphics programs and the latest software allow the company to carry out real-time design and immediately share information with all participants in the design process, including the client. These technologies facilitate high-quality work, quick project turnaround and satisfied clients - no matter how complex the task.

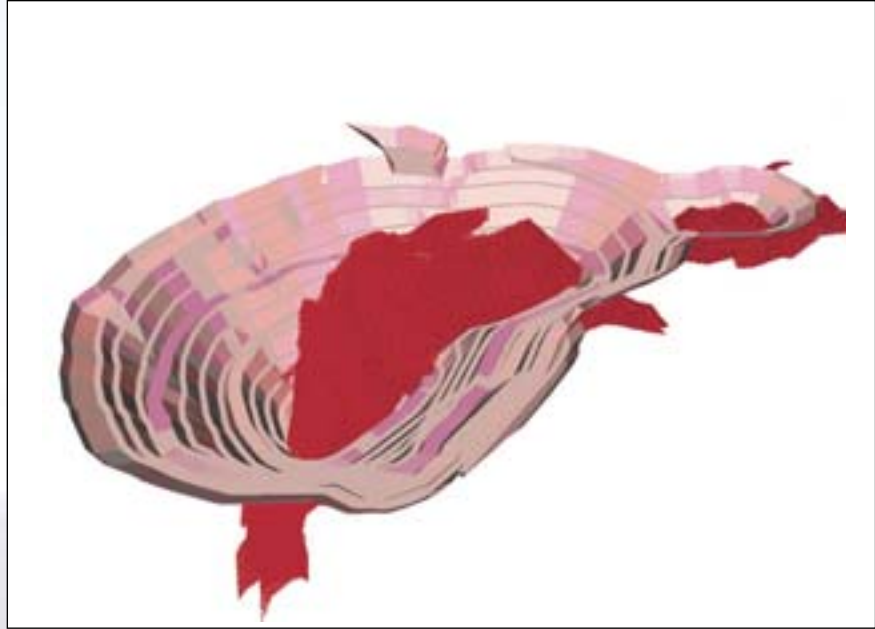
All development planning and issuing of project specifications is carried out in strict accordance with the real needs of the newly constructed, reconstructed or operating facilities. To ensure this, we use various hi-tech programs to form a detailed design schedule that is agreed upon by the parties and meets their individual requirements.

Polymetal Engineering carried out a variety of projects at facilities

managed by Polymetal, including starting-up and fine-tuning equipment (plant #2 at the Vorontsovskoye deposit and the[,] plant at the Khakanjinskoye deposit), testing technical parameters of heap leaching, conducting industrial tests of new reagent methods (plant at the Dukat deposit) and lowering reagent consumption.

In 2004, Polymetal Engineering's principal customers remained companies managed by Polymetal. However, in the past year, the company has begun offering its innovative design [and construction] services to third-party firms.





### ■ Dukat deposit

- conducting a feasibility study of permanent exploration conditions for estimating the mineral reserve base at the Dukat deposit, which will allow for decisions about economically viable ore mining under current conditions;
- creating technological solutions for ore processing that allowed for a complete processing cycle at the Dukat deposit and the production of Dore bars;

- design of a basic warehouse for storing chemical reagents at the plant and designing an oxygen production facility that will lower auxiliary costs;
- redesigning [constructing] drying and filtering facilities at the plant to increase equipment efficiency and plant reliability;
- studying and making preliminary technological specifications for the plant reconstruction to increase gold production by 10% and silver production by 5%;

- evaluating the possibility of producing precious metals from current and discarded tailings at the plant. The study confirmed the technical possibility of additional production through traditional methods such as impregnation and hydrometallurgy, as well as by heap leaching. Depending on the particular method used, silver production can be increased by 54 to 75%.

### ■ Lunnoye deposit

- redesigning [reconstructing] of the Dukat Settlement-Lunnoye Deposit road, which will enable uninterrupted, year-round transportation between these two deposits (even during seasonal floods);
- creating [designing] specifications

tions for the slag recycling facility at the plant's smelting shop. This project will increase the recovery rate of precious metals from slag when processing cementates into Dore bars;

- redesigning [reconstructing] portions of the plant's main building, which will minimize production losses in the combined

processing of ore from the Lunnoye deposit and concentrate from the Dukat deposit;

- creating a strategy to increase productivity at the gold extraction plant by 20%, with estimates indicating the possibility of increasing productivity up to 360,000 tpa of ore

### ■ Khakanjinskoye deposit

- conducting a feasibility study of producing and processing silver-manganese concentrate at the Khakanjinskoye plant;
- designing specifications for reconstructing the ore processing facility that makes the technological scheme more univer-

sal and, as a result, increases productivity;

- drawing up specifications for reconstructing the grinding facility at the plant's main building. This project will construct and launch an additional grinding line at the operating facility and increase ore processing by at least 20%;

- developing [creating] a project for utilizing the brushwood storage facility at the Khakanjinskoye plant from 2004 to 2006. This project will significantly improve operational safety at the storage facility.





Gennady N. Larionov,  
Head of Design  
Department



Alexander S. Aleksanin,  
Deputy Managing  
Director



Boris V. Aksenov,  
Head of Technological  
Research  
Department

### ■ Vorontsovskoye deposit

- developing [constructing] Stage II of the [a] mining and metallurgy facility at the Vorontsovskoye deposit;
- designing [constructing] an ore preparation facility for processing primary ore using the carbon-in-pulp method. Project design was carried out simultaneously with construction. Design technology, previously adopted by the company, decreased the construction time

of the ore enrichment facility by one year and allowed for mining and processing 600,000 additional tons of primary ore;

- designing a project for reconstructing [pairing] a facility that will improve repair work quality and minimize non-production costs;
- technological study of processing off-balance oxidized ore at the Vorontsovskoye deposit, which allowed additional production of metal from off[non]-balanced ore in 2004;

- modelling of heap leaching from two layers of rock. This model provided initial data to design two-level stacks without using any additional premises for this purpose. It also allowed for additional gold leaching from previously used stacks with minimal production costs;

In the past year, the company began working with third-party clients. Today, it is the leading company in Russia for designing [and constructing] solid mineral resource projects.

### ■ Mikhailovsky GOK (Ore Enrichment Works; MGOK)

In 2004, the company designed the flotation shop of the crushing and enrichment facility at the

Mikhailovsky GOK (one of Russia's leading iron ore processing companies). The project increased iron content in the concentrate to 70% and reduced silicon oxides to less than 3%. This was the first

time that this technology was used at a Russian production facility.

### ■ 50 Year Oktyabrya deposit (Kazakhstan)

During 2004, Polymetal Engineering estimated the efficiency of exploration efforts at the 50 Year Oktyabrya copper pyrite deposit (Kazakhstan).

The project was completed in a

condensed time period and the client was kept well-informed about intermediate progress [results]. This allowed for optimizing mining operations, in relation to current production costs, determining the optimal production capacity of the facility for processing ore into copper concentrates and selecting appropriate mining and trans-

portation equipment. The project report contained detailed information and well-formulated suggestions that allowed the client to optimally structure its financial resources, quickly prepare and sign contracts for designing and constructing the enrichment facility and purchasing mining and transportation equipment.

### ■ Syrybmet deposit

In 2004, the company studied the capacity of tin ore at the Syryb-

met deposit to create ore-dressing technology. The company prepared specifications for designing the plant at the deposit with a

production capacity of 1,000,000 tpa of ore.

The professionalism of scientists at Polymetal Engineering enables the company to carry out complex design and technological studies in the areas of precious, ferrous

and nonferrous metals. In addition to the previously mentioned projects, in 2004, the company conducted more than 70 studies aimed at developing technologies,

expanding companies' ore reserves, upgrading existing technologies and finding new reagents and processes.

In 2004, world silver production was 634.4 mln. oz. (a 4% increase compared with 2003). The most

significant contribution to growing global production came from primary silver production mines that

increased their production by 23.2 mln. oz.

### Top 10 world silver producers, 2004 (mln. oz.)

Country	Production
Mexico	99.2
Peru	98.4
Australia	71.9
China	63.8
Poland	43.8
Chile	42.8
Canada	40.6
USA	40.2
Russia	<b>37.9</b>
Kazakhstan	20.6

Source: GFMS, Silver Institute

According to 2004 results, Polymetal demonstrated the most rapid production growth among leading silver producers. In 2004, Polymetal accounted for

2.7% of global silver production.

In Russia, silver production reached 37.9 mln. oz., including 21.4 mln. oz. from primary produc-

tion. Polymetal remained Russia's leading silver producer and accounted for 81% of the country's total primary production.

### Top 10 world silver producers, 2004 (mln. oz.)

Company	Country	Production
BHP Billiton	Australia	49.7
Industrias Penoles	Mexico	44.5
KGHM Polska Miedz	Poland	43.2
Grupo Mexico	Mexico	19.4
Kazakhmys	Kazakhstan	17.7
<b>Polymetal</b>	<b>Россия</b>	<b>17.3</b>
Barrick Gold	Canada	17.3
Rio Tinto plc.	Great Britain	14.8
Coeur d'Alene Mines	USA	14.1
Cia de Minas Buenaventura	Peru	12.8

Source: GFMS, Silver Institute

In 2004, the Dukat and Lunnoye deposits strengthened their positions among the top 10 global silver production deposits.

Top-10 world primary silver mines in 2004 (mln. oz.).

Deposit/Country	Company	Production
Cannington / Австралия	BHP Billiton	45,91
Fresnillo (Proano) / Мексика	Industrias Penoles SA de CV	31,60
<b>Dukat / Russia</b>	<b>Polymetal</b>	<b>12,06</b>
Uchucchacua / Перу	Compania de Minas Buenaventura SA	9,83
Greens Creek / США	Kennecott Minerals/Hecla Mining Co	9,71
Arcata / Перу	Minas de Arcata SA	7,94
Rochester / США	Coeur d'Alene Mines Corp	5,67
Imiter / Марокко	Société Métallurgique d'Imiter	4,95
Huaran / Перу	Pan American Silver Corp	4,08
<b>Lunnoe / Russia</b>	<b>Polymetal</b>	<b>3,70</b>

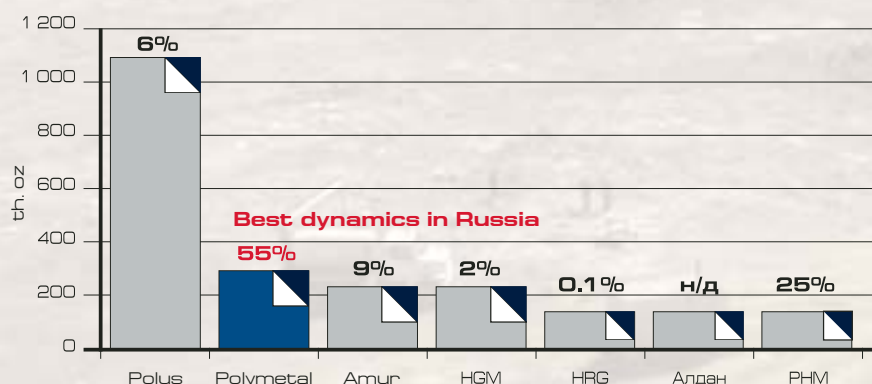
Source: GFMS, Silver Institute

According to figures from 2004, global gold production was 79.2 million oz (down 5% from 2003). Russia is among the world's top gold producing countries. In the

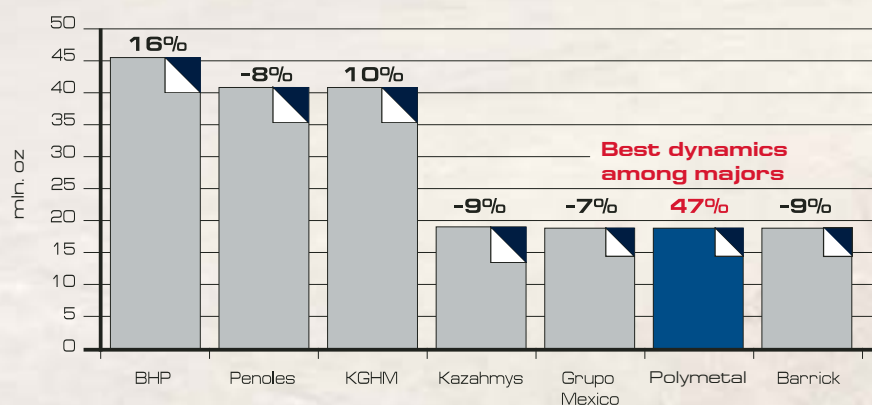
last year, Russia's gold production (including co-production and secondary production) increased 2% and reached 5.8 million oz. Polymetal demonstrated the

most dynamic growth figures for gold production (a 55% increase), and the company was Russia's second largest gold producer.

Top Russian gold producers in 2004



Top world silver producers in 2004



The current level of development, along with continued investment in exploration and state-of-the-art technology, allows one to expect that the company will maintain its leading position in the Russian industry.



Polymetal follows widely accepted global corporate governance practices in its financial and production activities. The company also strictly complies with norms and regulations stated in the Code of Corporate Governance issued by the Federal Agency on Financial Market of the Russian Federation.

Corporate governance principles in society are based on respecting the rights and legal interests of all members of society. Effective corporate governance principles should also stimulate a company's efficient operations, including increasing the value of its assets, creating new jobs and maintaining financial stability.

Polymetal observes Russian and international business standards and ethics. The company protects the rights of its shareholders, provides credible, complete, open and transparent information to concerned parties and organizes meetings of the Board of Directors and shareholders. The company strongly believes in adhering to environmental protection standards (both Russian and international) and in meeting norms and requirements dealing with the health, safety and social security of its employees.

Polymetal also actively collaborates with Russian regional authorities in planning and implementing social and economic development programs in the

regions where the company operates.

Polymetal actively takes measures to upgrade informational transparency for its shareholders, investors and other interested parties. The company prepares auditing reports in accordance with US GAAP standards (auditor: PricewaterhouseCoopers), certifies the quality of key business operations in accordance with ISO-9001 standards and maintains relations with investors and analysts in domestic and international financial markets. The company's website provides detailed and relevant information about all aspects of the company's activities in both Russian and English.

In 2004, Polymetal took steps to increase business and technological efficiency and improve openness for investors. A key step was forming the holding company. The holding corporate structure will maximize our ability to comply with international principles and improve our efficiency in managing subsidiary companies.

A great deal of work was done during the reported period to ensure that all aspects of the company's operations comply with international standards. Polymetal designed a long-term technical-economic model for developing its mining facilities. This model was approved during geological auditing carried out by the international consulting company, SRK Consulting. Clifford Chance carried out a comprehensive juridical auditing of all companies managed by Polymetal. Together with a specialized international company,

Polymetal is working on a detailed risk management program.

To minimize possible losses - due to equipment malfunction or delay, fire at workplaces and other risk factors characteristic of the mining industry - the company's subsidiaries have signed insurance contracts. These contracts include complete coverage from western underwriters through two leading global insurance brokers, AON (GB) and Marsh (GB).

In the future, we plan to take numerous steps to reform our ecological standards and industrial and labor safety practices to comply with international norms, in particular with World Bank standards. We also expect to complete recalculating the company's mineral reserve base according to international JORC classifications in the near future. These measures are aimed at effectively branding Polymetal among potential strategic and portfolio investors, demonstrating the transparency and attractiveness of the company and creating grounds for the company to potentially enter the international public market.

## Environmental policy and health and safety



Tatiana V. Kuleshova,  
Head of Environmental  
& Industrial Sanitation  
Department



Polymetal strictly follows ecological guidelines when exploring precious metals deposits. The company monitors ecological parameters at all stages - from feasibility studies and project design to the construction of mining facilities to mine closures.

Based on the results of careful environmental research and analysis, Polymetal works to develop new, stricter limits for the accepted disturbance to the environment caused by atmospheric pollution, sewage dumping into the water supply and the placement of waste. Polymetal develops and implements programs to monitor the environment in areas in the vicinity of operating facilities. The company also designs programs to control and minimize negative environmental effects caused by these facilities. In addition, Polymetal engages in ecological studies to develop innovative new methods of waste treatment.

Environmental protection departments operate at all of the company's mining subsidiaries. These departments supervise their respective companies' compliance with ecological regulations. They also cooperate with local governmental organizations.

In the past year, subsidiary companies implemented programs to monitor the environment in the area of the mining and metallurgy facility at the Khakanjinskoye deposit, calculated and categorized air pollution at the Lunnoye deposit, corrected a project addressing waste norms and limits on their storage at the Vorontsovskoye and Lunnoye deposits and monitored maximum pollution norms at the Dukat deposit. One of 2004's main goals was to obtain a positive result from an ecological inspection conducted by the Russian Ministry of Natural Resources for the project of constructing a mining and metallurgy facility at the Vorontsovskoye deposit (Stage II). This positive result allowed us to quickly move forward with completing construction and to begin the startup and tuning of equipment at the end of the year.

Monitoring the physical environment and our facilities' impact on it was carried out at all of Polymetal's sites, including geological surveying projects. We also monitored environmental effects for third-party companies as part of Polymetal Engineering's project design contracts (in particular, for Mikhailovsky GOK.

In 2004, Polymetal, together with a specialized international consulting company, began preparing

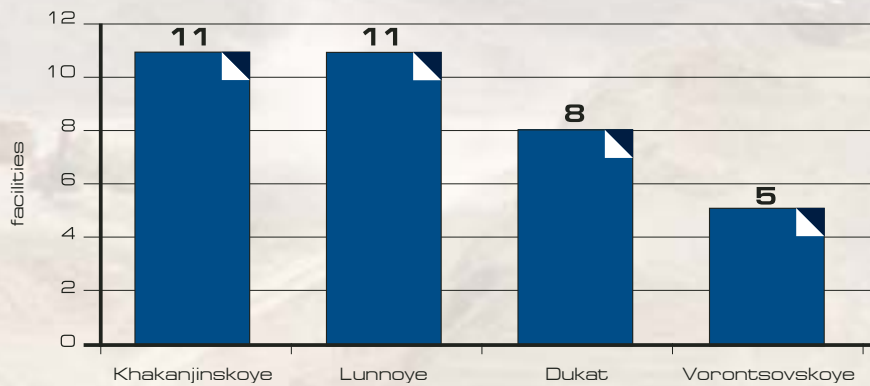
all necessary documentation and taking steps to ensure that its facilities comply with international standards in the areas of environmental protection, industrial sanitation norms and industrial safety, according to World Bank requirements.

Improving industrial safety occurs through better supervision of the production process and is implemented by the subsidiaries taking comprehensive measures aimed at creating safe operating conditions at key production facilities. These steps should be two-fold - taking preventive measures to minimize accident and emergency risks and preparing workers, management and the facility to be able to quickly and effectively address any emergency that does occur.



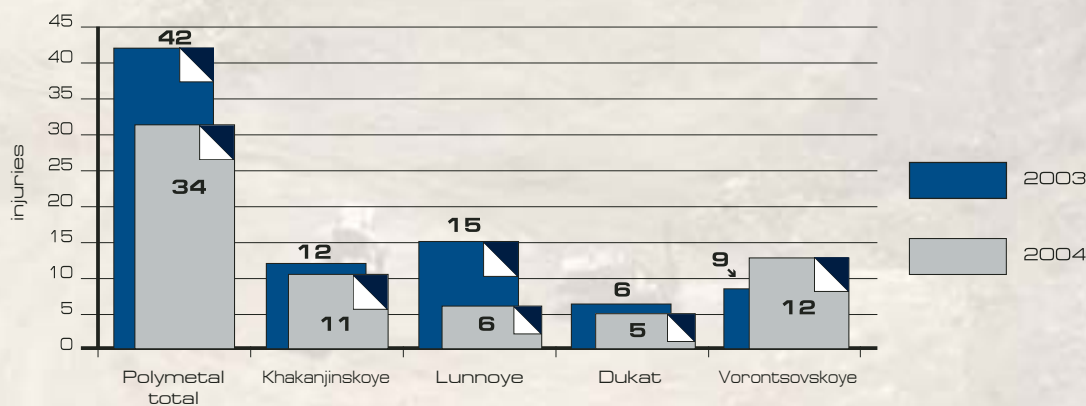


### ■ Hazardous facilities at the deposits



Potentially hazardous facilities were registered in the Russian national registry and insured in accordance with applicable laws.

### ■ Industrial injuries at the deposits



Because of active preventive measures taken by Polymetal (both to minimize the risk of accidents and emergencies and to quickly address them), there has been a steady decrease in the number

of accidents and emergencies during the facilities' operating history.

According to 2004 results, the average number of accidents de-

creased by 1.2 times (8 accidents) compared with 2003.



## Human resources and social responsibility

Upgrading and maintaining the qualifications of its personnel is one of Polymetal's key goals. The company also works to actively support the regional economies where its operating facilities are located and to improve the standard of living for people in these areas. Polymetal's rapid and im-



Alexander A. Zarya,  
Deputy CEO  
for Internal Matters



Alexander P. Sandalov,  
Human Resources  
Director

pressive success can be attributed in large part to its human resources' policy of forming a team of dedicated professionals focused on achieving the company's corporate goals and capable of finding solutions to complex problems. To strengthen its position on the global precious metals market, the company is consistently searching for the best pro-

fessionals to fill available positions. Three simple words - partnership, development and openness - fully explain our human resources' policy.

### Improving organizational structure

In 2004, Polymetal's structure was revamped and separate managerial and engineering companies were created. All mining and geological survey and exploration were transferred under the control of the management company. This restructuring required a thorough reevaluation of different departments' roles and

responsibilities - both in the main company and in its subsidiaries. New organizational departments with new functions and responsibilities for their executives were created as part of the process of transferring managerial control to a single company - Polymetal Management.

An important part of this process was delegating a greater degree of administrative and economic

responsibilities to deputy personnel managers. This process allowed for more efficiently addressing key issues affecting the company's staff and creating additional perks, such as organizing company cafeterias and guaranteeing a healthy standard of living for its employees.

### Human resources policies

As of December 31, 2004, the total number of employees at Polymetal was 4,352, which was

4.5% lower than in 2003. Managerial staff comprises 6.5% of the staff, while 83.4% of employees worked at mining facilities (up from 80% in 2003) and 10.1%

are employed at geological survey and exploration companies in various Russian regions.

### Personnel in the company's divisions

Company	Personnel (employees)	% of the total
Mining facilities	3 630	83,4%
Exploration companies	439	10,1%
Management company	170	3,9%
Engineering company	102	2,3%
Head office	11	0,3%
<b>Total</b>	<b>4 352</b>	<b>100%</b>

## Personnel at mining facilities

Company	Personnel (employees)	% of the total
Magadan Silver	1 086	25%
Northern Urals Gold	988	23%
Okhotsk Geologic and Mining Company	814	19%
Silver Territory	742	17%
Other companies	722	16%
<b>Total for Polymetal</b>	<b>4 352</b>	<b>100%</b>

The prevailing number of the company's personnel are highly qualified specialists - 1,343 (36.9% of the total) - with specialized, higher educations. Twenty-seven employees with Ph.D.'s are currently employed in the company's divisions. Approximately 60% of the staff at the mining and exploration companies are qualified workers.

The company actively works to attract young specialists to spur the development of its projects. Currently, 52.3% of Polymetal's employees are younger than 40, and at Magadan Silver 63% of managers, specialists, clerks and workers are younger than 40 years old.

In 2004, the company's labor productivity grew significantly compared to 2003 - 67% in gold production and 65% in silver production (for mining, labor productivity in gold increased 64% and rose 59% for silver).







#### ▣ Labor productivity at mining facilities

Company	2003		2004	
	Au (oz./person)	Ag (oz./person)	Au (oz./person)	Ag (oz./person)
Magadan Silver	0,6	252	0,7	346
Silver Territory	0,6	108	1,3	154
Northern Urals Gold	2,9	2,0	2,4	1,8
Okhotsk Geological and Mining Company	-	-	3,0	56,0
<b>Total at mining facilities</b>	<b>1,1</b>	<b>93</b>	<b>1,8</b>	<b>148</b>
<b>Total for Polymetal *</b>	<b>0,9</b>	<b>75</b>	<b>1,5</b>	<b>124</b>

**Note:**

*\* Including the personnel of the head, managerial, engineering and geological survey and exploration companies*

The company carries out short-, mid- and long-term personnel planning policies. The primary regions for finding and attracting new employees to Polymetal are the Sverdlovsk, Magadan, Irkutsk and Chita Regions and the Khabarovsk and Primorski Territories. In 2004, the company developed a unified Personnel Reserve database containing de-

tailed information on more than 700 managers and specialists. This database allows the company to quickly select, replace and rotate personnel. Different methods for attracting highly qualified specialists were used to help create the Personnel Reserve database. The company has established relations with regional departments of the Federal Employment Service

in Magadan, Irkutsk, Ekaterinburg, Tomsk and Khabarovsk and with other federal and regional employment agencies. Through this process, Polymetal contributes to the economic development of Russian regions by creating jobs and helping to address the serious issue of unemployment.



## ■ Upgrading skills

In 2004, the company was actively involved in a program to improve the skills of its employees at its subsidiary companies. Altogether, 1,097 employees (25.2% of the total workforce) participated in various educational programs during the last year. Courses were held at the Urals National Mining Academy, Krasnoturyinsk Industrial College, the Far East Technology Center (Khabarovsk), Khabarovsk Educational Center and other institutions.

As part of the program for upgrading skills, in 2004, the company began creating its own educational programs.

## ■ Attracting young specialists

Attracting young, motivated individuals to the company is vital for Polymetal's future development. In 2004, the company launched its Youth, Professionalism, Career program for students at institutions of higher learning and young specialists in the industry. The program offers internships for third, fourth and fifth year students at the company's facilities and prepares these students for future employment at Polymetal.

Over the course of the year, 44 students from the St. Petersburg Mining Institute, educational institutions in Ekaterinburg, Irkutsk National Technical University, the Northern International University and a number of other professional schools held internships at the company. The company conducted presentations at leading Russian

educational institutions and invited hundreds of young specialists to join the company as interns or employees. The program will continue for several years and will improve the company's competitiveness by attracting young and talented specialists to the company. By communicating and sharing their experience and knowledge with established professionals at the company, professional growth will occur for all specialists.

## ■ Social responsibility

During 2004, the company developed numerous programs to improve workers' motivation and up workplace morale. Currently, steps are being taken to implement the following programs:

- organizing hospital care and medical examinations for employees through contracts with St. Petersburg medical institutions;
- providing full sets of summer and winter corporate clothing for every employee;
- organizing summer vacations for employees' children;
- organizing sports and recreational activities for employees (for example, company soccer teams and rental of sports facilities).

In 2004, Polymetal and its subsidiaries offered sponsorship and charity to various organizations in the regions in which they operate. The company is interested in fostering favorable social conditions and upping living standards, not only for its employees, but also for

citizens in the regions where the company's facilities are located. We intend to continue to implement large-scale sponsorship and charity projects aimed at developing infrastructure, sports, health-care and culture.

In 2004, the company offered aid to kindergartens, schools and sports organizations to organize sports events. It also supported individual young athletes as part of the Second Sports Games for Children. The company also engaged in programs for war veterans and the disabled and assisted regional hospitals and clinics. Polymetal, in cooperation with the Government of the Sverdlovsk Region, played an active role in constructing a clinic at the Sverdlovsk Regional Hospital. The company also participated in the government-organized Springs of the Urals program. In addition, Polymetal actively reconstructed infrastructure in the Omsukchansk District of the Magadan Region and helped organize celebrations to recognize the 60th anniversary of victory in WWII.

In 2004, companies managed by Polymetal spent approximately 500,000 USD on charity and sponsorship activities.

## Executives

Polymetal Board  
of Directors

### **Alexey BOLSHAKOV**

Chairman of the Board of Directors

Mr. Bolshakov is one of the founders of ICT Group and Polymetal. He has extensive business and government experience in Russia. Beginning in 1991, he worked as the General Director of RAO High-Speed Roadways (RAO VSM). And in 1994, Mr. Bolshakov served as Deputy Prime Minister of the Russian Federation. He has been Chairman of the Board of Directors of Polymetal since 1998.

### **Alexey GUDAITIS**

Member of the Board of Directors

Mr. Gudaitis is one of the founders of ICT Group and Polymetal. In 1990, he worked as the Director of the Production Association "Reserve" and in 1994, he became vice president at ICT. Since 1998, Mr. Gudaitis has been a member of Polymetal's Board of Directors. He holds a Ph.D. in technical sciences.

### **Mikhail USHAKOV**

Member of the Board of Directors

Mr. Ushakov is one of the founders of ICT Group and Polymetal. Beginning in 1990, he served as the Commercial Director of GP Metallurg. In 1993, he moved to ICT Group, where he has held a variety of executive positions. From 1996 to 2005, Mr. Ushakov worked as the Director of Strategic Planning at Baltiysky Shipyard. In 1998, Mr. Ushakov was named a vice president of ICT and was appointed to the Board of Directors of Polymetal.

### **Vitaly NESIS**

Member of the Board of Directors

Mr. Nesis graduated from Yale University in 1997. From 1997-1999, he worked as an analyst at Merrill Lynch (USA) and from 1999-2000, he worked in the Moscow branch of McKinsey&Company. Mr. Nesis served as the Director of Strategic Development at UAZ in 2000-2001. Before joining Polymetal as its CEO, he worked as General Director of Vostsibugol (Irkutsk).

### **Konstantin YANAKOV**

Member of the Board of Directors

From 1997-1998, Mr. Yanakov worked as the head of the Department of Shareholders' Capital at Russian Credit Bank. And from 1998-1999, he was a department head at Metaloinvest Holding. Before his appointment as Polymetal's CFO in 2003, Mr. Yanakov worked as vice president - manager of the Moscow branch and head of the Department for the Development of the Regional Network at MDM-Bank. He is currently employed as the CFO at ICT Group.



**Vitaly NESIS**

CEO

Mr. Nesis graduated from Yale University in 1997. From 1997-1999, he worked as an analyst at Merrill Lynch (USA) and from 1999-2000, he worked in the Moscow branch of McKinsey & Company. Mr. Nesis served as the Director of Strategic Development at UAZ in 2000-2001. Before joining Polymetal as its CEO, he worked as General Director of Vostsibugol (Irkutsk).

**Igor VENATOVSKIY**

COO

In 1971, Mr. Venatovskiy began working as a hydro-engineer and later became the General Director of Krasnokholmskgeologiya Production and Geological Association of the General Department of the Ministry of Geology of the USSR. In 1995, he took part in organizing Polymetal and he has served as the COO since 2000. Mr. Venatovskiy has received numerous awards including recognition as an Honorable Geologist of the USSR, Laureate of the Biruni National Award in Science and Technology from the Republic of Uzbekistan and a medal for labor prowess.

**Sergey CHERKASHIN**

CFO

From 1993-1994, Mr. Cherkashin worked as a consultant at AT Kearney consulting company. He served as the Deputy General Director for Economics at the Timashevsk Dairy Farm (Krasnodarsk District) from 1994-1999. And he was employed as the Marketing Director of the Ulianovsk Automobile Plant (UAZ) from 1999-2000. From 2001-2004, Mr. Cherkashin worked as the Deputy General Director for Economics at the Volgograd Dairy Farm. Before his appointment as CFO at Polymetal, he was the Director of the Department for Agricultural Machine-Building at Interpipe Corp. (Ukraine).

**Vladimir RYABUKHIN**

Deputy General Director for Mineral Resources

From 1970-1992, Mr. Ryabukhin held numerous scientific positions, including working as the Head Geologist at the Krasnokholmsk Production Geological Association (Tashkent). He discovered the Koscheka and Dzhan-tuar uranium deposits in the Kyzylkumskaya Province. From 1992-1998, he worked as the Head Geologist at Nevskgeologiya (St. Petersburg). And since 1998, Mr. Ryabukhin has been employed at Polymetal.

Alexander Zarya, Deputy General Director

From 1991-1994, Mr. Zarya worked as the General Director of NPO Quartz (St. Petersburg). Beginning in 1995, he organized the first gold production projects of Polymetal - Bashkiria Gold Mining Company and the South Urals Gold Mining Company. He has worked at Polymetal since its inception.

**Yury MALAKH**

Deputy General Director for Materials and Technical Supplies

From 1983-1990, Mr. Malakh worked at the Kazan Branch of the Academy of Sciences of the USSR. From 2000-2001, he was employed as the head of the Department of Information Technologies at Slavneft. Mr. Malakh worked as the Director of Tyazhpromeksport from 2001-2003. In 2003, by an order of the Russian Deputy Prime Minister, Mr. Malakh was appointed the Russian Co-Director for the Russian-EC Center for Power Industry Technologies. He holds a Ph.D. in physics and mathematics.

**Yury DMITRIEV**

Deputy General Director for Security

Mr. Dmitriev served in Russia's Armed Forces for 41 years - 39 years in national security. He retired as a Major General and the head of the Military Counterintelligence Department for troops in the Far East Military Base. Mr. Dmitriev's service was recognized with Red Banner and Red Star medals.

**Valery TSYPLAKOV**

Polymetal Engineering CEO

From 1978-1988, Mr. Tsyplakov worked as an engineer, chief engineer and research fellow in the Department of Plasma Physics at the Moscow Institute of Engineering and Physics. He worked at the Institute of Physics in Aarhus, Denmark from 1986-1987. And from 1988-1993, he was a research fellow, head of the laboratory and department head at the USSR R&D Institute of Aviation Automatic Equipment. From 1993-2000, he worked as the leading specialist and Deputy General Director for ICT-M. Since 2000, Mr. Tsyplakov has been head of the Department for Technological Research and Deputy General Director for Design and Technologies at Polymetal. He holds a Ph.D. in physics and mathematics.



# APPENDIX #1

JOINT-STOCK COMPANY "ISPA "POLYMETAL"  
CONSOLIDATED FINANCIAL STATEMENTS  
AND REPORT OF INDEPENDENT AUDITORS  
FOR THE YEARS ENDED DECEMBER 31, 2004 and 2003



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### **Report of Independent Auditors**

To the Board of Directors and Shareholders  
of Joint-Stock Company "ISPA "Polymetal":

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, cash flows and changes in shareholders' equity present fairly, in all material respects, the financial position of Joint-Stock Company "ISPA "Polymetal" at December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated 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 of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

St. Petersburg, Russia  
July 8, 2005

**JSC "ISPA "POLYMETAL"  
CONSOLIDATED BALANCE SHEETS**

(In thousands of U.S. Dollars, except as indicated)

Assets	Notes	At December 31 2004	At December 31 2003
Cash and cash equivalents	4	1 353	1 925
Prepayments to suppliers		5 268	2 717
Related party receivables and prepayments	5	26 465	37 436
Loans to related parties	6	5 867	4 174
Loans to third parties	7	71 141	-
Inventories	8	83 711	54 778
Short-term VAT receivable	12	48 676	27 432
Other current assets	11	22 958	1 661
<b>Total current assets</b>		<b>265 439</b>	<b>130 123</b>
Long-term investments and intangible assets, net	9	9 576	9 215
Property, plant and equipment, net	10	256 662	204 117
Long-term VAT receivable	12	3 770	15 538
Deferred tax asset	24	5 803	5 467
<b>Total assets</b>		<b>541 250</b>	<b>364 460</b>
Liabilities and shareholders' equity			
Accounts payable and accrued liabilities	13	20 417	15 397
Accounts payable and promissory notes - related parties	14	4 028	1 647
Short-term debt and current portion of long-term debt	15	51 318	114 621
Short-term debt - related parties	16	42 156	39 471
Tax payable		5 134	3 307
Deferred tax liability	24	6 422	-
Current portion of capital lease liabilities	19	19 467	20 228
<b>Total current liabilities</b>		<b>148 942</b>	<b>194 671</b>
Long-term capital lease liabilities	19	15 195	17 427
Long-term debt	17	116 567	30 916
Long-term debt - related parties	18	108 918	82 215
Deferred tax liability	24	11 921	5 714
Reclamation and mine closure obligation	20	4 430	4 830
<b>Total liabilities</b>		<b>405 973</b>	<b>335 773</b>
Minority interest		24 431	7 057
Commitments and contingent liabilities	29	-	-
Shareholders' equity			
Share capital (4 850 000 shares authorized at December 31, 2004 and 2003, par value Rubles 100 per share; 550 000 shares issued and outstanding at December 31, 2004 and 2003)	21	6 397	6 397
Additional paid-in capital		52 124	52 124
Accumulated other comprehensive income (loss)		1 792	(3 841)
Retained earnings (accumulated deficit)		50 533	(33 050)
<b>Total shareholders' equity</b>		<b>110 846</b>	<b>21 630</b>
<b>Total liabilities and shareholders' equity</b>		<b>541 250</b>	<b>364 460</b>

Approved on behalf of the Board of Directors on July 8, 2005.

Nesis V. N., General Director

Cherkashin S. A., Finance Director

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



**JSC "ISPA "POLYMETAL"**  
**STATEMENT OF OPERATIONS**

(In thousands of U.S. Dollars, except as indicated)

	Notes	Year ended December 31 2004	Year ended December 31 2003
Revenues	22	204 487	92 357
Cost of sales	23	(92 850)	(55 800)
<b>Income from mining operations</b>		<b>111 637</b>	<b>36 557</b>
Exploration expenses		(554)	(256)
General, administrative and selling expenses		(15 523)	(9 542)
<b>Operating income</b>		<b>95 560</b>	<b>26 759</b>
Interest expense		(29 223)	(21 110)
Capital lease finance costs	19	(5 541)	(5 441)
Other expenses, net		(7 546)	(4 395)
Gain on partial disposal of interest in a consolidated subsidiary	28	-	13 850
Exchange gains, net		8 725	7 587
<b>Income from continuing operations before income tax and minority interest</b>		<b>61 975</b>	<b>17 250</b>
Income tax (expense) benefit	24	(11 277)	3 163
<b>Income from continuing operations before minority interest</b>		<b>50 698</b>	<b>20 413</b>
<b>Minority interest</b>		<b>(12 782)</b>	<b>(642)</b>
<b>Income from continuing operations</b>		<b>37 916</b>	<b>19 771</b>
<b>Discontinued operations</b>			
Loss from operations of disposed subsidiary		(1 884)	(6 303)
Gain on disposal of subsidiary	25	47 551	-
<b>Income (loss) on discontinued operations</b>		<b>45 667</b>	<b>(6 303)</b>
<b>Net income</b>		<b>83 583</b>	<b>13 468</b>

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

**JSC "ISPA "POLYMETAL"  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands of U.S. Dollars, except as indicated)

	Year ended December 31 2004	Year ended December 31 2003
<b>Cash flows from operating activities</b>		
Net income	83 583	13 468
Adjustments to reconcile net income to cash provided by operations:		
Depreciation and depletion	12 341	6 662
Amortization of intangible assets	168	224
Accretion of reclamation and mine closure obligation	665	581
Gain on disposal of subsidiaries	(47 551)	-
Gain on partial disposal of interest in a consolidated subsidiary	-	(13 850)
Deferred income tax expense (benefit)	7 863	(3 221)
Loss on disposal of property, plant and equipment	1 338	475
Exchange gains, net	(8 873)	(8 868)
Minority interest	12 782	642
Changes in operating working capital, excluding cash and debt:		
Prepayments to suppliers	(2 551)	1 644
Related party receivables and prepayments	10 971	(7 084)
Inventories	(16 812)	(12 211)
VAT receivable	(9 687)	(16 972)
Other current assets	(21 297)	1 239
Accounts payable and accrued liabilities	7 401	2 414
Tax payable	1 625	(120)
<b>Net cash provided by (used in) operating activities</b>	<b>31 966</b>	<b>(34 977)</b>
<b>Cash flows from investing activities</b>		
Additions to property, plant and equipment	(29 595)	(46 660)
Purchase of additional shares in subsidiary	(21 226)	(296)
Proceeds from disposal of interest in consolidated subsidiaries	10 890	20 787
Prepayments for acquisition of third party promissory notes	-	(12 277)
Loans made to third parties	(31 117)	-
Repayment of loans made to third parties	9 670	-
Loans made to related parties	(12 783)	(3 593)
Repayment of loans made to related parties	10 766	-
<b>Net cash used in investing activities</b>	<b>(63 395)</b>	<b>(42 039)</b>
<b>Cash flows from financing activities</b>		
Ordinary shares issuance	-	27 160
Proceeds from short-term loans and borrowings	138 713	38 518
Repayment of short-term loans and borrowings	(202 913)	(12 317)
Proceeds from long-term debt	105 000	135 001
Repayment of long-term debt	(21 893)	(145 952)
Proceeds from short-term loans and borrowings - related parties	141 454	50 520
Repayment of short-term loans and borrowings - related parties	(141 999)	(14 841)
Proceeds from long-term debt - related parties	203 040	62 978
Repayment of long-term debt - related parties	(176 807)	(38 971)
Purchase of bonds	-	(8 093)
Sale of bonds	6 520	-
Lease payments	(20 406)	(15 689)
<b>Net cash provided by financing activities</b>	<b>30 709</b>	<b>78 314</b>
Exchange effects on cash balances	148	46
<b>Net (decrease) increase in cash and equivalents</b>	<b>(572)</b>	<b>1 344</b>
Cash and cash equivalents, beginning of the year	1 925	581
<b>Cash and cash equivalents, end of the year</b>	<b>1 353</b>	<b>1 925</b>

**Supplementary cash flow information**

Interest paid, except for interest capitalized	33 230	16 843
Income taxes paid	3 300	54
Accounts receivable for subsidiary disposal	1 401	-
Noncash additions to property, plant and equipment - capital lease	17 715	24 756

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

**JSC "ISPA "POLYMETAL"**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

(In thousands of U.S. Dollars, except as indicated)

	Share capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings (accumulated deficit)	Total shareholders' equity
<b>Balance at December 31, 2002</b>	<b>6 227</b>	<b>25 134</b>	<b>-</b>	<b>(46 518)</b>	<b>(15 157)</b>
Comprehensive income:					
Net income	-	-	-	13 468	13 468
Currency translation adjustment (including income tax expense of U.S. Dollar 2 296, charged to other comprehensive loss)	-	-	(3 841)	-	(3 841)
Total comprehensive income					9 627
Share issue (50 000 shares with par value Ruble 100 per share)	170	26 990	-	-	27 160
<b>Balance at December 31, 2003</b>	<b>6 397</b>	<b>52 124</b>	<b>(3 841)</b>	<b>(33 050)</b>	<b>21 630</b>
Comprehensive income:					
Net income	-	-	-	83 583	83 583
Currency translation adjustment	-	-	5 633	-	5 633
Total comprehensive income					89 216
<b>Balance at December 31, 2004</b>	<b>6 397</b>	<b>52 124</b>	<b>1 792</b>	<b>50 533</b>	<b>110 846</b>

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



## JSC "ISPA "POLYMETAL"

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In thousands of U.S. Dollars, except as indicated)

#### NOTE 1

##### Background

##### Description of Business

Open joint stock company "Inter-regional Research and Production Association "Polymetal" (JSC "ISPA "Polymetal" or "the Company") was incorporated on March 12, 1998 in the Russian Federation. The Company is engaged in gold and silver mining and related activities, including exploration, extraction, processing and reclamation. Since incorporation, the Company has acquired a number of gold and silver mining properties in the Russian Federation, which require significant investment to bring to commercial production. The Company has producing assets at Vorentsovskoye and Lunnoye fields, Dukat and Khakandjinskoye mines. The latter was brought into commercial production at the beginning of 2004.

The majority shareholder of the Company is ZAO ICT, which, together with its subsidiaries forms the ICT group.

The Company's ability to meet its obligations and maintain operations is contingent upon the continuing support of ICT group,

the successful development and future profitable production of its mining assets, the mining licenses being maintained in good standing and the political, economic and legislative stability in the Russian Federation.

##### Liquidity and Capital Resources

In prior years the Company's mining assets were at the developmental stage which required financing of its capital expenditures with debt. At December 31, 2003, the Company had a working capital deficit (calculated as the difference between total current assets and total current liabilities). In 2004 the liquidity situation caused by recurring working capital deficit and lack of long-term financing was addressed by management by means of the following measures:

■ In March 2004, the Company received a U.S. Dollar 23 million short-term loan from Standard Bank London. At the date of issuance of these consolidated financial statements, this loan was repaid,

■ In December 2004, the Company received a U.S. Dollar 105

million long-term loan from Standard Bank London (see Note 17),

■ In September - November 2004, the Company received short-term loans in total amounting to U.S. Dollar 30 million from NIKoil Bank (see Note 15),

■ Renegotiation of the short-term debt to MDM-Bank totaling U.S. Dollar 56 million and extending repayment terms to November 2004 - January 2005. At the date of issuance of these consolidated financial statements, this loan was repaid,

■ In 2004, shares of Zun Hada engaged in development of Barun-Kholba mine were disposed of. On 27 June and 28 June 2005, Zun Hada repaid amounts (U.S. Dollar 49 397) due to the Group companies (see Note 25).

##### Composition of the Group

ISPA "Polymetal" and its subsidiaries are collectively referred to as "the Group".

The structure of the Group as at December 31, 2004 included the following significant mining subsidiaries:

Name of subsidiary	Voting interest, %	Effective ownership interest, %
ZAO Zoloto Severnogo Urala	99,95	83,33
OAO Okhotskaya GGC	67,35	67,35
ZAO Serebro "Territorii"	97,11	97,11
ZAO GC Dukat	85,00	85,00
ZAO Serebro Magadana	100,00	88,00
ZAO Kurilskaya GGC	100,00	100,00

The Group's 100% interest in a variable interest entity is consolidated (see Note 3).

Changes in the Group structure and voting and ownership interest

in major production subsidiaries in 2003 and 2004 are discussed Notes 25 through 28.

The company has the following significant mining licenses: Vo-

rontsovskoye field (Sverdlovsk region), Lunnoye field and Dukat field (Magadan region), Khakandjinskoye field (Khabarovsk region), Urjevskoe field (Khabarovsk region).

## NOTE 2

### Summary of Significant Accounting Policies

#### Basis of Presentation

The consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

#### Reclassifications

Certain reclassifications have been made to previously reported balances to conform to the current year's presentation; such reclassifications have no effect on net result of shareholders' equity.

#### Use of estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, including discussion and disclosure of contingent liabilities. Management's estimates are made in accordance with mining industry practice. Significant areas requiring the use of management estimates relate to determination of mineral reserves, reclamation and environmental obligations, impairment of assets and valuation allowances for deferred tax assets. Actual results could differ

from such estimates.

#### Reporting and functional currency

The Company's functional currency is the Russian Ruble. The most of the Company's sales revenues and purchases and certain financing agreements are settled in Russian Rubles. The U.S. Dollar is the reporting currency selected by the Group for purposes of financial reporting in accordance with U.S. GAAP.

In November 2002, the International Practices Task Force (IPTF) concluded that the Russian Federation ceased to be a highly inflationary economy as of January 1, 2003. As a result, the Company has determined that its functional currency management uses the Russian Ruble to manage the financial risks and exposures, and to measure its performance. Under FAS No. 52, revenues, costs, assets and liabilities had been remeasured at historical exchange rates prevailing on the transaction dates up to December 31, 2002. On January 1, 2003, all non-monetary assets and liabilities, monetary assets and liabilities, equity items were translated into Rubles at the exchange rate prevailing at that date. In accordance with the provisions of Emergency Issue Task Force 92-8 consensus, Accounting for the Income Tax Effects Un-

der the FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary, deferred tax associated with the temporary differences that arise from a change in functional currency when an economy ceases to be considered highly inflationary was reflected in translation adjustment within shareholders' equity at January 1, 2003.

Starting from January 1, 2003, all non-monetary and monetary assets and liabilities are translated at exchange rates prevailing on the balance sheet date. Revenues, expenses, gains and losses are translated into the reporting currency using exchange rates prevailing at the respective transaction dates. Equity items are translated at historic exchange rates. Translation adjustment, net of tax, is accounted for as part of cumulative translation adjustment component of shareholders' equity.

The exchange rates for one dollar were Ruble 27.75 at December 31, 2004, and Ruble 29.45 at December 31, 2003 and January 1, 2004.

The Russian Ruble is not a convertible currency outside of the Russian Federation and material exchange restrictions and controls exist relating to converting Russian Rubles into other currencies.



## JSC "ISPA "POLYMETAL"

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In thousands of U.S. Dollars, except as indicated)

#### NOTE 2

##### Summary of Significant Accounting Policies (continued)

Within Russia, the daily foreign exchange market determines the Russian Ruble to U.S. Dollar exchange rate, with some intervention from the Central Bank of the Russian Federation. Future movements in the exchange rate between the Russian Ruble and the U.S. Dollar will affect the carrying value of the Group's Russian Ruble denominated monetary assets and liabilities. Such movements may also affect the Group's ability to realize non-monetary assets represented in U.S. Dollar in these consolidated financial statements. Accordingly, any translation of Russian Ruble amounts to U.S. Dollar should not be construed as a representation that such Russian Ruble amounts have been, could be, or will in the future be converted into U.S. Dollar at the exchange rate shown or at any other exchange rate.

##### Principles of consolidation.

The consolidated financial statements include the operations of all entities in which the Group directly or indirectly controls more than 50 percent of voting power and all variable interest entities for which the Group is determined to be the primary beneficiary.

Long-term investments over which the Company does not exercise significant influence are accounted for at cost and adjusted for estimated impairment.

All intercompany transactions and balances between group companies have been eliminated.

Variable Interest Entities are consolidated if the Group is the primary beneficiary in accordance with FASB Interpretation No. 46(R) ("FIN 46 (R)").

##### Comparative figures

Certain comparative figures have been restated to be consistent with the current year presentation.

##### Cash and cash equivalents

Cash and cash equivalents include cash and highly liquid investments that are readily convertible to known amounts of cash and with an original maturity of three months or less at the date of purchase.

##### Inventories

Raw materials, spare parts, supplies, ore and dor are valued at lower of cost and net realizable value, using the weighted average cost method.

##### Property, plant and equipment

Property, plant and equipment include the cost of development of the mining properties, the costs of acquisition or construction of plant and equipment and capitalized interest. Expenditures for major improvements and renewals are capitalized. The cost of maintenance, repairs, and replacement of minor items of property is charged to income as incurred. Interest directly attributable to the acquisition or construction of property, plant and equipment is capitalized as a cost of the asset up to the time the asset is put into use. All other interest is expensed

as incurred. Gains and losses on the disposal of assets are included in the statement of operations in the period of disposal.

Mineral exploration costs are expensed as incurred. When it has been determined that a mineral property can be economically developed as a result of establishing proven and probable reserves, the costs incurred to develop such property, including costs to further delineate the ore body and remove overburden to initially expose the ore body, are capitalized.

Depreciation and depletion are computed using the units-of-production method based on the actual production for the year compared with total estimated proven and probable reserves (in thousands of tons of mineral bearing ore).

Leased property, plant and equipment meeting the criteria of finance lease is capitalized; valued at the lower of asset purchase price and net present value of lease payments. The corresponding part of lease payments is recorded as a liability. Amortization of capitalized leased assets is computed using the units-of-production method.

Property, plant and equipment are assessed for possible impairment in accordance with SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 requires long-lived assets with recorded values that are not expected to be recovered through future cash flows to be written down to current fair value. Fair value is generally determined from estimated discounted future net cash flows.



### **Deferred development expenditures**

In general, mining costs are charged to operations as incurred. However, certain of the Company's deposits require significant capital expenditures, such as tunneling in preparation of a new mining area. These expenditures are charged to cost of production in the proportion that the amount of ore extracted bears to the amount estimated to be accessed by the preparation work. Unamortized balances of capitalized development expenditure are expensed when the area that they cover is depleted, or deemed to be depleted by management.

### **Reclamation and mine closure**

The Company accounts for reclamation, site restoration and closure obligations based on the provisions of SFAS No. 143 Accounting for Asset Retirement Obligations. When the liability is initially recorded, the Company capitalizes the cost by increasing the carrying amount of the related long lived asset. Over time, the liability is accreted to its present value each period, and capitalized cost is amortized over the useful life of the related asset.

### **Revenue recognition**

In accordance with the guidance outlined in Staff Accounting Bulletin No. 101 Revenue Recognition in the Financial Statements, and applicable precious metals industry-specific guidance outlined in Accounting Research Bulletin No.43 Restatement and Revision of Accounting Research Bulletins,

the Company recognizes revenue upon the delivery of refined gold and silver to customers.

### **Income taxes**

Deferred income tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, in accordance with SFAS No. 109 Accounting for Income Taxes. Deferred income tax assets and liabilities are measured using enacted tax rates in the years in which these temporary differences are expected to reverse. Valuation allowances are provided for deferred income tax assets when management believes that it is more likely than not that the assets will not be realized. Contributions to local authorities

Infrastructure expenditure, which is required to be contributed to the local authorities as a condition of mineral license agreements, is charged to statement of operations as incurred.

### **Comprehensive income**

SFAS No. 130 "Reporting Comprehensive Income", requires disclosure of all changes in equity during a period except those resulting from investments by and distributions to the Company's shareholders.

### **Pension obligations**

The Company pays mandatory contributions to the state social funds, which are expensed as in-

curred.

### **Recently issued accounting standards**

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs-an amendment of ARB No. 43, Chapter 4," which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material as current period costs. It also requires that allocations of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The Statement applies to inventory costs incurred in the first fiscal year beginning after June 15, 2005. Management believes that the adoption of SFAS No. 151 will not have a material impact on the Company's reported financial position, net earnings or cash flows.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets an amendment of APB No. 29". This Statement amends APB Opinion No. 29, "Accounting for Non-monetary Transactions" to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. This Statement is effective for fiscal years beginning after June 15, 2005. Management believes that the adoption of SFAS No. 153 will not have a material impact on the Company's reported financial position, net earnings or cash flows.

## JSC "ISPA "POLYMETAL" NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In thousands of U.S. Dollars, except as indicated)

### **Certain accounting and reporting issues in the mining industry**

In March 2004 the Financial Accounting Standards Board ratified Emerging Issues Task Force Consensus 04-02 ("EITF 04-02"), Whether Mineral Rights Are Tangible or Intangible Assets, and Emerging Issues Task Force Consensus 04-03 ("EITF 04-03"), Mining Assets: Impairment and Business Combinations. EITF 04-02 concludes that mining entities should account for mineral rights acquired as tangible assets. EITF 04-02 allows inclusion of reserves beyond the mining entity's proved and probable reserves ("value beyond proved and probable") in determination of fair values of acquired mining properties for purposes of purchase price allocation in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations. Both EITF 04-02 and 04-3 are effective for first reporting period beginning after the Board ratification. Management is currently evaluating the impact that these pronouncements may have on the Company's financial statements.

### **Financial Instruments Fair values.**

A financial instrument is defined as cash, evidence of an ownership interest in an entity, or a contract that imposes an obligation to deliver or right to receive cash or another financial instrument. The fair values of financial instruments are determined with reference to

various market information and other valuation methods, as considered appropriate. However, considerable judgment is required to interpret market data and to develop the estimates of fair value. Accordingly, the estimates presented herein may differ from the amounts the Company could receive in current market exchanges.

The net carrying values of cash and cash equivalents, other short-term investments, accounts and notes receivable, accounts and notes payable and accrued liabilities, taxes payable and short-term debt approximate their fair values because of the short maturities of these instruments.

Long-term investments in unquoted companies are valued at their historical cost adjusted for impairment, as appropriate. Management believes that the carrying values of long-term investments approximate their fair values.

The fair value of the Company's long-term debt was U.S. Dollar 214 486 and U.S. Dollar 101 346, while the carrying value of such liabilities was U.S. Dollar 225 485 and U.S. Dollar 113 131 as of December 31, 2004 and 2003, respectively.

### **Credit risks.**

A significant portion of the Company's accounts receivable is balance of VAT receivable from local tax bodies. Management believes

there is no significant risk of loss to the Company associated with recoverability of these balances.

### **Concentration risks.**

Management believes, that no significant concentration risk was associated with any cash and cash equivalents, accounts receivable and prepayments balances at December 31, 2004.

**NOTE 3**  
**Variable Interest Entity**

Starting 2004 the Group operated an entity which qualified for consolidation into the Group as a variable interest entity (VIE) for which the Group is the primary beneficiary. The entity's primary activity is marketing of metals produced by the Group's mining and production subsidiaries. Included within revenues in the

consolidated statement of operations for the year ended December 31, 2004 was U.S. Dollar 36 612 representing third-party sales of gold and silver by the entity. Included within net income in the consolidated statement of operations for the year ended December 31, 2004 was U.S. Dollar 4 584 net income of VIE. During 2004 the entity provided guarantees for certain of the Group's short-term debt facilities. None of

these guarantees were outstanding at December 31, 2004 as the related debt had been repaid in full prior to that date. Included within loans to third parties in the consolidated balance sheet at December 31, 2004 was U.S. Dollar 21 450 representing third-party short-term loans receivable issued by the entity.

**NOTE 4**  
**Cash and Cash Equivalents**

The Company maintains both Russian Ruble and U.S. Dollar bank accounts.

	December 31 2004	December 31 2003
Denominated in U.S. Dollars	68	54
Denominated in Russian Rubles	1 285	1 871
<b>Total cash and cash equivalents</b>	<b>1 353</b>	<b>1 925</b>

**NOTE 5**  
**Related party receivables and prepayments**

	December 31 2004	December 31 2003
Prepayments to Daniz	-	20 370
Trade receivables from Nomos-Bank	25 785	15 974
Other related party receivables and prepayments	680	1 092
<b>Total related party receivables and prepayments</b>	<b>26 465</b>	<b>37 436</b>

Nomos-Bank is an associate of ZAO ICT, the Company's parent, and Daniz is a subsidiary of ZAO ICT. The prepayments to Daniz at

December 31, 2003 included a prepayment of U.S. Dollar 12 397 for third party promissory notes received in 2004 and included in

other current assets in the consolidated balance sheet at December 31, 2004.



## NOTE 6

### Loans to related parties

	Interest rate %	December 31 2004	Interest rate %	December 31 2003
Aurum	1%	386		-
Geotekhservice	1%	5 002	1%	3 835
Other loans to related parties	0-1%	479	0-1%	339
<b>Total loans to related parties</b>		<b>5 867</b>		<b>4 174</b>

At December 31, 2004, Aurum was associate and Geotekhservice was under common control of ZAO ICT.

## NOTE 7

### Loans to third parties

	Interest rate %	December 31 2004	Interest rate %	December 31 2003
Zun Hada	1%	49 397		-
Teina	4%	21 450		-
Other loans to third parties	1%	294		-
<b>Total loans to third parties</b>		<b>71 141</b>		<b>-</b>

Loans receivable from Zun Hada and Teina were repaid in 2005. Zun Hada was a subsidiary of the Group till December 2004 (Note 25).

## NOTE 8

### Inventories

	December 31 2004	December 31 2003
Raw materials, spare parts and supplies	41 771	33 723
Ore	16 660	4 688
Work in progress	2 791	5 205
Dore	15 038	8 548
Finished goods	7 451	2 614
<b>Total inventories</b>	<b>83 711</b>	<b>54 778</b>

## NOTE 9

### Long-term Investments and Intangible Assets, net

	December 31 2004	December 31 2003
Long-term investments	7 222	6 804
Intangible assets, net	2 354	2 411
<b>Total long-term investments and intangible assets</b>	<b>9 576</b>	<b>9 215</b>

Investments mainly represent ordinary shares in Nomos-Bank, a related party, (4.96% of total shares issued), acquired in October 2001 and accounted for at cost. Intangible

assets are primarily mineral rights acquired by the Company upon purchase of subsidiaries. Accumulated amortization of intangible assets was U.S. Dollar 939 and U.S. Dollar 726 at

December 31, 2004 and 2003, respectively.

## NOTE 10

### Property, Plant and Equipment, net

	December 31 2004	December 31 2003
Здания и подземные сооружения	73 107	32 911
Машины и оборудование	90 463	51 845
Транспорт и прочее	28 675	23 158
Незавершенное строительство	102 964	110 915
<b>Стоимость</b>	<b>295 209</b>	<b>218 829</b>
<b>Накопленный износ</b>	<b>(38 547)</b>	<b>(14 712)</b>
<b>Итого основные средства, чистая сумма</b>	<b>256 662</b>	<b>204 117</b>

At December 31, 2004, of the total cost of U.S. Dollar 295 209, U.S. Dollar 66 929 (of which Machinery & Equipment was U.S. Dollar 47 430 and Transport & other was U.S. Dollar 19 499) related to capitalized leases (December 31, 2003: U.S. Dollar 49 214, of which Machinery & Equipment was U.S. Dollar 34 449 and Transport & other was U.S. Dollar 14 765).

At December 31, 2004, of the total accumulated depreciation and depletion of U.S. Dollar 38 547, U.S. Dollar 15 116 (of which U.S. Dollar 10 857 was attributed to Machinery & Equipment, and U.S. Dollar 4 259 to Transport & other) relates to capitalized leases (December 31, 2003: U.S. Dollar 6 709, of which U.S. Dollar 4 696 was attributed to Machinery

& Equipment, and U.S. Dollar 2 013 to Transport & other).

Included within construction in progress were long-term deferred exploration expenditures of U.S. Dollar 5 283 and U.S. Dollar 7 710 at December 31, 2004 and 2003, respectively.

## NOTE 11

### Other current assets

	December 31 2004	December 31 2003
Deferred development expenditures	3 772	971
Promissory notes from Severo-Zapad Invest Prom	12 397	-
Promissory notes from Khanty-mansiyskiy Bank	1 630	-
Other debtors	1 935	682
Deferred expenditures	3 224	8
<b>Total other current assets</b>	<b>22 958</b>	<b>1 661</b>

## NOTE 12

### VAT receivable

	December 31 2004	December 31 2003
Short-term VAT receivable	48 676	27 432
Long-term VAT receivable	3 770	15 538

Long-term VAT receivable at December 31, 2004 and 2003 primarily represents VAT balances resulting from capital expenditures which are not expected to be recovered within twelve months following respective balance sheet dates. Management believes that such balances are fully recoverable from tax authorities at the time respective capital assets qualify as put into

operation for VAT purposes.

Short-term VAT receivable at December 31, 2004 and 2003 relates to capital expenditures in fixed assets expected to be put into use within twelve months following respective balance sheet dates and VAT receivable from current operations.

VAT claims are submitted to tax au-

thorities on a monthly basis.

The short term VAT receivable as at December 31, 2003 was mainly repaid by the tax authorities to the Group in 2004. As at June 30, 2005, of the amount of VAT receivable as at December 31, 2004 collected U.S. Dollar 7 373 and the Company expects the balance to be fully repaid during the second half of the year in due order.

#### NOTE 13

##### Accounts Payable and Accrued Liabilities

	December 31 2004	December 31 2003
Trade accounts payable	15 563	7 988
Accrued interest payable to third parties	1 689	3 910
Other accounts payable	3 165	3 499
<b>Total accounts payable and accrued liabilities</b>	<b>20 417</b>	<b>15 397</b>

#### NOTE 14

##### Accounts Payable and Promissory Notes - related parties

	December 31 2004	December 31 2003
Trade accounts payable to Geotekhservice	598	
Trade accounts payable to Press-Invest	1 653	
Other trade accounts payable	1 777	1 393
Short-term promissory notes	-	254
<b>Total accounts payable and promissory notes - related parties</b>	<b>4 028</b>	<b>1 647</b>

At December 31, 2004 Press-Invest was under control of ZAO ICT.

#### NOTE 15

##### Short-term Debt and Current Portion of Long-term Debt

	Interest rate %	December 31 2004	Interest rate %	December 31 2003
Khanti-Mansiisk Bank (U.S. Dollar)		-	11%	7 500
Khanti-Mansiisk Bank (RR)		-	16%	7 639
Alfa-Bank (U.S. Dollar)		-	9,5%	40 000
MDM-Bank (U.S. Dollar)		-	11,5-12,5%	32 275
NIKoil Bank (U.S. Dollar)	9%	30 000		-
Current portion of long-term loans		21 318		27 207
<b>Total short-term debt and current portion of long-term debt</b>		<b>51 318</b>		<b>114 621</b>



Loans from NIKoil Bank in total of U.S. Dollar 30 000 are guaranteed by ZAO Inkas-Service and Severo-Zapadnaya Leasing Company LLC in amount of U.S. Dollar 6 984 (including pledged equipment in total

amount U.S. Dollar 1 164) and U.S. Dollar 18 054 (including pledged equipment in total amount U.S. Dollar 3 009), respectively. Loans from NIKoil Bank mature in November 2005.

Pledged to the loan agreement with NIKoil Bank property and equipment of U.S. Dollar 5 535 at net book value as at December 31, 2004.

## NOTE 16

### Short-term Debt - Related Parties

	Interest rate %	December 31 2004	Interest rate %	December 31 2003
Nomos-Bank (RR)		-	17-21%	19 471
Nomos-Bank (U.S. Dollar)	9%	38 910	15%	20 000
Linex (RR)	17,6%	3 246		-
<b>Total short-term debt- related parties</b>		<b>42 156</b>		<b>39 471</b>

## NOTE 17

### Long-term Debt

	Interest rate %	December 31 2004	Interest rate %	December 31 2003
Standard Bank London (U.S. Dollar)	LIBOR + 3,5-4,0%	105 000		-
Magadan Region Administration (U.S. Dollar)	6%	5 856	6%	6 135
MDM-Bank (U.S. Dollar)		-	16%	26 525
Bonds (RR)	17-19%	27 029	17-19%	25 463
Less current portion of long-term loans		(21 318)		(27 207)
<b>Total long-term debt</b>		<b>116 567</b>		<b>30 916</b>

In March 2003 ISPA "Polymetal" issued 750 000 non-convertible bonds at par value of U.S. Dollar 27 029. The bonds mature in 2006. All bonds are issued and registered both as at December 31, 2003 and December 31, 2004. Interest on bonds amounting to 17-19% is paid semiannually.

## NOTE 17

### Long-term Debt (continued)

Long-term debt is repayable as follows:

	December 31, 2004	December 31, 2003
1 to 2 years	52 667	-
2 to 3 years	19 400	30 916
3 to 4 years	19 500	-
4 to 5 years	25 000	-
	<b>116 567</b>	<b>30 916</b>

In December 2004 the Company received the long-term loan totaling U.S. Dollar 105 000 from Standard Bank London for the purpose of re-financing its debts and development

of current operations. Loan should be repaid in monthly installments starting April 1, 2005 with the last payment being made in 2009. According to the loan agreement with

Standard Bank London the Group should meet certain financial and non-financial covenants to avoid withdrawal of loan facility.

As at December 31, 2004, ISPA "Polymetal" pledged 23 443 shares (97.11% of the issued and outstanding share capital) of ZAO Serebro "Territorii", 85 shares (85% of the issued and outstanding share capital) of ZAO GC Dukat and 150 324 shares (83.33% % of the issued and outstanding

share capital) of ZAO Zoloto Severnogo Urals as collateral under the Standard Bank London facility. ZAO GC Dukat pledged 5 400 shares (80% of the issued and outstanding share capital) of ZAO Serebro Magadana as collateral under the Standard Bank London facility. The aggregate carrying value of prop-

erty, plant and equipment associated with the subsidiaries whose shares were pledged was U.S. Dollar 137 309 at December 31, 2004.

Borrowing from Magadan region Administration was guaranteed by Nomos-Bank in amount of U.S. Dollar 5 856.

## NOTE 18 Long-term Debt - Related Parties

	Interest rate %	December 31 2004	Interest rate %	December 31 2003
Nomos-Bank (U.S. Dollar)	-	-	10%-13%	12 500
Tant (RR)	-	-	17,6%	31 510
Linex (RR)	14%	14 846	17,6%	38 205
Accord-Invest (RR)	1-14,3%	83 082		-
Recital (RR)	1,2%	10 899		-
Investros (RR)	0%	91		-
<b>Total long-term debt - related parties</b>		<b>108 918</b>		<b>82 215</b>

## NOTE 18 Long-term Debt - Related Parties (continued)

Long-term debt due to Related parties is repayable as follows:

	December 31 2004	December 31 2003
1 to 2 years	43 929	82 215
2 to 5 years	-	-
5 to 6 years	64 989	-
	<b>108 918</b>	<b>82 215</b>

Interest expense for the year ended December 31, 2004 totaling U.S. Dollar 31 201 (2003: U.S. Dollar 23 594) includes U.S. Dollar 11 286 (2003: U.S. Dollar 10 774) interest accrued on loans provided by related parties.

## Note 19 Long-Term Capital Lease Liabilities

The Group entered into certain Russian Ruble denominated lease-

es for machinery and equipment and transport vehicles. The third party lessors generally provide payment of taxes, maintenance and certain other operating costs related to the leased property.

Future minimum lease payments for the assets under capital leases at December 31, 2004, are as follows:

	Future payments under capital leases
Year ending December 31	
2005	22 582
2006	11 849
2007	5 845
2008	1 564
2009	16
Later years	11
<b>Total</b>	<b>41 867</b>
Less amount representing interest (@ 16%)	(7 205)
Total present value of minimum payments	34 662
Less current maturities of capital lease liabilities	(19 467)
Long-term capital lease liabilities	15 195

Equipment with a carrying value of U.S. Dollar 2 120 was pledged as collateral on the capital lease liability to OOO Baltisky Leasing

## Note 20

### Reclamation and Mine Closure Obligation

Mine closure obligations are recognized on the basis of existing project business plans as follows:

Deposit	Vorontsovskoye mine	Barun-Kholba	Dukat	Lunnoye mine	Khakandjinskoye mine	Total
Reclamation and mine closure obligation at December 31, 2003	805	1 018	1 512	770	725	<b>4 830</b>
Revision in estimated cash flows	(62)	(80)	(117)	(60)	79	<b>(240)</b>
Accretion of reclamation and mine closure obligation	108	136	202	103	116	<b>665</b>
Settlements	-	-	-	-	-	-
Translation effects	52	67	99	50	48	<b>316</b>
Disposal		(1 141)				<b>(1 141)</b>
Reclamation and mine closure obligation at December 31, 2004	903	-	1 696	863	968	<b>4 430</b>

Barun-Kholba field is the deposit owed by ZAO Zun Hada, which was a subsidiary of the Group till December 2004 (Note 25).

## NOTE 21

### Shareholders' Equity

The authorized share capital of the Company is comprised of 4 850 000 of common shares (of which 550 000 were issued and

outstanding as at December 31, 2004 and 2003) with par value Ruble 100 and 100 000 series A preference shares (of which issued nil) with par value Ruble 100.

In 2003 ISPA "Polymetal" issued

an additional 50 000 ordinary shares for a price of Ruble 16 000 per share.

The structure of share capital of the Company is as follows:

Year of issuance	Number of shares	Exchange rate, U.S. Dollar/RR	Share capital, U.S. Dollar
2001	350 000	6,08	5 752
2002 and subsequent	200 000	29,45 - 31,58	645
<b>Total</b>	<b>550 000</b>		<b>6 397</b>



Reserves available for distribution to shareholders are based on the statutory accounting reports of the Company as a stand-alone entity, which are prepared in accordance with Regulations on Accounting and Reporting of the Russian Federations and which differ significantly from U.S. GAAP. Russian

legislation identifies the basis of distribution as net income. For 2004, the current year statutory retained earnings of ISPA "Polymetal" as reported in its annual statutory accounting report were RR 37 329 thousand (unaudited). However, current legislation and other statutory regulations dealing with distribution

rights are open to legal interpretation, consequently, actual distributable reserves may differ from the amount disclosed.

At December 31, 2004, of the total number of issued and outstanding shares 549 994 (99.999%) were held by ZAO ICT.

## NOTE 22 Revenues

	Year ended December 31 2004	Year ended December 31 2003
Sales to third parties: Alfa-Bank	38 402	-
Sales to third parties: MDM-Bank	95 389	57 303
Sales to third parties: Standard Bank London	36 458	1 126
Sales to related parties: Nomos-Bank	33 405	33 101
<b>Total Revenue from gold and silver sales</b>	<b>203 654</b>	<b>91 530</b>
Other sales	833	827
<b>Total Revenue</b>	<b>204 487</b>	<b>92 357</b>

Sales broken down by gold and silver were as follows:

	Year ended December 31 2004			Year ended December 31 2003		
	Thousand ounces	Kg	Thousands of U.S. Dollar	Thousand ounces	Kg	Thousands of U.S. Dollar
Gold	213	6 639	85 959	129	4 008	45 921
Silver	17 301	538 137	117 695	9 839	306 034	45 609

Discounts from the London Metals Exchange quotation on sales to banks for the year ended De-

cember 31, 2004, totaling 4 417 U.S. Dollar (2003: U.S. Dollar 2 847) for gold and 3 053 U.S. Dol-

lar (2003: U.S. Dollar 2 924) for silver sales were netted against the amount of sales.

## NOTE 23 Cost of sales

	Year ended December 31 2004	Year ended December 31 2003
Operating costs (excluding staff costs)	45 593	25 032
Staff costs	17 919	13 500
Total operating costs	64 512	38 532
Mining tax	9 000	5 334
Other taxes, except for income taxes	4 418	3 277
Depreciation and depletion	12 341	6 306
Amortization of intangible assets	168	224
Accretion of reclamation and mine closure obligation	665	423
Development costs written off	232	549
Other costs	1 514	1 155
<b>Total cost of sales</b>	<b>92 850</b>	<b>55 800</b>

## Note 24

### Income Tax

The income tax expense consists of the following:

	Year ended December 31 2004	Year ended December 31 2003
Current tax expense	3 414	58
Change in deferred tax assets	(4 667)	(3 007)
Net change in valuation allowance	4 331	(2 460)
Change in deferred tax liability	8 199	4 542
Less deferred tax liability charged to accumulated translation adjustment	-	(2 296)
Income tax expense (benefit)	11 277	(3 163)

The actual tax expense (or tax credit) differs from the amount which would have been determined by applying the statutory rate of 24 % (2003: 24 %) to the income from continuing operations before taxes and minority interest as a re-

sult of the application of Russian tax regulations, which disallow certain deductions which are included in determination of income before taxes under U.S. GAAP (social related expenditures and other non-production costs, certain general, adminis-

trative, financing, foreign exchange related and other costs). At the same time certain gains and revenues recognized under U.S. GAAP may represent nontaxable income (gain on disposal of subsidiary).

The components of deferred tax assets and liabilities were as follows:

	December 31 2004	December 31 2003
Deferred tax asset:		
Property, plant and equipment	-	(1 240)
Intangible assets	(15)	(32)
Accounts payable	(263)	(248)
Provisions	(280)	(396)
Inventory - production materials and work in progress	(7 034)	(3 114)
Tax losses carried forward	(7 572)	(5 467)
<b>Total deferred tax asset</b>	<b>(15 164)</b>	<b>(10 497)</b>
Valuation allowance	9 361	5 030
Total net deferred tax asset	(5 803)	(5 467)
Deferred tax liability:		
Property, plant and equipment	5 753	-
Accounts receivable	8 160	3 826
Inventory - Finished goods	-	(408)
Translation effect in the cost of property, plant and equipment	-	2 296
Deferred tax liability on property, plant and equipment	4 430	-
<b>Total deferred tax liability</b>	<b>18 343</b>	<b>5 714</b>

A valuation allowance of U.S. Dollar 9 361 (2003: U.S. Dollar 5 030) has been provided for due to the uncertainties of realizing deferred tax assets, other than those arising from tax losses carried forward,

in the future. Tax losses carried forward are amounts, which will be off-set against future taxable profits by Serebro "Territorii", Serebro Magadana and Okhotskaya GGC during the period up to year 2010.

Each legal entity within the Group represent a separate tax-paying component for income tax purposes. Tax losses at one entity cannot be used to reduce taxable income of other entities in the Group.

Additional deferred tax liability on property, plant and equipment amounting to U.S. Dollar 4 430 arose on acquisition of ZAO Serebro Magadana (Note 26).

Deferred tax liabilities may be classified as follows:

	December 31 2004	December 31 2003
Deferred tax liability:		
Current deferred tax liability	6 422	-
Long-term deferred tax liability	11 921	5 714
<b>Total deferred tax liability</b>	<b>18 343</b>	<b>5 714</b>

#### **NOTE 25** **Sale of subsidiary**

In December 2004, the Company sold its 70.5% equity interest in ZAO Zun Hada, a subsidiary holding licenses to develop the Barun-Kholba properties, for U.S. Dollar 1 453 without recourse. Of total amount, U.S. Dollar 412 was paid in 2004. The remaining receivable of U.S. Dollar 1 041 is included within other current assets in the consolidated balance sheet at December 31, 2004. ZAO Zun

Hada had suspended extraction of ore in July 2003 and had not conducted any significant operations thereafter and through the disposal. As ZAO Zun Hada had significant accumulated losses at the time of disposal, the Group recognized a pre-tax gain on disposal of U.S. Dollar 47 551. As at December 31, 2004 the Group had loans receivable from Zun Hada totaling U.S. Dollar 49 397 (see note 7). These loans receivable were fully recovered on June 27, 2005 and June 28, 2005.

As the operations and cash flows of ZAO Zun Hada have been eliminated from the ongoing operations of the Group and the Group will not have any significant continuing involvement in the operations of ZAO Zun Hada, the results of operations of the disposed components for 2004 and 2003 together with the gain on disposal are reported as a separate component of income in the statements of operations.

#### **NOTE 26** **Acquisitions**

In November 2004, the Company acquired the remaining 20% in its subsidiary ZAO Serebro Magadana, the license owner for

the Dukat mine. The Company paid U.S. Dollar 21 266 in cash and will pay up to U.S. Dollar 22 500 in contingent future payments. The future payments will be paid annually based on the average yearly silver price per troy ounce (FPS)

in the range U.S. Dollar 5.5 per ounce to U.S. Dollar 10.0 per ounce:

	Annual installments
5.5 < FPS < 6.0	500
6.0 < FPS < 7.0	1 000
7.0 < FPS < 8.0	2 000
8.0 < FPS < 9.0	5 000
9.0 < FPS < 10.0	6 000
10.0 < FPS	8 000

The agreement also contains provisions for early repayment of the future payments on the occurrence of certain events, such as a public share offering.



In accordance with FAS 141, the contingent payments have not been recorded in the accompanying financial statements as the outcome of the contingency is not determinable beyond a reasonable doubt. Accordingly, any future payments will be recorded when made.

On the basis that the half year average silver price to June 30, 2005 of U.S. Dollar 7.05 per ounce remains unchanged for the foreseeable future, the Company will pay U.S. Dollar 2 000 per year until 2015 and U.S. Dollar 500 in 2016.

The acquisition of the 20% inter-

est in ZAO Serebro Magadana has been recorded using the purchase method of accounting. The difference between the purchase consideration of U.S. Dollar 21 266 and the historic value of the minority interest acquired totaling U.S. Dollar 7 200, has been recorded as property, plant and equipment.

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**NOTE 27**  
**OAO Okhotskaya GGC**  
**share issue**

In February 2004, ISPA "Polymetal" sold 538 ordinary shares (25.08% equity interest) of OAO Okhotskaya GGC to third parties. Consideration received amounted

U.S. Dollar 5. As a result, Polymetal share in OAO Okhotskaya GGC reduced to 54.9%. In April 2004, OAO Okhotskaya GGC issued 20 592 common shares at par value Russian rubles 100 per share, of which 14 136 shares were purchased by ISPA "Polymetal" for

U.S. Dollar 22 942, and 6 456 shares - by other shareholders for U.S. Dollar 10 478. As a result of the second transaction the interest of ISPA "Polymetal" in OAO Okhotskaya GGC has increased to 65.35%.

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**NOTE 28**  
**Subsidiary Preference Shares**  
**Issuance**

In September 2003 ZAO Zoloto Severnogo Urala, a Company's subsidiary, issued 30 000 series A preferred shares with par value Ruble 1 000 per share for a price of Ruble 20 409 per share. The proceeds from the issuance totaled U.S. Dollar 20 787 and the

entire issue was sold to Nomos-Bank, a related party (associate of ZAO ICT). According to the terms of the issue, the preferred share have a liquidation preference of 50% of stated par value and convey dividend rights equal to those enjoyed by holders of common shares. As a result of the issue, the Company's effective ownership interest in ZAO Zoloto Severnogo Urala decreased from

99.95% to 83.33%.

The transaction was accounted for as a disposal of an interest in a consolidated subsidiary, and the Company recognized a gain on disposal of U.S. Dollar 13 850 determined as the difference between the proceeds from the preferred share issuance and the carrying value of the disposed interest.

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**NOTE 29**  
**Commitments and Contingent**  
**Liabilities**

**Capital commitments imposed**  
**by license agreements**

The "Khakanjinskoye" mine mineral license agreement (with amendments) imposes an obligation on the OAO Okhotskaya GG to contribute U.S. Dollar 500 to the project of Okhotsk region infra-

structure development till 1 July 2005. As at December 31, 2004, U.S. Dollar 60 was contributed.

**Operating environment**

Whilst there have been improvements in economic trends in the country, the Russian Federation continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of

a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

The future economic direction of the Russian Federation is largely

dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

### **Environmental contingencies**

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

### **Legal contingencies**

During the year, the Group was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated financial statements.

### **Insurance policies**

The Group holds no insurance

policies in relation to its assets, operations, or in respect of public liability or other insurable risks, except for insurance for property in total amount of U.S. Dollar 22 474 (including insurance for assets under capital lease in amount U.S. Dollar 9 419)

### **Sales commitments.**

In accordance with the loan agreement of ZAO Zoloto Severnogo Urala with Nomos-Bank, Nomos-Bank has a priority right to buy gold produced in 2005 from Zoloto Severnogo Urala. The price is not specified in the agreement.

### **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 may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2004 man-

agement believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these financial statements.

### **Political environment.**

The operations and earnings of the Company are affected by political, legislative, fiscal and regulatory developments, including those related to environmental protection. Because of the capital-intensive nature of the industry, the Company is also subject to physical risks of various kinds. The nature and frequency of these developments and events associated with these risks, which generally are not covered by insurance, as well as their effect on future operations and earnings, are not predictable.

**NOTE 30**  
**Subsequent events**  
**Bank loan repayment**

In April - June 2005, the Company repaid U.S. Dollar 6 700 of total U.S. Dollar 105 000 long-term

loan from Standard Bank London.





# APPENDIX #2

PRODUCTION COSTS BY GOLD INSTITUTE STANDARDS

## Vorontsovskoye (Northern Urals Gold)

In thousands USD, except as indicated	2004	2003
Direct mining expenses	16 954	12 578
Stripping and mine development adjustments	-	-
Third-party smelting, refining and transportation costs		
By-product credits silver	(407)	(345)
By-product credits	(154)	(892)
Other	139	17
<b>Cash Operating Costs</b>	<b>16 532</b>	<b>11 358</b>
Royalties	1 664	937
Production taxes	88	89
<b>Total Cash Costs</b>	<b>18 283</b>	<b>12 384</b>
Depreciation	3 526	3 158
Depletion \ amortization	-	-
Reclamation and mine closure	21	17
<b>Total Production Costs</b>	<b>21 830</b>	<b>15 559</b>
<b>By-product (method 1): Silver as a by-product</b>		
Production costs	18 845	13 621
By-product credits	(561)	(1 237)
	18 283	12 384
<b>Reported gold ounces produced</b>	<b>82 742</b>	<b>95 351</b>
<b>Reported total cash costs per ounce</b>	<b>221</b>	<b>130</b>
Reported noncash costs per ounce	43	33
<b>Total production costs per ounce</b>	<b>264</b>	<b>163</b>

### Note:

The calculations take into account that silver is a co-product at the Vorontsovskoye deposit (according to Gold Institute Standards).

**Khakanjinskoye** (Okhotsk Mining and Geological Company)

In thousands USD, except as indicated	2004 r.
Direct mining expenses	12 848
Stripping and mine development adjustments	4
Third-party smelting, refining and transportation costs	-
By-product credits silver	(7 449)
By-product credits	(217)
Other	197
<b>Cash Operating Costs</b>	<b>5 383</b>
Royalties	2 608
Production taxes	667
<b>Total Cash Costs</b>	<b>8 658</b>
Depreciation	5 227
Depletion \ amortization	-
Reclamation and mine closure	55
<b>Total Production Costs</b>	<b>13 940</b>
<b>By-product (method 1): Silver as a by-product</b>	
Production costs	16 324
By-product credits	(7 666)
	8 658
<b>Reported gold ounces produced</b>	<b>75 795</b>
<b>Reported total cash costs per ounce</b>	<b>114</b>
Reported noncash costs per ounce	70
<b>Total production costs per ounce</b>	<b>184</b>

**Note:**

The calculations take into account that silver is a co-product at the Khakanjinskoye deposit (according to Gold Institute Standards). In 2003, only mining operations took place at the Khakanjinskoye deposit; no metal production occurred.



**Dukat and Lunnoye** (Magadan Silver, Silver Territoty)

In thousands USD, except as indicated	2004	2003
Direct mining expenses	50,603	31,527
Stripping and mine development adjustments	228	549
Third-party smelting, refining and transportation costs	-	-
By-product credits	(32,300)	(12,601)
Other	-	139
<b>Cash Operating Costs</b>	<b>18,532</b>	<b>19,614</b>
Royalties	8,038	5,254
Production taxes	1,910	66
<b>Total Cash Costs</b>	<b>28,480</b>	<b>24,934</b>
Depreciation	3,491	2,945
Depletion \ amortization	-	-
Reclamation and mine closure	11	17
<b>Total Production Costs</b>	<b>31,982</b>	<b>27,896</b>
<b>By-product (method 1): Gold as a by-product</b>		
Production costs	60,780	37,535
By-product credits	(32,300)	(12,601)
	28,480	24,934
Reported silver ounces produced	16,933,856	9,765,675
<b>Reported total cash costs per ounce</b>	<b>1.68</b>	<b>2.55</b>
Reported noncash costs per ounce	0.21	0.30
<b>Total production costs per ounce</b>	<b>1.89</b>	<b>2.86</b>

**Note**

Precious metals production at the Dukat and Lunnoye deposits is a single technological process. The above figures are calculated for both deposits together. Silver is a co-product at the deposit. Calculations are [This was into account during calculations] based on Gold Institute Standards.

### Excerpt from production cost calculation methodology using Gold Institute Standards

To improve [the] reporting practices within the gold mining industry, the North American gold industry has adopted revisions to its Production Cost Standard [{"Standard"}] – [,] a uniform format for reporting production costs per ounce [on a per-ounce basis]. The Standard was first adopted by the industry in 1996.

The purpose of the Standard is to give the financial community and individual investors a tool to make meaningful comparisons between [of] gold mining companies and their individual [separate] operations, using [with sufficient information in] a uniform format. The production cost standard was developed under the aegis of The Gold Institute, by a committee of senior financial executives representing leading North American gold producers.

In developing the Standard, the Institute [it was] recognized that each company had its own accounting policies and practices and that these differences could [may] result in different [cost] per ounce cost calculations, even at facilities [operations] where companies operated as [are] joint venture partners. Rather than trying to change [or conform] these individual practices, a "uniform disclosure matrix" (or reporting standard) was developed. The Standard has been widely adopted throughout the global gold industry. [The success of The Gold Institute Production Cost Standard and its wide acceptance are due to this disclosure-based philosophy]. The revised Standard is shown below.

#### Revised Standard for Reporting Production Costs

	Per Ounce (1)
Direct mining expenses (2)	\$ XXX
Stripping and mine development adjustments (3)	XXX
Third-party smelting, refining and transportation costs	XXX
By-product credits (4)	XXX
Other	XXX
<b>Cash Operating Costs</b>	<b>X X X</b>
Royalties (5)	XXX
Production taxes (6)	XXX
<b>Total Cash Costs</b>	<b>X X X</b>
Depreciation (7)	XXX
Depletion \ amortization (8)	XXX
Reclamation and mine closure (9)	XXX
<b>Total Production Costs</b>	<b>\$ X X X</b>

- 1) Per ounce of gold produced or sold based [in accordance with] on each company's own reporting practices;
- (2) Direct mining expenses include all expenditures incurred at the site, including inventory changes, site-specific corporate charges (e.g. insurance, computer services, etc.) and in-mine drilling expenditures that are production related (e.g. in-fill drilling, grade control, etc.). Exploration expenditures are not included in direct mining expenses. In case of a joint venture or partnership, management or overhead fees charged by that operation's operator, that are in addition to site-specific corporate charges, should be included in each company's mine-site cash expenditures;
- (3) These adjustments include normalization[ing] of stripping costs at open-pit operations and normalization of costs associated with developing and accessing new production areas in underground operations. Footnote disclosure of the total amount of these adjustments is encouraged;
- (4) When by-product accounting is employed, if the by-product represents more than 5% of an individual mine's revenues, the effect on reported production costs of using co-product accounting also should be disclosed. This information should be reported on a mine-by-mine basis in each company's external reporting documents. (See Exhibit 1 for an example of additional disclosure requirements.);
- (5) Information with respect to royalties, on an operation-by-operation basis, should be disclosed in each company's external reporting documents;
- (6) Includes net proceeds tax, severance tax and other similar taxes. Ontario and British Columbia provincial mining taxes are considered to be forms of income taxes rather than property taxes, and as such should not be included in production cost calculations;
- (7) Treatment of capital lease payments should follow the normal accounting practice of being excluded from cash costs but included in noncash costs as part of depreciation expenses.
- (8) Additional footnotes may be required to disclose what amounts have been included or excluded in the calculations (e.g. includes purchase accounting adjustments);
- (9) Includes costs of final site reclamation, which are accrued on a unit[s]-of-production basis over the entire life of an operation. To the extent that an operation elects to perform a portion of this final reclamation concurrently with active mining, these costs also should be included in noncash production costs.

<b>Examples of Additional Disclosures:</b>		
Reporting method No.1 - By-product Accounting		
Silver is accounted for as a by-product at the XYZ mine whereby revenues from silver are deducted from operating costs in the calculation of cash costs per ounce. If the Company had accounted for silver production as a co-product, whereby costs were allocated separately to gold and silver based on their proportion of revenues, the following costs per ounce would be reported:		
	<b>Gold</b>	<b>Silver</b>
Total cash costs	\$219	\$2.92
Noncash costs	46	.62
	\$265	\$3.54





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