



ALROSA Finance S.A.

incorporated as a société anonyme with limited liability in Luxembourg

US\$300,000,000 8.875 per cent. Notes due 2014

Unconditionally and irrevocably guaranteed by

ALROSA Company Limited

incorporated in the Russian Federation

Issue Price: 99.511 per cent.

ALROSA Finance S.A. (the "Issuer"), a private company incorporated with limited liability under the laws of the Grand Duchy of Luxembourg ("Luxembourg") and a wholly owned subsidiary of Alrosa Finance B.V., a private company incorporated with limited liability under the laws of The Netherlands, wholly owned by ALROSA Company Limited ("ALROSA Ltd." or the "Guarantor"), a closed joint stock company organised under the laws of the Russian Federation ("Russia"), with the alternate legal name AK "ALROSA" (ZAO), is issuing the US\$300,000,000 8.875 per cent. Notes due 2014 (the "Notes"). The Issuer and ALROSA Ltd. will enter into a loan agreement to be dated 16 November 2004 (the "Intercompany Loan") pursuant to which the Issuer will lend the net proceeds of the offering of the Notes, equal to US\$295,983,000 (after payment of commissions), to ALROSA Ltd., and ALROSA Ltd. will agree to repay an amount equal to the aggregate principal amount of the Notes. The Notes will mature on 17 November 2014.

Interest on the Notes will be payable semi-annually in arrear on 17 May and 17 November of each year, commencing on 17 May 2005, at the rate of 8.875 per cent. per annum. Payments on the Notes will be made free and clear of, and without withholding or deduction for or on account of, any taxes imposed by Luxembourg, The Netherlands or Russia, to the extent described under Condition 9 "Taxation" in "Terms and Conditions of the Notes". Except in certain limited circumstances, the Notes are not redeemable prior to 17 November 2014 (the "Maturity Date").

The Notes will be general unsecured and unsubordinated obligations of the Issuer, and will rank senior to all future subordinated obligations and equal to all future unsecured obligations of the Issuer. The Notes will be constituted by a trust deed to be dated 16 November 2004 (the "Trust Deed") between the Issuer, ALROSA Ltd., and J.P. Morgan Corporate Trustee Services Limited (the "Trustee"), and will be unconditionally and irrevocably guaranteed by ALROSA Ltd. (the "Guarantee"). This Guarantee will be unsecured indebtedness of ALROSA Ltd. and will rank senior to all future subordinated obligations and equal to all future unsecured obligations of ALROSA Ltd. The Notes are limited recourse obligations of the Issuer. Where principal, interest and additional amounts, if any, are stated to be payable in respect of the Notes, the obligation of the Issuer to make any such payment shall constitute an obligation only to account to the Noteholders, on each date upon which such principal, interest and additional amounts, if any, are due in respect of the Notes, for an amount equivalent to all principal, interest and additional amounts, if any, actually received by or for the account of the Issuer pursuant to the Intercompany Loan. The Issuer will have no other financial obligation under the Notes. **Accordingly, holders of the Notes will be deemed to have accepted and agreed that they must rely solely and exclusively on the credit and financial standing of ALROSA Ltd. in respect of the financial servicing of the Notes.**

References to "we" and "us" in this offering circular (this "Offering Circular") refer collectively to ALROSA Ltd. and its consolidated subsidiaries, including the Issuer.

Application has been made to list the Notes on the Luxembourg Stock Exchange. Application has also been made for the Notes represented by the Rule 144A Global Note (as defined below) to be designated as eligible for trading on The Portal Market of the NASDAQ Stock Market, Inc. ("PORTAL").

An investment in the Notes involves a high degree of risk. See "Risk Factors" beginning on page 23.

The Notes and the Guarantee (collectively, the "Securities") have not been, and will not be, registered under the US Securities Act of 1933 (the "Securities Act") or under any securities laws of any other jurisdiction. The Notes are being offered and sold outside the United States in offshore transactions in reliance on Regulation S under the Securities Act ("Regulation S") and in the United States to "qualified institutional buyers" (as defined in Rule 144A under the Securities Act ("Rule 144A")) in reliance on Rule 144A. The Issuer has not been and will not be registered under the Investment Company Act of 1940 (the "Investment Company Act").

All Notes will be in registered form, without coupons. The Notes are being issued pursuant to exemptions from registration under the Securities Act. Notes that are sold to qualified institutional buyers within the meaning of Rule 144A will be represented by interests in a global registered Note (the "Rule 144A Global Note"), deposited with a custodian for, and registered in the name of a nominee for, The Depository Trust Company ("DTC") on or about 16 November 2004 (the "Closing Date"). Notes that are sold in transactions outside the United States in reliance on Regulation S will be represented by interests in a global registered Note (the "Regulation S Global Note"), deposited with a common depository for, and registered in the name of a nominee for, Euroclear Bank S.A./N.V. as operator of the Euroclear System ("Euroclear") and Clearstream Banking, société anonyme ("Clearstream, Luxembourg").

The Notes have been assigned a preliminary rating of B2 by Moody's Investor Service, Inc. ("Moody's") and B by Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P"). These ratings address the Issuer's ability to make interest and principal payments in accordance with the terms and conditions of the Notes (the "Terms and Conditions"). The Guarantor has been assigned a senior implied rating of B1 by Moody's and a credit rating of B/Stable by S&P. A rating is not a recommendation to buy, sell or hold the Notes and may be subject to suspension, reduction or withdrawal at any time by Moody's or S&P, as applicable. A suspension, reduction or withdrawal of the rating assigned to the Notes may adversely affect the market price of the Notes.

Joint Lead Managers and Joint Bookrunners

JPMorgan

ING Financial Markets

Co-Managers

Barclays Capital

Web-invest Bank

11 November 2004

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In making an investment decision, you should rely only on the information contained in this Offering Circular. We have not, and none of the Managers named under "Plan of Distribution" (the "Managers") has, authorised any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it.

We are offering to sell the Notes only in places where such offers and sales are permitted.

Unless otherwise stated to the contrary, you should not assume that the information contained in this Offering Circular is accurate as of any date other than the date on the front cover of this Offering Circular.

"ALROSA", "Brillianty ALROSA", "ALROSA-Nyurba", "Severalmaz" and "Almazny Dvor" are our most important trade marks and trade names. All other trade marks and trade names referred to in this Offering Circular are the property of their respective owners.

In connection with this offering, J.P. Morgan Securities Ltd. ("JPMorgan") may over-allot or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there may be no obligation on JPMorgan to do this. Such stabilising, if commenced, may be discontinued at any time and must be brought to an end after a limited period.

Having made all reasonable enquiries, we confirm that (i) this Offering Circular contains all information with respect to our business, the Guarantee and the Notes that is material in the context of the issue and offering of the Notes (the "Offering"); (ii) there are no untrue statements of material fact contained in this Offering Circular in relation to our business, the Guarantee or the Notes; (iii) there is no omission to state a material fact which is necessary in order to make the statements made in relation to our business, the Guarantee or the Notes, in the light of the circumstances under which they were made, not misleading; (iv) the opinions, expectations and intentions expressed in this Offering Circular with regard to us are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions; (iv) there are no other facts in relation to us, the Guarantee or the Notes, the omission of which would, in the context of the Offering, make any statement in this Offering Circular misleading in any material respect; and (v) we have made all reasonable enquires to ascertain such facts and to verify the accuracy of all such information and statements. We accept responsibility accordingly. Neither the Managers nor any of their respective affiliates nor any person acting on their behalf makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained in this Offering Circular.

We are providing this Offering Circular only to prospective purchasers of the Notes. You should read this Offering Circular before making a decision whether to purchase the Notes. You must not use this Offering Circular for any other purpose.

In addition, the distribution of this Offering Circular may be restricted by law in certain jurisdictions, about which restrictions you agree to inform yourself. By accepting delivery of this Offering Circular you agree to the foregoing restrictions.

We have prepared this Offering Circular and are solely responsible for its contents. You are responsible for making your own examination of our business and your own assessment of the merits and risks of investing in the Notes. By purchasing the Notes, you will be deemed to have acknowledged that:

- you have reviewed this Offering Circular;
- you have had an opportunity, in connection with making an informed investment decision with respect to the Notes, to request additional information that you need from us; and
- the Managers are not responsible for, and are not making any representation to you concerning, our future performance or the accuracy or completeness of this Offering Circular or otherwise in connection with this Offering.

We are not providing you with any legal, business, tax or other advice in this Offering Circular. You should consult with your own advisers, as needed, to assist you in making your investment decision and to advise you whether you are legally permitted to purchase the Notes.

You must comply with all laws that apply to you in any place in which you buy, offer or sell any Notes or possess this Offering Circular. You must also obtain any consents and approvals that you need in order to purchase any Notes. Neither we nor the Managers are responsible for your compliance with these legal requirements.

Industry and Country Information

In this Offering Circular, we rely on and refer to information regarding the world diamond industry, its segments and its participants which has been obtained from market research reports, analyst reports and other publicly available information released by official and unofficial sources. These sources include, but are not limited to, the US Geological Survey Minerals Handbook and the World Diamond Industry Directory and Yearbook, as well as publications prepared by the De Beers Group ("De Beers"); Terraconsult, a geological consulting group; and Yorkton Securities. See "Industry Overview". Although we believe that this information is reliable, we have not independently verified this information and cannot guarantee its accuracy and completeness. In addition, some of the information contained in this document has been derived from official data published by the Government of the Russian Federation (the "Government of Russia"). Official statistics and other data published by Russian federal, regional and local governments are substantially less complete or transparent than those of Western countries. Official statistics may also be compiled on the basis of methodologies different from those used in Western countries. Accordingly, we accept responsibility for the information contained in this Offering Circular other than the information related to Russia and industry information described under "Industry Overview" (except where it relates specifically to us), in respect of which we only take responsibility for the correct extraction of that industry and country information from the relevant sources.

Regulatory Issues Related to the Offering

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of us or the Managers to subscribe or purchase, any Notes in any jurisdiction where such offer or invitation would be unlawful if made. The distribution of this Offering Circular and the Offering of the Notes in certain jurisdictions may be restricted by law. We and the Managers require persons into whose possession this Offering Circular comes to inform themselves about and to observe any such restrictions.

IN PARTICULAR, THE NOTES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE US SECURITIES AND EXCHANGE COMMISSION (THE "SEC"), ANY STATE SECURITIES COMMISSION IN THE UNITED STATES OR ANY OTHER US REGULATORY AUTHORITY, NOR HAVE ANY OF THE FOREGOING AUTHORITIES PASSED UPON OR ENDORSED THE MERITS OF THE OFFERING OR THE ACCURACY OR ADEQUACY OF THIS OFFERING CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.

Neither we nor the Managers have authorised any offer of Notes to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (the "Regulations"). Notes may not lawfully be offered or sold to persons in the United Kingdom except in circumstances which do not result in an offer to the public in the United Kingdom within the meaning of the Regulations or otherwise in compliance with all applicable provisions of the Regulations. For a description of certain further restrictions on offers and sales of Notes and distribution of this Offering Circular, see "Plan of Distribution".

No person is authorised to provide any information or to make any representation not contained in this Offering Circular and any information or representation not so contained must not be relied upon as having been authorised by or on behalf of us, the Trustee for the Notes or the Managers. The delivery of this document at any time does not imply that the information contained in it is correct as at any time subsequent to its date.

United Kingdom. The Notes are not offered, prior to the expiry of a period of six months from the issue date of such Notes, to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments

(as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Regulations.

A person may only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000 (the "FSMA")) received by it in connection with the issue or sale of any Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer or ALROSA Ltd.

This communication is directed only at persons who (1) are outside the United Kingdom, (2) have professional experience in matters relating to investments or (3) are persons falling within Article 49(2)(a) to (d) ("high net worth companies, unincorporated associations, etc.") of the FSMA (Financial Promotion) Order 2001 (all such persons together being referred to as "relevant persons"). This communication must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this communication relates is available only to relevant persons and will be engaged in only with relevant persons.

United States. The Notes have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States except in certain transactions exempt from or not subject to the registration requirements of the Securities Act. The Notes are being offered and sold outside the United States in offshore transactions in reliance on Regulation S and within the United States to qualified institutional buyers in reliance on Rule 144A. Prospective purchasers are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Regulation S and Rule 144A. For a description of these and certain further restrictions on offers, sales and transfers of the Notes and the distribution of this Offering Circular, see "Plan of Distribution" and "Transfer Restrictions".

Russia. This Offering Circular is being distributed to a limited circle of persons only and is provided for your own information and is not to be provided or otherwise made available by you to any other person or entity. The information provided in this Offering Circular is not an advertisement of the Notes in Russia and is not intended to create or maintain an interest in Alrosa Finance S.A., ALROSA Ltd. or the Notes or facilitate any sale, exchange or transfer of the Notes in Russia or to any Russian person or entity.

The Notes are securities of a foreign issuer under Russian law. No sale, exchange or transfer of the Notes may take place in the Russian Federation or to any Russian person or entity. Neither the issue of the Notes nor a securities prospectus in respect of the Notes has been, or is intended to be, registered with the Federal Service for Financial Markets of the Russian Federation. The information provided in this Offering Circular is not an offer, or an invitation to make offers, to sell, exchange or otherwise transfer the Notes in Russia or to any Russian person or entity.

Each Manager has represented, warranted and agreed that the Notes will not be offered, sold or otherwise transferred as part of their initial distribution or at any time thereafter to or for the benefit of any persons (including legal entities) resident, incorporated, established or having their usual residence in Russia or to any person located within the territory of Russia unless and to the extent otherwise permitted under Russian law.

Italy. Each Manager has represented, warranted and agreed that the offering of the Notes in the Republic of Italy ("Italy") has not been registered with the *Commissione Nazionale per le Società e la Borsa* ("CONSOB") pursuant to Italian securities legislation and, accordingly, that it has not offered, and will not offer, any Notes in Italy in a solicitation to the public at large (*sollecitazione all'investimento*) within the meaning of Article 1, paragraph 1, letter (t) of Legislative Decree no. 58 of 24 February 1998, that such Notes shall not be placed, sold and/or offered, either in the primary or in the secondary market, to individuals resident in Italy and that sales of Notes in Italy will only be (1) negotiated on an individual basis with "Professional Investors" (*operatori qualificati*), as defined under Article 31, paragraph 2, of CONSOB Regulation no. 11522 of 1 July 1998, as amended; (2) effected in compliance with Article 129 of the Legislative Decree no. 385 of 1 September 1993 and the implementing instructions of the Bank of Italy, pursuant to which the issue or offer of securities in Italy is subject to prior notification to the Bank of Italy, unless an exemption, depending *inter alia* on

the amount of the issue and the characteristics of the securities, applies; (3) effected in accordance with any other Italian securities, tax and exchange control and other applicable laws and regulations and any other applicable requirement or limitation which may be imposed by CONSOB or the Bank of Italy; and (4) made by an investment firm, bank or financial intermediary permitted to conduct such activities in Italy in accordance with the relevant provisions of Italian law.

Netherlands. Each Manager has represented and agreed that the Notes may not, directly or indirectly, be offered, sold, transferred or delivered in or from The Netherlands, whether at their initial distribution or at any time thereafter, and neither the Offering Circular nor any other document in respect of the offering may be distributed or circulated in or from The Netherlands, other than to individuals or legal entities who or which trade or invest in securities in the conduct of their profession or trade (which includes banks, investment institutions, securities intermediaries, insurance companies, pension funds, other institutional investors and treasury departments and finance companies of large enterprises), in which case it must be made clear upon making the offer and from any documents or advertisements in which a forthcoming offering of Notes is publicly announced that the offer is exclusively made to the said individuals or legal entities.

Notice to New Hampshire Residents

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES ("RSA 421-B") WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENCED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING, NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

Limitation on Enforcement of Civil Liabilities

Substantially all of our directors and executive officers and the experts named in this Offering Circular reside in Russia. All or a substantial portion of their and our assets are located in Russia. As a result, it may not be possible for you to:

- effect service of process outside Russia upon substantially all of our directors and executive officers and the experts named in this Offering Circular; or
- enforce outside Russia court judgments obtained against us or substantially all of our directors and executive officers and the experts named in this Offering Circular in non-Russian courts in any action, including actions under the civil liability provisions of US securities laws.

In addition, it may be difficult for you to enforce, in original actions brought in courts in jurisdictions located outside the United States or the United Kingdom, respectively, liabilities predicated upon the United States securities laws or English law, as applicable.

Judgments rendered by a court in any jurisdiction outside Russia may only be recognised by courts in Russia if (i) an international treaty providing for the recognition and enforcement of judgments in civil cases exists between Russia and the jurisdiction where the judgment is rendered and/or (ii) a federal law providing for the recognition and enforcement of foreign court judgments is adopted in Russia. Even if such a treaty or federal law exists, Russian courts could nonetheless refuse to recognise and/or enforce a foreign court judgment on the grounds provided in such treaty and/or in Russian legislation in effect at the moment when such recognition and/or enforcement is sought. No such federal law has been adopted and no such treaty for the mutual enforcement of foreign court judgments exists between either of the United Kingdom or the United States and Russia.

The Intercompany Loan and the Trust Deed will be governed by English law and will provide the option for disputes, controversies and causes of action brought by any party thereto against us to be settled by arbitration in accordance with the UNCITRAL Arbitration Rules in London, England. Russia and the United Kingdom are parties to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (the "New York Convention"). However, it may be difficult to enforce arbitral awards in Russia due to a number of factors, including:

- a contradiction between the arbitral award and a judgment rendered earlier by a Russian court on the same issue;
- a contradiction of the arbitral award with Russian legislation;
- the lack of experience of the Russian courts in international commercial transactions and enforcement of arbitral awards; and
- official and unofficial political resistance to the enforcement of awards against Russian companies in favour of foreign parties.

See "Risk Factors – Risks Related to the Legal and Regulatory Environment in Russia – Russia's unpredictable acknowledgement and enforcement of foreign court judgments or arbitral awards give rise to significant uncertainties".

Cautionary Statement Regarding Forward-Looking Statements

This Offering Circular includes statements that may be considered to be “forward-looking statements” within the meaning of the US Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact contained in this Offering Circular, including, without limitation, those regarding our future financial position and results of operations, strategy, plans, objectives, goals and targets, future developments in the markets in which we participate or seek to participate, and any statements preceded by, followed by or that include the words “believes”, “expects”, “aims”, “intends”, “plans”, “will”, “may”, “anticipates” or similar expressions or the negative thereof, are forward-looking statements. These forward-looking statements include, amongst other things, statements concerning:

- estimates of future production for specific operations;
- estimates of future production costs and other expenses for specific operations;
- estimates of future capital expenditures and other cash needs for specific operations and expectations as to the funding thereof;
- statements as to the projected development of certain diamond deposits, including estimates of development and other capital costs, financing plans for these deposits and expected production commencement dates;
- estimates of future costs and other liabilities for certain environmental matters;
- estimates of diamond reserves; and
- estimates of certain tax liabilities.

The forward-looking statements included in this Offering Circular involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance, achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements are based on numerous assumptions regarding present and future business strategies and the environment in which we will operate in the future. You should be aware that a number of important factors could cause the industry's or our own actual results or performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements, including, amongst others:

- our ability to continue to export diamonds through De Beers or to find alternative purchasers for the rough diamonds that we currently sell through De Beers;
- our ability to obtain additional financing in the future;
- our ability to adapt our business to Russia's changing regulatory environment and to implement and successfully execute our strategy;
- our ability to complete existing and future projects on schedule and within budget;
- losses from operational hazards and uninsured risks;
- risks related to our business development, operations and financial condition;
- our ability to obtain, maintain and renew the permits, licences and other governmental authorisations required to conduct our operations;
- legal, political and regulatory compliance risks relating to our operations;
- inflation, interest rate and exchange rate fluctuations;
- the effects of, and changes in, the policy of the Government of Russia;
- the effects of changes in laws, regulations, taxation or accounting standards or practices;
- acquisitions or divestitures;
- technological changes;
- the effects of international political events on our business; and
- our success in managing the risks of the aforementioned factors.

This list of important factors is not exhaustive. Additional factors that could cause actual results, performance or achievements to differ materially include those discussed under “Risk

Factors". While relying on forward-looking statements, you should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update or revise any of them, whether as a result of new information, further events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.

This Offering Circular includes market data and industry forecasts and projections that have been obtained from internal surveys, market research, publicly available information and industry publications. Industry publications generally state that the information they provide has been obtained from sources believed to be reliable, but that the accuracy and completeness of such information are not guaranteed. The forecasts and projections are based on industry surveys and the preparers' experience in the industry, and there is no assurance that any of the forecasts or projections will be achieved. Similarly, we believe that the surveys and market research others have performed are reliable, but we have not independently verified this information.

In addition, this Offering Circular describes our diamond reserves and expected ability to continue mining at current production levels. See "Our Business – Diamond Reserves" and "Appendix A – Certification of Diamond Deposits". Although this information has been certified by the Russian Federal Geological Fund of the Ministry of Natural Resources of Russia and the Ministry of Finance of Russia (collectively, the "Ministries"), the Notes have not been guaranteed by the Ministries or by any other agency or political subdivision of Russia, and do not represent obligations of any such body.

Presentation of Financial Information

This Offering Circular includes audited consolidated financial statements of ALROSA Ltd. and its subsidiaries as at and for the years ended 31 December 2003, 2002 and 2001 and unaudited consolidated financial statements of ALROSA Ltd. and its subsidiaries as at and for the six months ended 30 June 2004 and 2003. The consolidated financial statements contained in this Offering Circular have been prepared in accordance with International Financial Reporting Standards ("IFRS"), formerly known as International Accounting Standards ("IAS").

Our reporting currency is the Rouble. Until 1 January 2003, the Rouble was considered a hyperinflationary currency under IFRS and we have accordingly prepared our financial statements in accordance with International Accounting Standard 29, "Financial Reporting in Hyperinflationary Economies" ("IAS 29"). As a result, the financial information with respect to periods prior to 1 January 2003 contained in this Offering Circular, unless otherwise stated, is presented in terms of the general purchasing power of the Rouble at 31 December 2002. Effective 1 January 2003, the Rouble was no longer considered a hyperinflationary currency under IFRS, and our financial information for periods subsequent to 1 January 2003 is not subject to inflationary adjustment and is presented on a historical basis.

We prepare unaudited interim consolidated financial statements.

In this Offering Circular, diamond sales figures expressed in Roubles have been calculated net of value added tax ("VAT") and export duties, whilst diamond sales figures expressed in US Dollars have been calculated net of VAT but including export duties. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Certain Factors Affecting Our Results of Operations – Sales".

Consequently, because diamond sales percentages (e.g., export diamond sales to total diamond sales) presented in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in our consolidated financial statements included in this Offering Circular are calculated based on diamond sales expressed in Roubles, such percentages are, to some extent, different from diamond sales percentages presented elsewhere in this Offering Circular that are calculated based on diamond sales expressed in US Dollars.

Currencies and Exchange Rates

All references in this Offering Circular to:

- “RUB” and “Rouble” are to the lawful currency of Russia;
- “\$”, “US\$”, “Dollars” and “US Dollars” are to the lawful currency of the United States of America; and
- “€” and “euro” are to the currency introduced at the start of the third stage of European Economic and Monetary Union pursuant to the treaty establishing the European Community (“EC”), as amended by the Treaty on European Union.

Our principal exchange rate risk involves fluctuations in the value of the Rouble relative to the US Dollar. In previous periods, the Russian economy has been characterised by high levels of inflation and an unstable currency. The value of the Rouble depreciated significantly against the US Dollar from 1991 through the first half of 1995, but stabilised, in part due to new policies adopted by the Central Bank of Russia (the “Central Bank”), until August 1998 when the Rouble again depreciated significantly against the US Dollar following the decision by the Government of Russia to temporarily stop supporting the Rouble. See “Risk Factors – Risks Related to Our Business – We may be negatively affected by currency fluctuations and Russian law is uncertain with respect to our ability to use hedging instruments”.

The table below sets forth, for the periods and dates indicated, certain information regarding the exchange rate between the Rouble and the US Dollar, based on the official exchange rate quoted by the Central Bank. Fluctuations in the exchange rates between the Rouble and the US Dollar in the past are not necessarily indicative of fluctuations that may occur in the future.

Year ended 31 December	Roubles per US Dollar			
	High	Low	Average ⁽¹⁾	Period End
1997	5.96	5.57	5.80	5.96
1998	20.99	5.96	10.12	20.65
1999	27.00	20.65	24.67	27.00
2000	28.87	26.90	28.13	28.16
2001	30.30	28.16	29.22	30.14
2002	31.86	30.13	31.39	31.78
2003	31.88	29.25	30.61	29.45

Month	Roubles per US Dollar	
	High	Low
November 2004 (through 10 November)	28.78	28.65
October 2004	29.22	28.77
September 2004	29.26	29.21
August 2004	29.28	29.14
July 2004	29.13	29.04
June 2004	29.09	29.00
May 2004	29.08	28.87
April 2004	29.00	28.50
March 2004	28.67	28.49
February 2004	28.62	28.49
January 2004	29.45	28.49
December 2003	29.70	29.25
November 2003	29.95	29.74
October 2003	30.61	29.82

Note:

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

Solely for the convenience of the reader, and except as otherwise specified, this Offering Circular contains translations of some Rouble amounts into US Dollars given as of 30 June

2004 at the conversion rate of RUB29.03 to US\$1.00, which was the official exchange rate quoted by the Central Bank on 30 June 2004. We make no representation that the Rouble amounts referred to in this Offering Circular could have been or could be converted into US Dollars at the above exchange rate or at any other rate.

Certain monetary amounts and other figures included in this Offering Circular have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be the arithmetical aggregation of the figures which precede them, and figures expressed as percentages in the text may not total 100 per cent. when aggregated.

Exchange Controls

Exchange control regulations in Russia currently do not restrict payments by us in respect of foreign currency loans from foreign parties with a maturity of over three years. However, under the new currency control regime, effective from 18 June 2004, the Central Bank has broad authority to introduce currency control restrictions with respect to foreign currency loans or any operations involving “performance by residents of obligations under external securities”. These restrictions may include the mandatory deposit of interest-free reserves with the Central Bank or an authorised Russian bank and/or mandatory use of special bank accounts. The Central Bank also has the authority to extend such restrictions to cover guarantees issued by Russian residents in favour of foreign creditors holding “external securities”, such as the Guarantee and the Notes. At present, however, the restrictions introduced by the Central Bank since the enactment of the new regime in June 2004 only apply to certain types of transactions such as short-term loans, but not to guarantees or loans with maturities exceeding three years.

Summary

This summary highlights information contained elsewhere in this Offering Circular. This summary does not contain all of the information that you should consider before investing in the Notes. Data on diamond reserves and production output of rough diamonds expressed in carats or value in Russia are classified as official state secrets. Further, certain information which investors in securities of a natural resources company might expect in order to evaluate such an investment is not publicly available in relation to our business. The Ministries have, however, provided certain assurances in respect of proven diamond reserves. See "Appendix A - Certification of Diamond Deposits". Prospective investors should read the entire Offering Circular carefully, especially the risks of investing in the Notes discussed in the "Risk Factors" section beginning on page 23.

Overview

We are the second largest diamond mining company in the world by diamond production, measured as a multiple of average market prices. In 2003 we produced approximately 19.0 per cent. of the world's rough diamond output, measured as a multiple of average market prices. Our principal mining operations are located in the Republic of Sakha (Yakutia) ("Yakutia"), in northeastern Siberia. In addition, we hold a 32.8 per cent. interest in Catoca Mining Ltd., a diamond mining company in Angola, and a 92.4 per cent. interest in OAO Seversalmaz ("Seversalmaz"), a diamond mining company that holds the licence to mine the Lomonosov diamond field in the Arkhangelsk region of northwestern Russia. We are also engaged in diamond exploration throughout northeastern Russia. We produce rough gem diamonds and near-gem diamonds, which are cut and used primarily in jewellery, and non-gem diamonds used primarily as industrial abrasives. During 2003 and the six months ended 30 June 2004, sales of gem and near-gem diamonds, including polished diamonds, accounted for approximately 99.4 per cent. and 99.5 per cent. of our total diamond sales, respectively. We are one of Russia's largest industrial enterprises by revenue, with 2003 total revenues of RUB60.0 billion (US\$2.1 billion), and total revenues for the six months ended 30 June 2004 of RUB34.8 billion (US\$1.2 billion).

We operate open-pit, underground and alluvial mines, which are located near the cities of Aikhal, Anabar, Mirny, Nyurba and Udachny within Yakutia, and our eight primary ore treatment production plants have an aggregate design capacity to process approximately 30 million tonnes of ore annually. In 2003 we mined 30.1 million tonnes of ore in Yakutia, processing approximately 30.2 million tonnes of ore to produce rough diamonds valued at US\$1.6 billion, based on average market prices. For the first six months of 2004 we mined approximately 15.2 million tonnes of ore in Yakutia, processing 15.1 million tonnes of ore to produce rough diamonds valued at US\$1 billion, based on average market prices. As of 30 June 2004 we employed 47,260 people, including 15,207 people in connection with our primary Russian mining operations.

We had total sales of diamonds for 2003 and the six-month period ended 30 June 2004 of US\$1.8 billion and US\$1.1 billion, respectively. Exports accounted for 47.7 per cent. of our sales of rough diamonds for 2003 and for the six-month period ended 30 June 2004. In each case, a significant portion of our exports were through sales to De Beers. Our exports have been established pursuant to periodic export quotas imposed by Russia and expressed in carats. In 2003 we were granted a five-year quota for the export of diamonds, under which we may export annually up to US\$1.3 billion of diamonds (based on current market prices).

Historically, we have sold diamonds to De Beers pursuant to trade agreements. The most recent trade agreement with De Beers (the "De Beers Trade Agreement") provides for annual sales to De Beers of up to US\$800 million, based on current market prices, over a period of five years. However, the De Beers Trade Agreement remains subject to approval by the Directorate-General of the European Commission. Pending resolution of the Statement of Objections issued by the European Commission relating to the De Beers Trade Agreement, we have made monthly sales to De Beers under ad hoc written agreements for each shipment and made export sales to customers other than De Beers in 2003 and the first six months of 2004. We expect the European Commission to reach a decision on this trade agreement within the next several months.

52.3 per cent. of our total rough diamond sales in 2003 and for the six-month period ended 30 June 2004, were made to domestic purchasers, primarily Russian cutting and polishing companies that process the diamonds for use in jewellery. We also cut and polish some of our rough diamond production primarily through our Brillianty ALROSA division. Our sales of polished diamonds were US\$124 million and US\$65 million for the year ended 31 December 2003 and the six-month period ended 30 June 2004, respectively. Before 2003, our sales of industrial diamonds were conducted almost exclusively through Almaziuvelirexport, a Government of Russia-owned jewellery exporter. In 2003, we sold US\$10 million of industrial diamonds, and our sales of such diamonds in the first six months of 2004 were US\$5 million.

Because of the Federal Law of the Russian Federation "On State Secrets" No. 5485-I, dated 21 July 1993, as amended (the "Secrecy Law") and the regulations thereunder, we are prohibited from disclosing our diamond reserves. However, as certified by the Russian Federal Geological Fund of the Ministry of Natural Resources of Russia, our proven diamond reserves of categories B and C₁ (see "Industry Overview – Calculation of Diamond Reserves") are sufficient to permit mining of diamonds until 31 December 2029 in an annual average volume that is not less than the volume of diamonds produced during 2003. The Ministry of Finance of Russia has certified that our proven reserves of natural diamonds (categories A, B and C₁) are sufficient to permit mining of diamonds until 31 December 2028 in an annual average volume that is not less than the volume of diamonds produced during 2003. The Russian Federal Geological Fund of the Ministry of Natural Resources of Russia also confirmed that the average quality of diamonds to be mined in each of the next 25 years will not be materially less than the average quality of the diamonds that we mined during the year ended 31 December 2003. See "Our Business – Diamond Reserves" and "Appendix A – Certification of Diamond Deposits". To increase our reserves, we engage in a variety of exploratory activities. These include geological surveying, detailed prospecting and developmental analysis of current mines.

To reduce our costs and ensure operational support, we are engaged in a number of businesses that provide materials and services to our mining operations, including construction and freight transportation services, timber and logging production, agriculture and food supplies and passenger air transport. We have also developed oil and natural gas extraction and hydroelectric plants to supply a portion of our energy needs. In addition, we continue to maintain for the benefit of our Russian employees certain non-productive, "social" assets, which we inherited from our predecessor entities. We are continuing to transfer the obligation to maintain these assets to the government of the Republic of Sakha (Yakutia) (the "Government of Yakutia").

We have established representative offices in London, England; Luanda, Angola; Ramat-Gan, Israel; and Antwerp, Belgium.

Our Formation and Development

The diamond industry in Russia dates back to the mid-1950s, following the discovery of significant diamond deposits in regions comprising the former Soviet Union, including the Mir and Zarnitsa diamond pipes.

We were established pursuant to Decree N158S of the President of Russia, dated 19 February 1992 ("Decree N158S") and were registered as a closed joint stock company in Yakutia on 13 August 1992 under the name "Almazy Rossii-Sakha", which was changed in 1998 to ALROSA Company Limited. We commenced operations as an independent entity on 1 January 1993. Pursuant to Decree N158S, we took direct control over the exploration, production, marketing and domestic and foreign sales of diamonds, with the objective of ensuring the efficient operation and development of Russia's diamond industry and strengthening Russia's position in the world diamond market. Under Decree N158S and a number of resolutions of the Government of Russia, various assets previously operated by the former State enterprise, Yakutalmaz, and the State-owned enterprise, Almaziuvelirexport, were transferred to our newly established company, largely by means of a lease. In connection with our formation, we also entered into a lease agreement with Yakutia in January 1993 (the "Lease Agreement") pursuant to which we operate certain key mining assets. See "Our Business – Regulatory and Environmental Matters – Lease Agreement".

Our largest shareholders are the Government of Russia, which holds 37 per cent. of our shares through the Federal Agency for the Management of Federal Property, and the Government of

Yakutia, which holds 32 per cent. of our shares through the Ministry of Property Relations of Yakutia. See "Principal Shareholders".

Strengths

We believe that we benefit from the following strengths:

- *We have a leading market position in a large and relatively stable market.* We are the second largest producer of rough diamonds in the world, accounting for approximately 19.0 per cent. of world production output in 2003, measured as a multiple of average market prices. As compared with other extractive industries, the market for rough diamonds is characterised by relatively stable prices. We believe that this stability is primarily attributable to the role of the Diamond Trading Company, a wholly owned subsidiary of De Beers, in the market for rough diamonds. The Diamond Trading Company purchases and sells rough diamonds and tends to promote stability of diamond prices by aggregating supply and demand.
- *We have significant diamond reserves.* We have increased the reserves of our predecessor entities through a combination of successful exploration and investment. Based upon our internal analyses and certifications of the Russian Federal Geological Fund of the Ministry of Natural Resources of Russia, we believe that we have sufficient diamond reserves to continue our Russian mining operations at least through 31 December 2029.
- *Our mines have consistently produced high-quality, high-margin gems.* Other than our smaller alluvial operations, our mines have consistently produced gem and near-gem diamonds with per carat values ranging from US\$15 to US\$10,000. We believe that the quality of our diamonds is relatively high as compared to the quality of diamonds of other producers. Based on our geological surveys and production experience, we believe that the quality of diamonds generally remains consistent throughout our deposits. Accordingly, we expect to continue to benefit from the production of high quality diamonds in the future.
- *We have a limited number of competitors.* In general, the global diamond mining industry is characterised by a limited number of competitors, which we believe results primarily from a combination of the limited number of diamond deposits suitable for commercial mining and the large capital requirements for exploration and excavation. Within Russia, we hold exclusive prospecting licences in numerous locations and, to date, no company other than ALROSA Ltd. and our majority-owned subsidiaries Severalmaz and ALROSA-Nyurba have been granted a licence to mine viable diamond pipes. Only three companies in Russia that are not members of our consolidated group have licences to mine diamonds from alluvial deposits, producing in the aggregate less than 2 per cent. of our diamond output in terms of both volume and value and selling them on the domestic market. In addition, Canada's Archangel Diamond Corporation ("ADC") and Russia's OAO LUKOIL ("LUKOIL") and its subsidiary OAO Arkhangel'skgeologodobycha ("Arkhangel'skgeologodobycha") are currently engaged in a dispute over the rights to the licence to mine the Verhotinskoye diamond deposit in the Arkhangel'sk region. Notwithstanding the liberalisation of the export controls relating to rough diamonds in early 2003 under the "Regulation on the import to Russia and export from Russia of rough diamonds and polished diamonds", affirmed by the Decree of the President of Russia No. 1373, dated 30 November 2002 (the "2002 Decree"), we believe that structural and legal barriers to entry will continue to exist in the Russian rough diamond market in the short term, which will assist us in maintaining our market position.
- *We continue to benefit from our export arrangements with De Beers.* Although we are developing alternative distribution channels, De Beers continues to purchase a substantial amount of rough diamonds from us each year, currently pursuant to ad hoc written agreements pending the European Commission's review of the De Beers Trade Agreement. We believe that the distribution of our diamonds through De Beers allows us to reduce our distribution costs and to obtain steady inflows of hard currency, as we receive all payments under the agreements with De Beers in US Dollars. See "Risk Factors – Risks Related to Our Business – The De Beers Trade Agreement has been challenged by the European Commission's Directorate-General for Competition and at least some limitation on our sales to De Beers is likely in the coming months. A final decision or settlement requiring an overly rapid or extensive reduction or a termination of our sales

to De Beers could have an adverse impact on our sales, operating results and financial condition” and “Risk Factors – Risks Related to Our Business – The announcement of a European Commission decision or settlement requiring a significant reduction or termination of sales to De Beers may have an adverse impact on the market price of the Notes”.

- *We have strong technical mining expertise.* Our predecessor entities have been engaged in diamond mining since 1957. In particular, we have developed unique mining expertise related to the permafrost environment of northeastern Russia, where winter temperatures can reach -50°C. In addition, one of our divisions, the Yakutian Scientific and Research Institute (the “Institute” or “YakutNiproAlmaz”), has 671 employees engaged in research and development, including development of new techniques of underground mining and ore processing. We believe that our experience helps us to increase efficiency and output and makes us an attractive partner for the joint development of mines outside of Russia.

Strategy

We generally formulate our long-term strategy pursuant to the adoption of five-year strategic plans and are currently in the process of developing a ten-year strategic plan. Under our current five-year plan we intend to:

- *Complete construction of new mines to enhance production.* We are currently constructing a number of new mines to replace mines which have recently closed and to enhance our long-term production capacity. We have put into operation at full capacity and are finalising the development of new Komsomolskaya and Nyurbinskaya open-pit mines and are developing the Botuobinskaya open-pit mine. In addition, we are constructing a new Mir underground mine to replace our recently closed Mir open-pit mine, as well as increasing the capacity of our Zarnitsa open-pit mine and our International and Aikhal underground mines. We are also planning the construction of the Udachny underground mine to continue the mining of diamonds at the Udachny pipe after the expected closure of the Udachny open-pit mine in 2010.
- *Lower costs and seek production efficiencies.* We are engaged in a number of cost reduction projects. In particular, we intend to continue to focus on reducing our energy costs through the construction of a hydroelectric power station on the Vilyui River in western Yakutia, our ongoing gas and oil refinery projects and the introduction of energy-saving equipment. We also intend to continue to modernise and automate our ore treatment plants and to implement more efficient technologies developed by our research institute. We anticipate that the use of new technologies, such as the dry enrichment technology which significantly reduces transportation expenses, would reduce our costs and permit us to engage in industrial mining of deposits whose development was considered non-economical in the past.
- *Divest social assets to improve focus on core business.* We are continuing to transfer to Yakutia and to local governments responsibility for the various social assets which we inherited from our predecessor entities, including residential houses, schools and hospitals. We believe that these transfers will enable us to reduce our maintenance and repair expenses over the long term. We also plan to increase our focus on core operations by divesting or reducing our participation in business ventures which are ancillary to our diamond production operations.
- *Capitalise on anticipated diamond market liberalisation in Russia.* We believe that the 2002 Decree, which became effective on 6 February 2003, and amendments to the Secrecy Law, which became effective on 20 February 2004, reflect the first step in a programme of liberalisation of the Russian diamond market. See “Industry Overview – Liberalisation of the Russian Diamond Market”. We believe that this liberalisation trend will create certain opportunities for our business. Based on discussions with officials of the Government of Russia, we believe that the Government of Russia will implement further diamond market liberalisation reforms, and we intend to pursue additional opportunities resulting from such market reforms, if and when they occur.
- *Develop and implement our sales and marketing strategy.* While we believe that our relationship with De Beers will continue to be important to our business, we are

currently developing a sales and marketing strategy. In preparation for the implementation of such strategy, we have begun to make alternative sales arrangements for the sale of rough diamonds both on the international and the domestic market and are considering additional strategies, including the establishment of a sales outlet outside Russia. We are working on establishing direct relationships with major diamond buyers and implementing arrangements for non-regular customers to buy diamonds from us on a tender or a non-tender basis. We have also started to increase our inventory of high-quality rough diamonds in order to improve the range and consistency of diamonds that we can offer to domestic and international retail customers, meet such customers' future demands, increase sales efficiency and be less dependent on the quality of diamonds that we produce in a particular period.

- *Continue our relationship with De Beers.* We are currently working with De Beers to obtain European Commission approval of the De Beers Trade Agreement. Pending resolution of the Statement of Objections issued by the European Commission's Directorate-General with respect to the De Beers Trade Agreement, we intend to continue our monthly sales to De Beers under individual sale agreements. See "Risk Factors – Risks Related to Our Business – The De Beers Trade Agreement has been challenged by the European Commission's Directorate-General for Competition and at least some limitation on our sales to De Beers is likely in the coming months. A final decision or settlement requiring an overly rapid or extensive reduction or a termination of our sales to De Beers could have an adverse impact on our sales, operating results and financial condition" and "Risk Factors – Risks Related to Our Business – The announcement of a European Commission decision or settlement requiring a significant reduction or termination of sales to De Beers may have an adverse impact on the market price of the Notes".
- *Further diversify geographically.* In addition to exploring regions of Russia outside Yakutia, such as in the Arkhangelsk region where our subsidiary Severalmaz operates, we intend to seek geographic diversification by participating in additional joint ventures in key diamond mining regions in other countries. We are currently focused on Angola, where the Catoca mine is entering a second production phase which is expected to double its ore-processing capacity. We are also participating, with the Government of Angola, in the development of the Angolan Lour diamond deposit and other joint ventures and are in the process of constructing a hydroelectric power station to provide electricity to the Catoca mine. We are also considering participation in projects in Sierra Leone, the Democratic Republic of Congo and other countries in Africa.
- *Enhance financial planning and improve the efficiency of our corporate governance.* We have been working to improve our financial planning to strengthen our financial stability. As part of our strategy we intend to continue to restructure our debt portfolio toward long-term unsecured debt, which we believe will enable us to better manage our cash and enhance our liquidity. We have recently hired a First Vice President and a Vice President who are responsible for the implementation of this restructuring. In addition, we are seeking to improve the efficiency of our management information and financial reporting systems through the implementation of a new integrated accounting software system.

In addition, while our primary focus continues to be on the production of rough diamonds, we have from time to time considered increasing our cutting and polishing operations, either through the expansion of our own facilities or the acquisition of other established polishing businesses.

The registered office of the Issuer is 8-10, rue Mathias Hardt, L-1717, The Grand Duchy of Luxembourg. The registered office of ALROSA Ltd. is 6 Lenin Street, Mirny 678170, Republic of Sakha (Yakutia), Russia, and the address and telephone number of its representative office in Moscow are 10/12 1st Kazachy per., Moscow 109017, Russia, telephone: +7 095 230 66 93.

Summary Consolidated Financial Information

The following table contains historical financial information derived from the audited consolidated financial statements of ALROSA Ltd. as at and for the three years ended 31 December 2003, 2002 and 2001, which were prepared in accordance with IFRS. The interim consolidated financial statements of ALROSA Ltd. as at and for the six-month periods ended 30 June 2004 and 2003 were prepared in accordance with IFRS, but are unaudited. The unaudited interim results for the six-month period ended 30 June 2004 are not necessarily indicative of the results that may be expected for the year ended 31 December 2004. The unaudited interim consolidated financial statements include all adjustments which our management considers necessary for a fair presentation of our consolidated financial position and results of operations for these periods.

You should read the following summary consolidated financial information in conjunction with the information contained in "Selected Financial Information", "Capitalisation", "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes thereto appearing elsewhere in this Offering Circular.

Our reporting currency is the Rouble. Until 1 January 2003, the Rouble was considered a hyperinflationary currency under IFRS and we have, accordingly, prepared our financial statements in accordance with IAS 29. As a result, the financial information contained in this Offering Circular for the periods prior to 1 January 2003, unless otherwise stated, is presented in terms of the general purchasing power of the Rouble at 31 December 2002. Effective from 1 January 2003, the Rouble is no longer deemed to be a hyperinflationary currency under IFRS, and our financial statements for periods after 31 December 2002 are not subject to inflationary adjustment.

Solely for the convenience of the reader, certain information derived from the consolidated financial statements included herein has been translated into US Dollars using the exchange rate of RUB29.03 to US\$1.00, which was the exchange rate quoted by the Central Bank on 30 June 2004. The US Dollar amounts set forth below were not included in our annual consolidated financial statements or our unaudited interim consolidated financial statements. No representation is made that such Rouble or US Dollar amounts could have been or could be converted into US Dollars or Roubles, respectively, at this exchange rate or at any other rate. See "Currencies and Exchange Rates" for further information regarding rates of exchange between the Rouble and the US Dollar. For a discussion of the effects of fluctuating exchange rates on our results of operations, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Certain Factors Affecting Our Results of Operations – Exchange Rates and Inflationary Accounting".

	For the six months ended 30 June				For the year ended 31 December			
	2004		2003		2003		2002	2001
	(unaudited)		(unaudited)		(unaudited)		(unaudited)	(unaudited)
	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(RUB)
Statement of Income Data:								
Sales ⁽¹⁾	34,768	1,198	28,030	966	60,004	2,067	59,119	67,048
Cost of sales	(17,362)	(598)	(12,771)	(440)	(29,818)	(1,027)	(31,106)	(31,879)
Royalty ⁽²⁾	(4,346)	(150)	(4,627)	(159)	(9,096)	(313)	(8,166)	(10,504)
General and administrative expenses	(1,460)	(50)	(1,482)	(51)	(2,881)	(99)	(3,101)	(2,519)
Other operating income	982	34	1,024	35	2,238	77	1,953	1,716
Other operating expenses of which:	(5,539)	(191)	(4,501)	(155)	(10,294)	(355)	(10,079)	(9,033)
Taxes other than profit tax and extraction tax ⁽³⁾	(1,196)	(41)	(1,044)	(36)	(2,240)	(77)	(3,617)	(2,741)
Social costs ⁽⁴⁾	(1,118)	(39)	(1,247)	(43)	(2,695)	(93)	(1,758)	(2,010)
Other non-operating gains and losses:								
Finance costs, net	(2,071)	(71)	(2,083)	(72)	(4,103)	(141)	(4,914)	(5,004)
Income from associated undertakings	240	8	163	6	400	14	497	289
Monetary gain	—	—	—	—	—	—	3,702	3,792
Exchange gains/(losses), net	305	11	1,067	37	1,910	66	(813)	(856)
Profit tax ⁽⁵⁾	(1,248)	(43)	(295)	(10)	(1,718)	(59)	(4,274)	(1,804)
Minority interest	(194)	(7)	(37)	(1)	(286)	(10)	(327)	(293)
Net profit ⁽⁶⁾	4,075	140	4,488	155	6,356	219	2,491	10,953
	As of 30 June		As of 31 December		As of 31 December		2002	2001
	2004		2003		2003		2002	2001
	(unaudited)		(unaudited)		(unaudited)		(unaudited)	(unaudited)
	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(RUB)
Balance Sheet Data:								
Investments ⁽⁷⁾	1,742	60	2,087	72	2,328	2,888		
Property, plant and equipment	108,754	3,746	104,443	3,598	96,440	84,072		
Other non-current assets	3,188	110	2,679	92	1,876	2,267		
Total current assets	38,692	1,333	27,160	936	25,967	24,967		
Total shareholders equity of which: ⁽⁶⁾	64,179	2,211	61,304	2,112	55,648	53,795		
Share capital	11,491	396	11,491	396	11,491	11,491		
Retained earnings	52,688	1,815	49,813	1,716	44,157	42,304		
Grant ⁽⁸⁾	9,994	344	10,498	362	11,560	12,798		
Minority interest	3,094	107	3,035	105	2,974	2,563		
Liabilities:								
Long-term debt, excluding current portion	26,883	926	24,684	850	15,903	7,651		
Provision for restoration liability ⁽⁹⁾	6,116	211	5,394	186	2,743	3,047		
Other long-term liabilities	4,153	143	5,644	194	5,454	3,116		
Total current liabilities	37,957	1,308	25,810	889	32,329	31,224		
	For the six months ended 30 June				For the year ended 31 December			
	2004		2003		2003		2002	2001
	(unaudited)		(unaudited)		(unaudited)		(unaudited)	(unaudited)
	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(RUB)
Statement of Cash Flows Data:								
Net cash provided by operating activities	1,896	65	896	31	9,997	344	11,584	10,520
Net cash used for investing activities	(5,811)	(200)	(5,490)	(189)	(10,317)	(355)	(16,537)	(11,370)
Net cash provided by financing activities	11,390	392	5,977	206	670	23	6,569	1,538

	As of, and for the six months ended 30 June				As of, and for the year ended 31 December			
	2004		2003		2003		2002	2001
	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(RUB)
<i>(amounts in millions, except certain ratios)</i>								
Other Financial Data: ⁽¹⁰⁾								
Adjusted EBITDA ⁽¹¹⁾	11,168	385	8,402	289	16,446	567	15,450	18,577
Gross interest expense ⁽¹²⁾	2,164	75	2,421	83	4,728	163	5,248	5,230
Net interest expense ⁽¹³⁾	2,071	71	2,083	72	4,103	141	4,914	5,004
Adjusted EBITDA/gross interest expense ^{(11)/(12)}	5.16		3.47		3.48		2.94	3.55
Adjusted EBITDA/net interest expense ^{(11)/(13)}	5.39		4.03		4.01		3.14	3.71
Net debt/Adjusted Annual EBITDA ⁽¹⁴⁾	N/A		N/A		2.12		2.10	1.34
Total debt ⁽¹⁵⁾	52,054	1,793	42,563	1,466	38,567	1,329	35,873	26,946
Net debt ⁽¹⁶⁾	40,858	1,407	37,655	1,297	34,880	1,202	32,468	24,831
Notes:								
(1) Sales includes revenue from diamond sales and ancillary services, including transport, trading, construction, social infrastructure and exploration activities.								
(2) Royalty expense represents payments made to Yakutia pursuant to the Lease Agreement.								
(3) Taxes other than profit tax and extraction tax include property tax, ecology fund expense, tax penalties and other taxes and accruals.								
(4) Social costs represent expenses related to maintenance of social infrastructure and charity.								
(5) Profit tax includes current profit tax and deferred profit tax.								
(6) Totals may not add due to rounding.								
(7) Investments is defined as equity accounted investments and available-for-sale investments classified as non-current assets in the balance sheet as at 30 June 2004 and at 31 December 2003, 2002 and 2001.								
(8) Grant is recorded at the carrying values of assets granted to ALROSA Ltd. pursuant to the Lease Agreement, which are reflected in property, plant and equipment. See "Our Business – Regulatory and Environmental Matters – Lease Agreement".								
(9) Provision for restoration liability is defined as the estimated net present value of the production assets that are to be returned to Yakutia at the expiration of the Lease Agreement in January 2018.								
(10) All line items in this table are unaudited with the exception of "Total debt" and "Net debt" as of 31 December 2003, 2002 and 2001 and "Gross interest expense" and "Net interest expense" for the year ended 31 December 2003, 2002 and 2001.								
(11) Adjusted EBITDA is defined as operating profit plus depreciation expense reduced for amortisation of the Grant plus the net impairment provisions for bad debts, property, plant and equipment, available-for-sale investments, inventory obsolescence and loss on disposal of property, plant and equipment. Adjusted EBITDA is included because management believes it is a useful indicator of its ability to incur and service its indebtedness. Adjusted EBITDA should not be considered as a substitute for operating earnings, net income, cash flow or other statements of operations or cash flow data computed in accordance with IFRS or as a measure of our results of operations or liquidity. Funds depicted by this measure may not be available for management's discretionary use (due to covenant restrictions, debt service payments and other commitments). Because all companies do not calculate adjusted EBITDA identically, this presentation of adjusted EBITDA may not be comparable to similarly titled measures of other companies.								
The following table sets forth our calculation of adjusted EBITDA:								
	For the six months ended 30 June				For the year ended 31 December			
	2004		2003		2003		2002	2001
	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(RUB)
<i>(unaudited)</i>								
<i>(amounts in millions)</i>								
Operating profit	7,043	243	5,673	195	10,153	350	8,620	14,829
Depreciation	3,000	103	2,699	93	5,487	189	4,642	4,945
Amortisation of Grant	(504)	(17)	(490)	(17)	(1,062)	(37)	(1,238)	(1,142)
Write down (reversal) of inventory	177	6	157	5	235	8	141	(326)
Bad debt expense	187	6	427	15	693	24	1,371	767
Impairment (reversal) of property, plant and equipment	667	23	—	—	(74)	(3)	627	—
Provision for impairment (reversal) of available-for-sale investments	263	9	(112)	(4)	(30)	(1)	543	(498)
Loss on disposal of property, plant and equipment	335	12	48	2	1,044	36	744	2
Adjusted EBITDA ⁽⁶⁾	11,168	385	8,402	289	16,446	567	15,450	18,577
(12) Gross interest expense is defined as interest expense on bank loans, commercial paper, bonds, provision for restoration liability and other interest.								
(13) Net interest expense is defined as gross interest expense less interest income.								
(14) This ratio is our net debt divided by our adjusted EBITDA for a twelve-month period.								
(15) Total debt is defined as short-term bank loans and other loans, the current portion of long-term debt, short-term commercial paper, short-term non-convertible bonds, long-term bank loans and other loans, long-term commercial paper, long-term non-convertible bonds and the 2008 Notes.								
(16) Net debt is defined as total debt less cash, cash equivalents and cash equivalents restricted as to withdrawal under the terms of certain borrowings and other contractual obligations.								

The following table sets forth our calculation of Adjusted Consolidated Cash Flow, Fixed Charges and Fixed Charge Coverage Ratio. In order to incur indebtedness, other than permitted indebtedness (as defined in the Terms and Conditions of the US\$500 million 8.125 per cent. notes due 2008 (the "2008 Notes") and the Notes, respectively), we are required to have a Fixed Charge Coverage Ratio of at least 3.5 to one. This requirement applies to both the 2008 Notes and the Notes. This is a debt incurrence rather than a debt maintenance requirement; therefore, the issuance of the Notes indicates that we are in compliance with this debt incurrence requirement.

	As of, and for the twelve months ended, 30 June 2004 ⁽¹⁾
	Pro forma⁽²⁾ <i>(amounts in RUB millions, except certain ratios)</i>
Adjusted Consolidated Cash Flow ⁽³⁾	19,774
Fixed Charges ⁽⁴⁾	4,155
Fixed Charge Coverage Ratio ⁽⁵⁾	4.76

Notes:

- (1) Calculated based on the information derived from management accounts.
- (2) Calculated to give effect to incurrence and repayment of indebtedness through 30 September 2004 and the issuance of the Notes in an aggregate principal amount of US\$300 million, as set forth under "Terms and Conditions of the Notes – Definitions – Fixed Charge Coverage Ratio".
- (3) Represents cash flows from operating activities without adjustment for changes in working capital and profit tax paid (amongst other things) as defined in the Terms and Conditions. See "Terms and Conditions of the Notes".
- (4) Represents interest expense adjusted for interest costs on debt incurred and repaid through 30 September 2004 and the issuance of the Notes as defined in the Terms and Conditions. See "Terms and Conditions of the Notes".
- (5) Fixed Charge Coverage Ratio is defined in the Terms and Conditions and understood for purposes of this calculation as the ratio of Adjusted Consolidated Cash Flow of ALROSA Ltd. to the Fixed Charges of ALROSA Ltd. and its subsidiaries for the two consecutive six-month fiscal periods ending on or prior to the date of determination. See "Terms and Conditions of the Notes".

The Offering

The following summary contains basic information about the Notes and the Guarantee and is not intended to be complete. For a more complete understanding of the Notes and the Guarantee, please refer to the section of this document entitled "Terms and Conditions of the Notes".

Issuer:	ALROSA Finance S.A.
Guarantor:	ALROSA Company Limited.
Issue:	Guaranteed Notes due 2014.
Amount:	US\$300,000,000.
Issue Price:	99.511 per cent.
Closing Date:	16 November 2004.
Maturity Date:	Unless previously redeemed, or purchased and cancelled, the Notes will be redeemed at their principal amount on 17 November 2014.
Interest:	8.875 per cent. per annum payable in equal instalments semi-annually in arrear on 17 May and 17 November in each year, commencing on 17 May 2005, with a long first coupon period.
Form:	<p>The Notes will be in registered form, without interest coupons attached, in denominations of US\$100,000 and multiples of US\$1,000 in excess thereof. Notes will be offered and sold outside the United States in reliance upon Regulation S and within the United States to "qualified institutional buyers" ("QIBs") in reliance on Rule 144A.</p> <p>The Notes will be issued in the form of a Regulation S Global Note and a Rule 144A Global Note, each in registered form without interest coupons. The Regulation S Global Note will be deposited with, and registered in the name of a nominee for, the common depository for Euroclear and Clearstream, Luxembourg. The Rule 144A Global Note will be deposited with a custodian for, and registered in the name of, Cede & Co., as nominee of DTC. Ownership interests in the Regulation S Global Note and the Rule 144A Global Note will be shown on, and transfer thereof will be effected only through, records maintained by DTC, Euroclear, Clearstream, Luxembourg and their respective participants. Notes in definitive form will be issued only in limited circumstances.</p>
Status of the Notes:	The Notes constitute (subject to Condition 4 of the Terms and Conditions) unsecured and unsubordinated obligations of the Issuer which rank <i>pari passu</i> and without any preference among themselves. The payment obligations of the Issuer under the Notes and of the Guarantor under the Guarantee shall, save for such exceptions as may arise by mandatory operation of law and subject to Condition 4 of the Terms and Conditions, at all times rank at least equally with all other present and future unsecured and unsubordinated obligations of the Issuer and the Guarantor, respectively.
Guarantee:	The payment, when due, of all sums expressed to be payable by the Issuer under the Trust Deed and the Notes has the benefit of an unconditional and irrevocable guarantee of the Guarantor (see Condition 2(a) of "Terms and Conditions of the Notes").

Cross Default:	There will be a cross default in respect of certain Indebtedness (as defined in the Terms and Conditions) of the Issuer, the Guarantor or any Material Subsidiary (as defined in the Terms and Conditions) equal to or greater than US\$10,000,000 (or its equivalent in another currency) (see Condition 10(c) of "Terms and Conditions of the Notes").
Negative Pledge:	There will be a negative pledge in respect of certain Indebtedness of the Issuer, the Guarantor and its Material Subsidiaries (see Condition 4 of "Terms and Conditions of the Notes").
Covenants:	<p>The Terms and Conditions contain restrictions on certain activities of the Issuer, the Guarantor and certain subsidiaries of the Guarantor, including their ability, amongst other things, to borrow money, pay distributions or dividends on equity, make certain investments, enter into sale and leaseback transactions, sell assets or merge with or into other companies, engage in transactions with affiliates and engage in unrelated businesses. For more information, see "Terms and Conditions of the Notes".</p> <p>The Terms and Conditions contain a covenant fall-away provision, pursuant to which certain covenants will no longer be applicable to the Notes if (i) the Notes are rated Baa3 or better by Moody's and BBB- or better by S&P (or, if either such entity ceases to rate the Notes for reasons outside the control of the Guarantor, the equivalent investment grade credit rating from any other "nationally recognised statistical rating organisation" within the meaning of Rule 15c3-1(c)(2)(vi)(F) under the US Securities Exchange Act of 1934 (the "Exchange Act")) selected by the Guarantor as a replacement agency, if any such agency exists at such time and (ii) no potential event of default or event of default shall have occurred and be continuing. Such covenants include covenants relating to asset sales, transactions with affiliates, restricted payments, incurrence of indebtedness, sale and leaseback transactions and, in part, limitation on merger and consolidation, as set forth in Conditions 5(a), (f), (g), (h), (j) and Clause D of Condition (k), respectively, of "Terms and Conditions of the Notes".</p> <p>There is no assurance that the Notes will ever achieve or maintain an investment grade credit rating.</p>
Tax Redemption:	The Issuer may redeem the Notes, in whole but not in part, at their principal amount, plus accrued interest, in the event of certain changes in taxation in Luxembourg or Russia.
Listing of Notes:	Application has been made to list the Notes on the Luxembourg Stock Exchange. We expect the Notes to be designated for trading on PORTAL.
Ownership Restrictions:	Neither Euroclear, Clearstream, Luxembourg nor DTC will monitor compliance with any transfer or ownership restrictions.
Transfer Restrictions:	The Notes and the Guarantee have not been and will not be registered under the Securities Act. You may offer to sell the Notes only in transactions exempt from, or not subject to, the registration requirements of the Securities Act and in compliance with all applicable laws of any relevant jurisdiction. See "Transfer Restrictions".

Principal Paying Agent, New York Paying Agent, London and New York Transfer Agent:

JPMorgan Chase Bank, N.A.

Trustee:

J.P. Morgan Corporate Trustee Services Limited.

Registrar, Luxembourg Paying Agent and Transfer Agent:

J.P. Morgan Bank Luxembourg S.A.

Governing Law and Arbitration:

The Notes and the Trust Deed (including the Guarantee) will be governed by and construed in accordance with English law and contain provisions for arbitration in London, England.

Use of Proceeds:

The net proceeds from this Offering, after payment of commissions related to the Offering, will be approximately US\$295,983,000. This figure does not include expenses related to the Offering, estimated to be approximately US\$2,000,000, which will be paid directly by the Guarantor. We expect to use the net proceeds of this Offering to repay short and medium-term indebtedness.

Security identification:

	ISIN	Common Code	CUSIP
144A Notes	US02109TAA07	020582863	02109T AA 0
Reg S Notes	XS0205828477	020582847	—

Risk Factors

An investment in the Notes involves a high degree of risk. Accordingly, you should carefully consider the risks described below, as well as the other information in this Offering Circular, before making an investment decision. The risks and uncertainties below are not the only ones we face. Additional risks and uncertainties not presently known to us, or that we currently believe are immaterial, could also impair our business operations. If any of the following risks actually materialises, our business, results of operations and financial condition could be materially and adversely affected. If that were to happen, the trading price of the Notes could decline and ALROSA Ltd. may be unable to meet its financial obligations to the Issuer or to fully perform its obligations under the Intercompany Loan and the Guarantee, in which case the Issuer would be unable to pay interest or principal on the Notes, and you may lose all or part of your investment.

Risks Related to Our Business

Our business is particularly susceptible to fluctuations in diamond prices

Our primary revenues are derived from the mining and sale of diamonds and, as a result, our financial results are affected by the marketability and price of diamonds. Unlike commodities, the price of rough diamonds has remained relatively stable in recent years, which we believe is primarily attributable to the role of the Diamond Trading Company. See “Industry Overview – Marketing and Role of the Diamond Trading Company”. The Diamond Trading Company purchases and sells rough diamonds and seeks to reduce market price volatility by aggregating supply and demand. However, a number of factors could result in fluctuations in rough diamond prices, including, amongst other things, the following:

- international or regional political and economic events or trends;
- structural changes in the world diamond market, such as a change in the system of marketing through the Diamond Trading Company, the Diamond Trading Company’s reduced participation, altered role or withdrawal from this market, whether as a result of changing market conditions, legal requirements, regulatory intervention or otherwise;
- speculative trading in diamonds;
- decreased demand for diamonds used in connection with the manufacture of jewellery, as well as for industrial and investment purposes;
- overproduction of diamonds; and
- drawdowns of existing diamond stocks held by private entities, governments, industrial organisations and individuals.

The prices we receive for our diamonds are based on the clarity, colour and quality of individual diamonds sold, as well as general trends in market supply and demand for diamonds. See “Our Business – Sales of Rough and Polished Diamonds”. To the extent that we sell diamonds to De Beers pursuant to contractual arrangements, we have an assured distribution outlet but eventually any sustained increase or decrease in prices will be passed through to us. Accordingly, any sustained drop in the market price of diamonds is likely to have an adverse impact on our business, results of operations and financial condition.

We are dependent on De Beers for the distribution of our diamonds outside the Commonwealth of Independent States

Until 6 February 2003, the effective date of the 2002 Decree that introduced certain market liberalisation measures, we exported our rough diamonds pursuant to an export licence that required all export sales to be made through De Beers, subject to certain limited exceptions and except for exports to countries within the Commonwealth of Independent States (“CIS”) to meet those countries’ internal requirements for rough diamonds. See “Our Business – Sales of Rough and Polished Diamonds”. We have, therefore, traditionally exported our rough diamonds outside the CIS pursuant to trade agreements with De Beers, which obligated De Beers to make minimum annual purchases of rough diamonds in amounts specified in those agreements. Exports through De Beers accounted for 34.4 per cent. of our total diamond sales in 2003 and 25.0 per cent. of our diamond sales in the first six months of 2004.

We and our predecessor entity, Yakutalmaz, have contracted exclusively with De Beers for the distribution of our exported diamonds on the international market since 1959. We executed the De Beers Trade Agreement on 17 December 2001. The Directorate-General for Competition (the "Directorate-General") of the Commission for the European Communities (the "European Commission") is currently conducting an investigation into our relationship with De Beers, and the De Beers Trade Agreement remains subject to approval by the European Commission. Pending such approval, we have made sales to De Beers under *ad hoc* written agreements for each shipment. However, as part of its investigation, the European Commission could require the termination of the De Beers Trade Agreement and the suspension of the practice of making sales to De Beers pursuant to the *ad hoc* written agreements, or the modification of the terms of the De Beers Trade Agreement or such *ad hoc* agreements. See "– The De Beers Trade Agreement has been challenged by the European Commission's Directorate-General for Competition and at least some limitation on our sales to De Beers is likely in the coming months. A final decision or settlement requiring an overly rapid or extensive reduction or a termination of our sales to De Beers could have an adverse impact on our sales, operating results and financial condition".

The De Beers Trade Agreement has been challenged by the European Commission's Directorate-General for Competition and at least some limitation on our sales to De Beers is likely in the coming months. A final decision or settlement requiring an overly rapid or extensive reduction or a termination of our sales to De Beers could have an adverse impact on our sales, operating results and financial condition

The European Commission's Directorate-General for Competition has reviewed the terms of the De Beers Trade Agreement, and has considered our legal arguments in support of the De Beers relationship and the De Beers Trade Agreement. On 17 January 2003, the European Commission issued a Statement of Objections (the "Statement of Objections"), expressing its view that:

- the De Beers Trade Agreement breaches the European Union prohibition on restrictive agreements by preventing us from competing with De Beers in the European market, and does not qualify for an exemption from such prohibition;
- De Beers' performance under the De Beers Trade Agreement constitutes an abuse by De Beers of its dominant position in the diamond market; and
- our *ad hoc* sales to De Beers pursuant to per-shipment, willing-buyer/willing-seller arrangements, as described above, which have, to date, approximated the sales levels of the De Beers Trade Agreement, amount to a constructive implementation of the De Beers Trade Agreement by the parties and should, therefore, be viewed in the same way as the De Beers Trade Agreement under EC competition law.

We have submitted a written response to the Statement of Objections and have held discussions with the European Commission's Directorate-General for Competition concerning a possible resolution of this matter, but have not reached any agreement to date. We currently expect that the European Commission will shortly adopt a final decision or reach a settlement with us providing for a phased reduction of our sales to De Beers. We understand that the Government of Russia has written to the European Commission in support of a phased reduction and has indicated its intention to continue the liberalisation of the Russian diamond market in accordance with World Trade Organization principles. We cannot, however, predict the precise timing and volume of any required reductions and can provide no assurances that the European Commission will not require overly rapid or extensive reductions or even an immediate termination of our sales to De Beers if no settlement is reached. While we believe that we would have grounds under EU competition law to appeal an unduly restrictive decision to the competent European courts, we can provide no assurance that such courts would stay a decision during any appeal or that we would prevail in that appeal.

A European Commission decision or settlement limiting or terminating our ability to sell diamonds to De Beers would require us to seek alternative purchasers for the rough diamonds that we are unable to sell to De Beers. We have already begun implementing alternative sales arrangements for the sale of such diamonds and are considering additional strategies, including the establishment of a sales outlet outside Russia. Such alternative arrangements are, however, not yet sufficiently well-established and comprehensive to accommodate the full range and volume of rough diamonds currently sold to De Beers. The implementation of

comprehensive alternative arrangements will require significant time and expense. Depending on the timing and the volume of reductions in sales to De Beers required by the European Commission, we may have difficulty maintaining our current level of sales until fully adequate alternative arrangements have been implemented. If the European Commission were to impose an overly rapid or extensive phase-out of our sales to De Beers, we could also for a time need to sell the rough diamonds previously sold to De Beers in *ad hoc* auctions in Russia, which could adversely affect both the volumes and prices realised from the sale of such diamonds. Moreover, the establishment of alternative export arrangements might well require us to maintain a significant inventory of different types and qualities of unsold diamonds, which could reduce sales short-term and necessitate a more substantial investment of working capital in such inventory. Finally, we cannot predict the impact of an adverse decision by the European Commission on world prices for diamonds, the impact that potential price fluctuations may have on our business and results of operations or the duration and magnitude of such price fluctuations.

Thus, although we believe that world demand for rough diamonds is such that we would ultimately be able to sell our rough diamonds for export in acceptable quantities and at acceptable prices and that we would in all circumstances be able to meet our obligations as they come due, an overly rapid or extensive phase-in of a mandatory reduction, or an immediate termination, of sales to De Beers could cause significant disruption in our export sales and a corresponding adverse effect on our revenues, operating results and financial condition.

We cannot be fined for violation of EC law with respect to the De Beers Trade Agreement because it has been notified to the European Commission. However, the European Commission could seek to impose fines in respect of our previous De Beers trade agreements, which were not notified to the European Commission, although we think that outcome is unlikely.

The announcement of a European Commission decision or settlement requiring a significant reduction or termination of sales to De Beers may have an adverse impact on the market price of the Notes

The announcement of a European Commission decision or settlement requiring a significant reduction or termination of our sales to De Beers could generate unfavourable publicity that could negatively affect perceptions of us in the financial markets and cause a decline in the market price of the Notes. We believe that any such negative perceptions would dissipate over time, as we believe that we would ultimately be able to maintain the volumes and prices of our rough diamond exports at acceptable levels and would be able to meet all of our obligations when due, despite possibly significant short-term disruptions in our sales, operating results and financial condition resulting from the European Commission decision or settlement.

We are prohibited from disclosing our Russian diamond reserves and other information which may be considered material by investors

The Secrecy Law was enacted in 1993 to prohibit the disclosure of certain data considered to be state secrets. Prior to 20 February 2004 the types of information that were considered a state secret under the Secrecy Law included information about volumes of diamond reserves, as well as extraction, production, delivery and consumption of natural diamonds. With effect from 20 February 2004, the above information in the Secrecy Law's list of state secret data was replaced by information about reserves of natural diamonds held by the State Fund for Precious Metals and Precious Stones of the Russian Federation and the Central Bank, as well as information about volumes of reserves, extraction, production and consumption of strategic mineral resources specifically identified by the Government of Russia. As of the date of this Offering Circular the Government of Russia has not identified diamonds as a "strategic mineral resource". However, under the Secrecy Law the President of Russia has the authority to approve a list of data that is a state secret based on the list set out in the Secrecy Law. The Decree of the President No. 1203, dated 30 November 1995, as amended as of 29 May 2002 (the "1995 Presidential Decree") specifically provides for secrecy as to deposits of precious stones (including diamonds) in Russia, certain production data relating to the Russian state diamond reserves and data in relation to deposits of diamonds containing reserves in excess of 25 million carats. The 1995 Presidential Decree has not been revised following the

enactment of the abovementioned amendments to the Secrecy Law that became effective on 20 February 2004. As a result, pending waiver of secrecy with respect to the relevant information set out in the 1995 Presidential Decree, we are prohibited from disclosing to you certain information, including information concerning:

- diamond deposits in carats;
- diamond extraction volumes in carats;
- diamond recovery rates;
- export quotas in carats;
- disposition of our diamond production in carats;
- consumption of diamonds within Russia in carats;
- diamond reserves located within Russia in carats; and
- diamond stockpiles in carats.

Accordingly, you will need to make your investment decision regarding the Notes without the benefit of this information, which may be material to that decision.

The Ministries have made certain confirmations regarding our reserves of diamonds and, with respect to future years, the expected average grade, production volumes and average value per carat to be realised by us. See “Appendix A – Certification of Diamond Deposits”. However, the Notes have not been guaranteed by the Ministries or any other agency or political subdivision of Russia, and do not represent obligations of any such body.

Estimates of our reserves are subject to uncertainties

To the extent that this Offering Circular contains estimates concerning our reserves, these estimates are subject to considerable uncertainty and are not comparable to Western reserves estimates. Such estimates may be based on interpretations of geological data obtained from sampling techniques. In addition, these estimates may rely on feasibility studies to predict grades of ore, configuration of the ore body, expected recovery rates of diamonds from the ore and other factors. See “Industry Overview – Calculation of Diamond Reserves”. Actual production results may differ significantly from original estimates. In addition, it may take many years from the initial phase of drilling before production is possible. During that time, the economic feasibility of exploiting a discovery may change as a result of changes in the market price of rough diamonds which would determine the projected realisable value of diamonds from the deposit.

In addition, although feasibility of production is considered by the Ministries in assessing our reserves, the official reserves estimates are more a function of analysis of the physical minerals in place and less a function of a commercial viability of such deposits than Western reserves estimates in accordance with generally accepted accounting principles in the United States (“US GAAP”) or IFRS.

We are dependent on licences and quotas issued by the Government of Russia and the Government of Yakutia to conduct our business

Russian legislation provides that all underground resources within the territory of Russia are state property and cannot be sold, purchased or pledged. Once extracted, mined resources may, however, become the property of the producer unless otherwise specified in a subsoil use licence. Pursuant to the Federal Law No. 2395-1 “On subsoil” dated 21 February 1992, as amended (the “Subsoil Law”), the Government of Russia and the regional administrations, including the Government of Yakutia, granted us licences to conduct geological exploration and mining operations on the basis of their joint decisions. Moreover, our ability to export rough diamonds from Russia is based on export licences issued annually after the general quota for export of rough diamonds outside of Russia has been approved by the Government of Russia. See “Our Business – Regulatory and Environmental Matters – Subsoil Licences”. The subsoil use licences and the export licences can be suspended and/or terminated by the licencing authorities if we are deemed to have violated their terms, or repeatedly violated the applicable requirements of Russian law.

The termination or modification of, or failure, for any reason, to renew these licences or any export quota in a timely manner could have a material adverse effect on our business, results

of operations and financial condition as we will not be able to carry on some or all of our current activities, including our diamond mining activities.

Failure or delay in obtaining separate export quotas and export licences by our subsidiaries could negatively affect domestic prices, force us to revise our financial forecasts and negatively affect our results of operations

Our subsidiary ALROSA-Nyurba holds prospecting licences for the deposits that are being developed by our Nyurba division. The Nyurba division began producing diamonds in large volumes in the last quarter of 2003 after the launch of Ore Treatment Plant No. 16, and is expected to account for more than 20 per cent. of our production from 2004. In addition, we expect our subsidiary Severalmaz to begin industrial production of diamonds in 2005. Under current Russian legislation, we may not export diamonds that ALROSA-Nyurba and Severalmaz produce under our export quota, and ALROSA-Nyurba and Severalmaz each need separate export quotas and export licences. In September 2004, we received the export quota and export licence for ALROSA-Nyurba for 2004, but the export quota and export licence are valid only until the end of 2004, and we have applied for a new quota and export licence for 2005. We intend to apply for the export quota and the export licence for Severalmaz when it starts producing diamonds in large volumes. Failure in obtaining the necessary quotas and licences for ALROSA-Nyurba and Severalmaz in a timely manner, or any failure or delay in receiving a new export quota and export licence for ALROSA-Nyurba for 2005, may force us either to offer all the diamonds produced by them on the domestic market, which may result in lower revenues and negatively affect domestic prices for the grades of diamonds that they produce, or to stockpile a portion of such diamonds until the necessary permits have been received, which may negatively affect our cash flows and lead to revisions of our financial forecasts.

Possible amendments to Russian legislation might prevent us from expanding or maintaining our operations in certain regions

The Anti-Monopoly Service and the Ministry of Natural Resources of Russia are currently considering amendments to the Law on Competition and the Subsoil Law that would prevent participation by companies that hold exploration or geological survey licences for over 65 per cent. of a specific region's mineral resources of a particular type in the tenders for subsoil use licences for such minerals in that region. If such a prohibition is introduced, it could limit the rights to diamond reserves that we can hold in any region, including Yakutia.

We lease mining assets from Yakutia and a modification to, or termination of, this lease could negatively affect our business

Pursuant to the Lease Agreement entered into in January 1993, we lease from Yakutia production and non-production facilities that were constructed by our predecessor entities in connection with the mines that we operate. The net book value of the assets covered by the Lease Agreement was RUB15.6 billion (US\$537.4 million) as of 30 June 2004. The Lease Agreement expires in January 2018, and contains an option to purchase the assets based on an agreed valuation prior to the expiration date. See "Our Business – Regulatory and Environmental Matters – Lease Agreement". However, the Lease Agreement could be terminated earlier if we are deemed to be in breach of the Lease Agreement terms and on a number of other grounds. Such early termination of the Lease Agreement could have a material adverse effect on our business, results of operations and financial condition as we would have to replace, or negotiate the purchase of, some or all of the assets covered by the Lease Agreement which would increase our capital costs and might interrupt our mining and other operations.

A number of terms and provisions of the Lease Agreement are susceptible to more than one interpretation or leave important matters to be agreed between the parties on an *ad hoc* basis. Future interpretations or agreements relating to the Lease Agreement may be contrary to our interests. In addition, as a general rule, the principal economic terms of the Lease Agreement are subject to renegotiation every five years, with the next renegotiation expected to occur in 2006. However, the terms of this Lease Agreement may be amended at any time by the parties. The terms of our Lease Agreement have been amended seven times in the 10 years since the Lease Agreement became effective. In recent years we have renegotiated the amount of lease payments on an annual basis and expect this practice to continue. If we are

not able to reach an agreement on the size of lease payments, such payments will remain at the previously set levels. Any future amendments to the Lease Agreement may result in increased lease payments, and Yakutia is likely to seek an increase in such payments if it expects that we will experience a shortfall in revenues which would materially decrease tax revenues paid by us to Yakutia. Any significant increase in the payments we are required to make under the Lease Agreement could have a negative effect on our business, results of operations and financial condition.

Under Russian law we are currently subject to restrictions on our ability to sell large and rare diamonds

Under the Decree of the President No. 1524 dated 15 November 1999 (the "1999 Decree") and Resolution No. 233 of the Government of Russia dated 26 March 2001, as amended ("Resolution No. 233"), we may only sell diamonds which weigh 10.8 carats or more within Russia pursuant to an auction authorised by the Government of Russia, except for those stones sold by the State Fund for Precious Metals and Precious Stones of the Russian Federation ("Gokhran") and polished by Brillianty ALROSA. In addition, diamonds with "special gemological qualities", as determined by the Ministry of Finance of Russia, may only be sold to the Government of Russia. These special diamonds include diamonds with characteristics which make them rare, such as their colour, as well as all diamonds weighing more than 50.0 carats. Although sales of these diamonds to the Government of Russia are at agreed market prices, the valuation of large and unique diamonds is generally difficult due to their relative scarcity. Because the auctions of diamonds of 10.8 or more carats must take place within Russia, and the process is subject to strict controls by the Government of Russia which could deter potential purchasers from participating, we cannot give any assurance that the prices we receive in these auctions are indicative of the prices that could be achieved if the sale of these gems were to be conducted without such restrictions. As the Government of Russia is the only permitted purchaser of diamonds with special gemological qualities, consensus as to the valuation of these stones is even more difficult to achieve and we may, as a result, be unable to sell certain high-value diamonds for extended periods of time. To the extent that the sale restrictions set forth in Resolution No. 233 prevent us from receiving the highest prices for our largest and most unique diamonds in the future, our revenue will continue to be negatively affected.

ALROSA Ltd.'s status as a closed joint stock company may violate Russian law

ALROSA Ltd. was established in 1992 in an uncertain and internally contradictory legal environment. A number of Presidential decrees and resolutions of the Government of Russia pursuant to which ALROSA Ltd. was set up were inconsistent and, to a certain extent, contradicted each other and other applicable laws. ALROSA Ltd. was established and continues to exist as a closed joint stock company, which may not be in strict compliance with the Law "On Joint Stock Companies" of 26 December 1995, as amended (the "JSC Law"). If ALROSA Ltd. were found not to be in strict technical compliance with the JSC Law, it could be subject to mandatory conversion into an open joint stock company or to liquidation. We believe that it is unlikely that a challenge of the current legal status of ALROSA Ltd. would be successful. However, we can offer no assurance that any of our shareholders, or any regulatory authorities, such as the Federal Agency for the Management of Federal Property, will not challenge the status of ALROSA Ltd. as a closed joint stock company and attempt to force it either to liquidate or to convert into an open joint stock company. See "- The Audit Chamber has issued a series of recommendations which, if implemented by the Government of Russia, would change our relationship with Yakutia, the ownership of our shares, the membership of our Supervisory Council and our ability to export diamonds".

In view of the uncertainty associated with the legality of our closed joint stock company status, our Supervisory Council is contemplating the conversion of ALROSA Ltd., subject to shareholder approval, into an open joint stock company in due course. However, we cannot predict with any degree of certainty the impact that a change in our legal-organisational structure from a closed joint stock company to an open joint stock company may have on our shareholding structure, our management structure or the composition of our Supervisory Council. In addition, a conversion of ALROSA Ltd. to an open joint stock company could result in technical breaches by ALROSA Ltd. of certain covenants and event of default provisions

contained in certain agreements to which ALROSA Ltd. is a party, to the extent that it is unsuccessful in obtaining waivers of such covenants and event of default provisions.

One of our largest domestic customers may be privatised

The Government of Russia may, in the future, privatise one of our largest domestic customers, diamond polisher Kristall in Smolensk ("Smolensk Kristall"). Smolensk Kristall is one of the largest polishing operations in the world with approximately 900 polishers. We are currently considering whether to participate in the privatisation of Smolensk Kristall.

There is no assurance, however, that we will ultimately decide to, or will be able to, participate in the privatisation of Smolensk Kristall. If Smolensk Kristall is ultimately privatised, its new owners may attempt to influence its diamond purchasing policies in a way that is disadvantageous to us. If Smolensk Kristall is ultimately privatised and is subsequently merged with, consolidated into, or forms an association with other Russian or foreign diamond polishers, the new company or association may be able to influence diamond prices or the level of demand for diamonds with specific characteristics which may adversely affect our revenues.

The Audit Chamber has issued a series of recommendations which, if implemented by the Government of Russia, would change our relationship with Yakutia, the ownership of our shares, the membership of our Supervisory Council and our ability to export diamonds

The Russian Audit Chamber (the "Audit Chamber") is an independent auditing body which is authorised to investigate Russian agencies and other entities associated with the Government of Russia. The Audit Chamber may report its findings and make recommendations to such entities; however, these recommendations do not carry the force of law and are, therefore, not mandatory.

On 15 December 2002, the Audit Chamber issued a report to the Government of Russia and to us in which it made certain recommendations (the "Audit Chamber Report"). See "Our Business – Legal Matters – The Audit Chamber". These included recommendations that the Government of Russia, amongst other things:

- transfer ownership of certain of the assets underlying our Lease Agreement from Yakutia to the Government of Russia, and amend the Lease Agreement so that the Government of Russia would lease these assets to us;
- acquire our shares from certain current shareholders to increase the Government of Russia's ownership in our shares to 51 per cent.;
- set up a new state-owned company which will effect sales of all of our production (rough and polished diamonds) to both internal and external markets; and
- replace certain members of our Supervisory Council.

We believe that it is highly unlikely that the Government of Russia will seek to implement the recommendations of the Audit Chamber and, since the issuance of the Audit Chamber Report in December 2002, no action has been taken to do so. In addition, we believe that there is some uncertainty as to whether Russian law would permit the full implementation of these recommendations, as proposed by the Audit Chamber. However, we cannot offer any assurance that the Government of Russia will not seek to implement some or all of the recommendations made by the Audit Chamber. The full implementation of these recommendations may require substantive changes to our Lease Agreement and the other documents under which we operate. It would also result in majority control of our business by the Government of Russia, changes to our management structure or to the composition of our Supervisory Council. We are unable to predict what effects, if any, these changes could have on our business, results of operations and financial condition.

In addition to the issue of the Audit Chamber Report in December 2002, the Audit Chamber has examined the 1993 contract under which we were required to sell approximately US\$1.2 billion of diamonds on behalf of Almaziuvlirexport. In connection with the Audit Chamber's review we were not able to supply records confirming all of these sales because, under our record retention policy, we do not maintain records dating back to the time of these sales. Based on the absence of records, the Audit Chamber issued a report which concluded that we may have breached certain contractual obligations in connection with our sale of diamonds on behalf of Almaziuvlirexport. Although the Audit Chamber has submitted this claim to the

General Prosecutor's Office with a request to initiate a criminal investigation, to date the General Prosecutor's Office has not instituted any claim against our management with respect to these sales and we do not expect it to do so in the future. However, we can provide no assurance in this regard, and any such claim could adversely affect our business.

From time to time, we could be subject to technical defaults under our credit agreements, loan facilities and other debt instruments

Although we intend to repay existing credit facilities and loans with the proceeds from the Offering, we anticipate that following the Offering we will retain some of our existing credit agreements, some of which contain broad and far-reaching event of default and cross-default provisions. Because of the breadth of these provisions and the ambiguities and imprecisions currently found in Russian laws to which such provisions may pertain (see “– Risks Related to the Legal and Regulatory Environment in Russia – Russia’s developing legal system creates a number of uncertainties for our business”), from time to time we may be deemed to be in technical default under such agreements, facilities and instruments. However, we have never been in a payment default under, and no lender has ever accelerated any of our indebtedness under, any such agreements, facilities or instruments, nor threatened any such acceleration. Future events which significantly impact our business or involve a change in our legal-organisational form could also be deemed to constitute defaults under one or more of our credit agreements, loan facilities and other debt instruments. Accordingly, we can give no assurance that the occurrence of any such default would not trigger additional defaults under applicable cross-default provisions in other credit agreements, loan facilities and debt instruments and lead to acceleration of indebtedness thereunder.

We are substantially exposed to the maintenance of social infrastructure in Yakutia

Our predecessor entities established most of the physical infrastructure in the areas within Yakutia in which we operate, as these areas were largely uninhabited prior to the discovery of diamond deposits in the 1950s. Although in recent years the economy of Yakutia has become more diversified with the development of oil and gas and other industries, the region remains economically dependent on our business to a significant degree. We are by far the largest employer in our areas of operation within Yakutia, and we estimate that our payments to Yakutia account for a majority of Yakutia’s total budget. Yakutia and its local municipalities have historically appealed to us for additional assistance, beyond our required Lease Agreement and tax payments, when local budgets have been insufficient to provide necessary public services. For instance, we have from time to time undertaken to complete necessary road repairs and maintenance to the extent that local budgets could not provide for these activities. We have also been called upon to assist in remedying natural disasters, such as the flooding in Lensk in 2001 in relation to which we incurred costs in 2001 of approximately RUB4.2 billion (US\$144.7 million), which included reconstruction of housing and payments to flood victims but excluded costs associated with the construction of a flood-control dam, as these costs are to be reimbursed by Yakutia. Although Yakutia is developing other industries which are not dependent on our business, we expect that Yakutia and its municipalities will continue to rely on us for a substantial portion of their budgets and for additional assistance, where necessary. Under existing legislation, there is no basis to require us to make any extraordinary payments to any governmental authorities, and to date, extraordinary payments made by us have generally either been set off against our required tax and lease payments or have been reimbursed by the relevant governmental entity, except with respect to the assistance we provided to victims of the flooding in Lensk. However, if we were to be required to make such payments to Yakutia and these local entities and these payments were not set off or reimbursed or reimbursement were delayed, then such payments would increase our expenses or adversely affect our working capital position.

We are currently appealing a damages award in an arbitration claim relating to certain ore treatment technologies used at our Nyurba operations

In addition to litigation arising in the ordinary course of business, we are involved in a civil claim relating to the technologies used at our Nyurba operations. In January 2003, Bateman Projects Limited, a South African company, and its Dutch subsidiary, Bateman International B.V. (collectively, “Bateman”), filed an arbitration claim against us for an alleged breach of contract relating to construction of an ore treatment plant at our Nyurba operations. The claim sought damages of approximately US\$46.1 million. The arbitration tribunal issued its

decision on 28 May 2004. Pursuant to the decision, we were ordered to pay Bateman US\$8 million (net of approximately US\$300,000 awarded to us on our counterclaim). We are appealing the decision of the arbitration tribunal and believe that our grounds for appeal are strong. We have fully provided for this liability. However, there can be no assurance that we will not be required to pay the sum awarded by the arbitration tribunal to Bateman. See “Our Business – Legal Matters – Litigation”.

We are subject to general mining risks

Our business operations, like those of other mining companies, are subject to all of the hazards and risks normally associated with the exploration, development and production of natural resources, any of which could result in work stoppages or damage to persons or property. In particular, hazards associated with our open-pit mining operations include:

- flooding of the open pit;
- collapses of the open-pit wall;
- accidents associated with the operation of large open-pit mining and rock transportation equipment;
- accidents associated with the preparation and ignition of large-scale open-pit blasting operations;
- production disruptions due to weather; and
- hazards associated with the disposal of mineralised waste water, such as groundwater and waterway contamination.

Hazards associated with our underground mining operations include:

- underground fires and explosions, including those caused by flammable gas;
- cave-ins or ground falls;
- discharges of gases and toxic chemicals;
- flooding;
- sinkhole formation and ground subsidence; and
- other accidents and conditions resulting from drilling, blasting and removing and processing material from an underground mine.

Hazards associated with our rock dump and production stockpile mining and tailings disposal include:

- accidents associated with operating a rock dump and production stockpile and with rock transportation;
- production disruptions due to weather;
- collapses of tailings dams; and
- ground and surface water pollution.

We are at risk of experiencing any and all of these environmental or other industrial hazards. The occurrence of any of these hazards could delay production, increase production costs and result in injury to persons and damage to property, as well as liability for us.

To the extent that liabilities resulting from any of these risks are not adequately covered by insurance, we may incur significant costs that could have a material adverse effect upon our business, results of operations and financial condition.

As our open-pit mines mature, we must increasingly rely on underground mining, which is more capital-intensive and subjects us to additional risks

We have historically operated open-pit mines. However, as some of our open-pit mines have matured and reached their target depths and some are close to maturity and reaching their target depths, we are in the process of shifting to underground mining in order to continue extracting diamonds from the deposits related to these open-pit mines. We now conduct underground mining at our International mine, have launched a pilot mining phase at our Aikhal underground mine and are constructing an underground mine to continue the extraction of ore at our Mir mine, where open-pit mining has ceased. In addition, we are

currently completing feasibility studies relating to the underground mining of our Udachny deposit.

Underground mines typically have lower ore production volumes than open-pit mines because the volume of ore that can be extracted is limited by the need to use access shafts to transport ore to the surface. In addition, underground mining is generally more capital-intensive than open-pit mining. Due to the above factors, where we replace open-pit mining with underground mining, the historical operating and financial results of the replaced open-pit mines will not necessarily be indicative of the operating and financial results that may be achieved in the future with underground mining. Transition from open-pit to underground mining will also lead to increased capital expenditure and increased operating expenses to maintain the more complex extraction infrastructure of underground mines. Any reductions in volumes and/or increases in operating expenses relating to our increasing use of underground mining could have an adverse effect on our business, results of operations and financial condition.

Underground mining is also considered to be more dangerous than open-pit mining. Underground mines present an increased risk of cave-ins and are dependent on artificial ventilation systems. Although we believe that the safety record of our underground mines has been consistent with that of our open-pit mining operations, we can offer no assurance that we will not experience material losses due to accidents in the future. For a description of the risks relating to underground mining, see “– We are subject to general mining risks”. Any such losses may have a material adverse effect on our business, results of operations and financial condition.

Our operations may be adversely affected by difficult geological conditions

The success of our operations depends, in part, upon the success of our engineering solutions to difficult hydrological and geothermal conditions. Significant removal of groundwater inflow and geothermal control is required during mining. While we have achieved considerable success to date in addressing these conditions, no assurance can be given that future efforts will be adequate or will meet future operational demands or expectations. A failure to resolve any unexpected problems relating to these conditions at a commercially reasonable cost could adversely affect the economics and/or feasibility of our operations.

We could be subject to liabilities which are not covered by insurance

The insurance industry is not yet well developed in Russia, and many forms of insurance protection common in more economically developed countries are not yet available in Russia on comparable terms, including coverage for business interruption. We insure the transport of all our diamonds from our production sites in Yakutia to our sorting facility in Moscow. We also maintain general liability insurance in an amount that we believe is sufficient for our mining operations. However, few of our operating assets are insured, and, in the case of assets which are insured, the insurance is generally insufficient to cover replacement costs. With respect to our passenger airline services we have carrier's liability insurance, and we also insure our airplanes. However, in the course of our business, certain claims may be brought against us relating to, amongst other things, personal injury, death or property damage caused by our operations. Accordingly, we may incur uninsured losses of assets and may be subject to a claim which is not covered, or not sufficiently covered, by insurance. Any such loss or claim may have a material adverse effect on our business, results of operations and financial condition.

We depend on our port facilities in Lensk and other self-maintained transportation infrastructure within Yakutia

For all of our mines, the vast majority of materials and supplies are shipped by rail to the river port at Osetrovo, then transported by the River Lena to our port at Lensk and delivered to the mines by truck, in part over gravel roads that we have constructed and maintain. In addition, we have built and maintain airports located in Mirny, Vitim, Lensk, Aikhal, Polyarny and Saskylakh for transportation of passengers, including our employees, and cargo used in our operations. In the future we may experience interruptions to this transportation network, including as a result of natural causes such as the severe flooding that in 2001 significantly damaged the municipality of Lensk along with our port facilities. In 2001 we incurred costs in connection with the flood of approximately RUB4.2 billion (US\$144.7 million), which included

payments to flood victims and construction of replacement housing but excluded the costs of building a flood-control dam, as these costs are to be reimbursed by Yakutia. We cannot assure you that similar interruptions in the transportation of our materials, supplies and employees will not occur in the future. Any such interruption may adversely affect our ability to operate our business, and may result in material additional costs associated with repairs and the implementation of alternative modes of transportation.

Our activities with respect to diamond cutting and polishing subject us to additional risks which may increase in the future

Through our Brillianty ALROSA division we cut and polish a limited amount of our production of rough diamonds. The business of diamond cutting and polishing entails difficulties and risks which are different from those we face as a producer of rough diamonds. As compared with mining, which is capital intensive, cutting and polishing operations entail high variable costs, as the cost of rough diamonds generally comprises approximately 90 per cent. of the total production costs. Because our polishing operations are supplied with rough diamonds from our own mines, we do not need to purchase rough diamonds on the international market. However, the further processing and sale of diamonds as polished gems rather than rough diamonds affects our cash flows by delaying receipt of the sale proceeds for those diamonds. In addition, the demand for polished diamonds is seasonal, and may be more sensitive to fluctuations in the world economy than the rough diamond market. The market for polished diamonds has in the past also been more prone to overproduction than the rough diamond market. As a result of these factors we can give no assurance that our cutting and polishing operations will continue to be profitable in the future. Any losses resulting from our polishing operations could have a material adverse effect on our business, results of operations and financial condition. To the extent that we expand our polishing activities in the future, our risks relating to these activities will also increase.

We may be subject to environmental liabilities

As part of our mining operations, we use various chemicals and produce overburden and wastewater, which could have a negative impact on wildlife and vegetation of adjacent areas if improperly discharged. In addition, we use hazardous materials, such as explosives used in mining operations and solvents used to clean, refurbish and maintain mining, processing and other equipment. Through our Irilyakhneft subsidiary, we are also currently engaged in the extraction, transport and storage of oil principally for use in our mining operations, and we dispense petroleum products from underground and above-ground storage tanks on our mining sites. These activities are subject to a number of federal laws and regulations relating to environmental protection (including a "pay-to-pollute" regime) administered by the Ministry of Natural Resources of Russia, the Federal Service for Hydrometeorology and Environmental Supervision and local authorities. Fees are assessed for exceeding agreed limits on emissions and effluents. Currently these fees are generally small in relation to the cost of environmental protection equipment and it is generally less expensive to pay the fees than to install anti-pollution devices. Further, the applicable laws do not generally require clean-up of environmental pollutants, and when clean-up is required, the applicable laws provide no guidance as to the extent to which the clean-up must be carried out. We are not currently subject to any material claims for environmental remediation or enforcement. However, enforcement of existing legislation, regulations and licences may become more stringent, and more comprehensive legislation could be adopted, particularly in connection with Russia's application to join the World Trade Organisation. Accordingly, future changes in environmental laws or in the enforcement of such laws may require us to make significant capital expenditures or otherwise alter aspects of our operations and this may have an adverse effect on our operations and financial condition.

We may be unable to implement some of the projects envisioned by our strategy

Our strategy envisions construction of new mines as well as a number of ancillary construction projects. We plan to finance implementation of these projects through funds generated from our operations and/or through project financing. Implementation of these projects is subject to a variety of uncertainties, including, but not limited to, our ability to generate sufficient funds, delays in completion, cost overruns and defects in design or construction. There can be no assurances that these projects will be completed on schedule or that the expected operational improvements will be fully realised as currently envisioned.

We may be negatively affected by currency fluctuations and Russian law is uncertain with respect to our ability to use hedging instruments

Our business is affected by currency fluctuations between the US Dollar and the Rouble. Our revenues are denominated in both currencies. However, our Rouble revenues are generally linked to the US Dollar insofar as our domestic sales are generally based on prices established in the world rough diamond market, which are quoted in US Dollars. The vast majority of our production costs are incurred in Roubles, but we have a significant amount of debt denominated in both currencies, and the Notes will be repayable in US Dollars. It is difficult to predict how currency fluctuations will impact us in the future. In addition, hedging arrangements may be unenforceable under Russian law and difficult to implement in light of existing exchange control requirements. We currently plan to hedge our short-term currency risks through deliverable foreign exchange forward contracts. However, such contracts may be unavailable in the market in sufficient volumes and are currently available only on a short-term basis. As a result, any sustained change in currency rates may have a material adverse effect on our financial condition.

Excessive appreciation of the Rouble against the US Dollar would adversely affect our margins and cash flows

After a protracted period of weakness, the Rouble has significantly appreciated against the US Dollar in recent years. Because our revenues are substantially linked to the US Dollar and our costs (other than debt service costs) are denominated primarily in Roubles, the appreciation of the Rouble has already had and may continue to have an adverse effect on our business, results of operations, financial condition and cash flows by causing our costs to increase in real terms relative to our revenue.

Catoca Mining Ltd., our associated undertaking, and our other Angolan operations are subject to the risks of doing business in Angola

We currently have a 32.8 per cent. interest in Catoca Mining Ltd., a joint venture which, pursuant to a concession from the government of Angola (the "Government of Angola"), mines the Catoca diamond pipe located in the Luande Norte Province in eastern Angola, approximately 1,000 kilometres north of that nation's capital. In addition to our investment, we provide advisory services to Catoca Mining Ltd. and as of 30 June 2004 we had 170 employees seconded to that company. In 2003 we began the construction of a hydroelectric station to supply electricity to Catoca. The construction, which is expected to cost approximately US\$45 million, is supervised by Hydroshikapa Ltd., a joint venture entity in which we hold 55 per cent. with the entities controlled by the Government of Angola holding the remaining 45 per cent. We have guaranteed the financing for this project. We also have agreed to participate in the development of a new mine in Angola to extract diamonds from the Lour deposit, which has ore of similar quality to the Catoca diamond pipe. The Lour diamond deposit is expected to be mined by Kamachia-Kamagiku Ltd., a joint venture between the entities controlled by the Government of Angola (55 per cent.) and Escom Alrosa (45 per cent.), a joint venture between us and Escom Mining in which we hold 44 per cent. We have reached a preliminary agreement with Escom Mining which contemplates that Escom mining will finance the entire US\$100 million of the expected capital expenditures for this project through a loan to Kamachia-Kamagiku Ltd., and we will pledge our 44 per cent. interest in Escom Alrosa as security for this loan. There is no recourse to us for this amount and our financial exposure in connection with this project is limited to US\$4 million, which represents our contribution to the charter capital of Escom Alrosa. See "Our Business – The Catoca Mine in Angola".

There are substantial risks associated with investments in less developed countries and countries with emerging economies, such as Angola, where civil unrest, nationalist movements, political violence and economic crises are possible. These countries may also pose heightened risks of expropriation of assets, increased taxation and a unilateral modification of concessions and contracts. Exploration, development and production activities in these countries are potentially subject to political and economic risks, including:

- cancellation or renegotiation of contracts;
- changes in domestic laws or regulations, including tax laws;
- royalty and tax increases or claims by governmental entities, including retroactive claims;

- expropriation or nationalisation of property;
- currency fluctuations and foreign exchange controls;
- import and export regulations, including restrictions on the export of diamonds; and
- risks of loss due to civil strife, acts of war, guerrilla activities, insurrection and terrorism.

Angola recently ended three decades of civil war, with a ceasefire in February 2002. However, the Angolan economy is still recovering from the effects of the civil war, which has displaced millions of people. In addition, the war destroyed much of the country's industrial infrastructure, and it is estimated that four million landmines have been laid in Angola's countryside. Our Angolan operations may be materially affected by these factors. These risks will increase to the extent that we increase our investment in Angola in the future as we intend to do. To limit these risks, we intend to finance our projects in Angola on a project finance basis, without recourse to us (except for possible completion guarantees).

Furthermore, as a result of our operations in Angola, we could be subject to the jurisdiction of Angolan courts in disputes relating to such operations, which could result in unpredictable or adverse outcomes.

We rely on the continued services of key managerial and technical personnel and, because of our remote operations, we may have difficulty retaining and attracting new employees

Our continued success will depend in part on our ability to retain our managers and skilled employees and to attract additional managers and employees who are skilled in our business. Currently, there is a high level of competition for highly trained managers, qualified geologists and other technical personnel. We may also have difficulties attracting and retaining skilled workers at our Yakutian facilities due to their remote location and the local climate. We believe that we will continue to hire the majority of our Yakutia-based employees from the cities surrounding our mining operations, and that we have been successful in attracting other skilled employees, in part through scholarship programmes with Russian universities and technical colleges. However, we may not be able to continue to attract and retain skilled employees in the future. Any failure in this regard could have a material adverse effect on our business, results of operations and financial condition.

To the extent that full liberalisation of the Russian diamond market is not implemented, our operational flexibility will continue to be subject to limitations

Despite the promulgation of the 2002 Decree implementing certain liberalisations of the Russian diamond market effective from February 2003, we remain subject to various governmental controls, including, amongst other things, export quotas, secrecy laws, subsoil use licencing, mandatory price lists and restrictions on the sale of large and rare diamonds. See "Industry Overview – Liberalisation of the Russian Diamond Market". Based on discussions with officials of the Government of Russia, we expect additional liberalisation initiatives to occur in the future, which may be implemented as part of reforms relating to Russia's application for membership in the World Trade Organisation. Our strategy considers ways in which we might capitalise on the additional flexibility that liberalisation would create. See "Our Business – Strategy". However, we can offer no assurance as to when or if further liberalisation will be adopted. To the extent that liberalisation of the Russian diamond market is delayed or abandoned, we will remain subject to the existing rules which materially limit our operational flexibility and our ability to implement a portion of our strategy.

We are subject to the control of our existing shareholders, whose interests may differ from the interests of Noteholders

Russia and Yakutia own 37 per cent. and 32 per cent. of our share capital, respectively. In addition, 8 per cent. of our share capital is held by districts within Yakutia. Collectively, these governmental entities are entitled to appoint a majority of the 15 members of our Supervisory Council, although none of these entities individually exercises control of the Supervisory Council. See "Principal Shareholders". As a result, Russia, Yakutia and the districts within Yakutia will continue to be able to exercise effective control over us, including the disposition of virtually all matters submitted to a vote of shareholders. As sovereign entities, their interests may not be aligned with the interests of private investors who have principally an economic interest in our company. Specifically, these entities may support policies which contribute to national and regional interests, such as policies intended to increase

employment, which may conflict with our interests and the interests of Noteholders. In addition, Russia, Yakutia and the districts within Yakutia may have divergent interests with respect to our management and operations, and any resulting disagreements could adversely affect the Supervisory Council's ability to effectively manage our affairs.

Terrorist activity and global instability could have an adverse impact on the diamond market

On 11 September 2001, terrorist attacks were conducted against multiple targets in the United States, causing the loss of many lives and extensive property damage. These events and their aftermath have had a significant effect on international financial and commodities markets, as well as the market for diamonds. Following 11 September, the average prices for rough diamonds fell by more than 14 per cent. However, diamond prices have recovered since that time. Any future acts of terrorism and, in particular, another terrorist attack in the United States, could have an adverse effect on the global economy and world diamond prices. A significant reduction in demand for diamonds, particularly in the United States, which consumes the majority by value of the world's supply of polished diamonds, could materially adversely affect our business, results of operations and financial condition.

Adverse publicity regarding "conflict diamonds" could have an adverse impact on the diamond industry and our business

Increasing attention has been focused within the last few years on the issue of "conflict diamonds", the name ascribed to diamonds which are extracted in war-torn regions and sold by rebel forces to fund insurrection. Allegations have been made in the press that such diamonds are used in connection with the financing of terrorist activities. Concerned participants in the diamond trade, including De Beers as well as certain other non-governmental organisations, seek to exclude such diamonds, which represent a small fraction of the world's supply, from legitimate trade through an international system of certification and legislative initiatives. We and other diamond producers have worked with The World Diamond Council and the United Nations to establish the "Kimberley Process", and Mr. Shtyrov, President of Yakutia, will chair the Kimberley Process in 2005. The Kimberley Process consists of a system of self-regulation in which a seller of diamonds must certify that it either has personal knowledge or has received a written warranty that the diamonds have been purchased from a legitimate source. It is expected that such efforts, if successful, will not substantially affect the supply of diamonds. In the near term, efforts by these non-governmental organisations to increase consumer awareness of the issue and encourage governmental initiatives to curb the proliferation of "conflict diamonds" could affect consumer demand for polished diamonds, and decrease demand for rough diamonds. Nevertheless, we expect that the Kimberley Process will result in greater transparency of the diamond market, leading to increased demand for diamonds from producers not involved in the proliferation of "conflict diamonds".

The diamond industry may be adversely affected by the discovery of an economically feasible method of producing artificial gem-quality diamonds

Since the creation of the first artificial industrial diamonds, there have been several attempts to develop an inexpensive process for the creation of gem-quality artificial diamonds. From time to time, third parties have made public claims of having successfully manufactured gem-quality diamonds by artificial means; however, to our knowledge there have been no claims regarding the successful commercialisation of such a process. To the extent that the synthetic manufacture of gem-quality diamonds is successfully commercialised in the future and the resulting artificial diamonds receive consumer acceptance as a substitute for naturally occurring gem-quality diamonds, these developments could have an adverse effect on the prices of diamonds generally as well as on our business, results of operations and financial condition.

Information we have obtained from third parties may be unreliable

For certain information included in this Offering Circular we have relied, without independent verification, on publicly available information. Such third party information was derived from press releases and information from various private and governmental publications, some or all of which could be based on estimates or unreliable sources. When reading this Offering

Circular, you should keep in mind that the information, data and statistics attributed to third parties could be incomplete or erroneous.

Risks Related to the Political and Social Environment in Russia

The volatile political situation in Russia could restrict our ability to obtain financing and our business and the value of the Notes could be negatively affected if governmental instability recurs

Political conditions in Russia were highly volatile in the 1990s, which negatively impacted Russia's business and investment climate. However, Russia's current president, Vladimir Putin, was re-elected for a second four-year term of office on 14 March 2004 and has maintained political stability and policies generally oriented towards the continuation of economic reforms. State Duma elections held in December 2003 resulted in an increase in the percentage of the aggregate vote received by United Russia and other members of the State Duma allied with the President. At the same time, the Russian political system remains vulnerable to social and ethnic unrest and our business could be harmed if political instability recurs or if reform policies are reversed or become ineffective. Such instability and any disruption or reversal of reform policies could lead to a deterioration of Russia's investment climate, which could result in a reduction in the value of the Notes.

Conflicts between Russian federal and regional authorities could create an uncertain operating environment for us

Russia is a federation of 89 sub-federal units comprising republics, territories, regions, districts, cities of federal importance and autonomous areas. The delineation of authority among Russia's constituent entities as well as among the branches of government is often uncertain and at times contested. The Russian political system is therefore vulnerable to tension and conflict between federal, regional and local authorities over various issues, including tax revenues, authority for regulatory matters and regional autonomy, and such conflicts may arise between Russia and Yakutia with respect to their ownership and control of our business. In addition, lack of consensus often results in the enactment of conflicting legislation at various levels, and may result in political instability. This lack of consensus creates uncertainties in the operating environment in Russia, which may prevent us from carrying out our business strategy effectively and efficiently. In this regard, President Putin has recently proposed that the executives of the sub-federal political units no longer be directly elected by the population but instead be nominated by the President of Russia and approved by the legislature of the sub-federal political unit. The effectiveness and consequences of this proposal, if enacted, are uncertain.

In addition, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict. Russian military and paramilitary forces were engaged in Chechnya in 1994 to 1996 and since 1999 continue to maintain a presence there. Violence and attacks relating to this conflict have spread to other parts of Russia. In 2004, Russia suffered a number of terrorist attacks, including bombings in Moscow, the simultaneous destruction of two passenger jets and over 1,000 people being taken hostage at a school in Beslan, North Ossetia. As a result of these terrorist attacks, more than 500 people were killed. The spread of violence and terrorism, or its intensification, could have significant political and economic consequences including the imposition of a state of emergency in some parts or throughout Russia. These events could materially adversely affect the value of investments in Russia, including the value of the Notes.

Organised crime and corruption and social instability may adversely affect our operations

Crime and corruption could disrupt our ability to conduct business and could adversely affect our financial condition and results of operations.

The political and economic changes in Russia since the early 1990s have resulted in reduced policing of society and increased lawlessness. The Russian and international press have reported high levels of organised criminal activity and official corruption in Russia and other countries of the former Soviet Union, including the bribing of officials. Press reports have also described instances in which state officials have engaged in selective investigations and prosecutions to further commercial interests of select constituencies. Additionally, published reports indicate that a significant number of Russian media regularly publish slanted articles

in return for payment. Our ability to conduct our business, as well as our financial condition and results of operations, could be adversely affected by illegal activities and corruption or by claims alleging involvement in illegal activities.

Social instability in Russia, coupled with difficult economic conditions, the failure of the state and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living have led in the past, and could lead in the future, to labour and social unrest and increased support for a renewal of centralised authority, increased nationalism, restrictions on foreign involvement in the economy, and increased violence. Any of these could restrict our operations, lead to the loss of revenues and materially adversely affect the value of the Notes.

Risks Related to the Economic Situation in Russia

Economic instability in Russia could adversely affect our operations

Since the late 1980s the government of the former Soviet Union (the “Government of the Soviet Union”) and, since late 1991, the Government of Russia have been attempting to implement policies of economic reform and stabilisation. These policies have involved liberalising prices, reducing defence expenditures and subsidies, privatising state-owned enterprises, reforming the tax and bankruptcy systems, and introducing legal structures designed to facilitate private, market-based activities, foreign trade and investment. Despite the implemented reform policies, the Russian economy experienced, at various times:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high levels of government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to Russian enterprises;
- high levels of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid commercial paper to settle commercial transactions;
- widespread tax evasion;
- the growth of a black and grey market economy;
- pervasive capital flight;
- high levels of corruption and the penetration of organised crime into the economy;
- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the Russian population.

The Russian economy has been subject to abrupt downturns. In particular, on 17 August 1998, in the face of a rapidly deteriorating economic situation, the Government of Russia defaulted on its Rouble-denominated securities, and the Central Bank stopped its support of the Rouble and imposed a temporary moratorium on certain hard currency payments. These actions resulted in an immediate and severe devaluation of the Rouble and a sharp increase in the rate of inflation, a dramatic decline in the prices of Russian debt and equity securities, and an inability of Russian issuers to raise funds in the international capital markets. These problems were aggravated by the near collapse of the Russian banking sector after the events of 17 August 1998, which further impaired the ability of the banking sector to act as a consistent source of liquidity.

Although economic conditions in Russia have recently improved, there is a lack of consensus as to the scope, content and pace of economic and political reform. No assurance can be given that reform policies will continue to be implemented and, if implemented, will be successful, that Russia will remain receptive to foreign trade and investment or that the economy in Russia will continue to improve. Any failure of the current policies of economic reform and stabilisation could have a material adverse effect on our operations.

There can be no assurance that recent positive trends in the Russian economy, such as the increase in the gross domestic product, a relatively stable Rouble and a reduced rate of

inflation, will continue or will not be abruptly reversed. Moreover, the fluctuations in international commodities prices, the strengthening of the Rouble in real terms relative to the US Dollar and the consequences of a relaxation in monetary policy, or other factors, could adversely affect Russia's economy and our business in the future.

Fluctuations in the global economy may adversely affect Russia's economy and our business

Russia's economy is vulnerable to market downturns and economic slowdown elsewhere in the world. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and adversely affect the Russian economy. In addition, a steep decline in the world price of oil could slow or disrupt the Russian economy because Russia produces and exports large amounts of oil. These developments could severely limit our access to capital and could adversely affect the purchasing power of our Russian customers and, consequently, our business.

We are only able to conduct banking transactions with a limited number of creditworthy Russian banks as the Russian banking system remains underdeveloped

Russia's banking and other financial systems are not well developed or regulated and Russian legislation relating to banks and bank accounts is subject to varying interpretations and inconsistent application. There are currently a limited number of creditworthy Russian banks with which we can conduct banking transactions, as the August 1998 financial crisis resulted in the bankruptcy and liquidation of many Russian banks and almost entirely eliminated the developing market for commercial bank loans. A less severe liquidity crisis in April through July 2004 caused failures of a number of Russian banks. Most creditworthy Russian banks are located in Moscow and there are few creditworthy Russian banks in the regions outside Moscow. We have endeavoured to reduce our risk by receiving and holding funds in a number of Russian banks. However, another prolonged or more serious banking crisis or the bankruptcy of a number of banks in which we receive or hold our funds could adversely affect our business and our ability to complete banking transactions in Russia. Russian companies face significant liquidity problems due to the limited supply of domestic savings, the scarcity of foreign sources of funds, high taxes, limited lending by the banking sector to the industrial sector and other factors. An intensification of liquidity problems or a further deterioration in the Russian banking system could have a material adverse effect on our business, financial condition and results of operations.

We face inflation and foreign exchange rate risks that may adversely affect our business

The Russian economy has been characterised by high rates of inflation. The annualised inflation rate in 1998 was 84.4 per cent., although it subsided to 15.1 per cent. in 2002 and 12.0 per cent. in 2003. Most of our revenues are either denominated in US Dollars or are linked to the US Dollar, and are affected primarily by the international price of diamonds while most of our operations costs (other than debt service costs) are denominated in Roubles. Our results of operations are therefore significantly affected by the relative movements of Rouble inflation and exchange rates. In particular, our operating margins are generally adversely affected by a real appreciation of the Rouble against the US Dollar because this will generally cause our costs to increase in real terms relative to our revenues. Conversely, our operating margins are generally positively affected by a real depreciation of the Rouble against the US Dollar because this will generally cause our costs to decrease in real terms relative to our revenues. Continued real appreciation of the Rouble against the US Dollar could adversely affect our financial condition and results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operation – Certain Factors Affecting Our Results of Operations – Exchange Rates and Inflationary Accounting – Impact of inflation and changes in the exchange rates on export sales and operating margins".

Restrictions on investments outside Russia, or in hard-currency-denominated instruments in Russia, expose our cash holdings to devaluation risk

A new Federal Law No. 173-FZ "On Currency Regulation and Currency Control" published on 10 December 2003 (the "New Currency Law") introduced a new currency control regime in Russia, effective from 18 June 2004. See also "– Risks Related to the Legal and Regulatory

Environment in Russia – Restrictive currency regulations may interfere with our ability to conduct routine business transactions”. Although the currency control regime was generally liberalised by the New Currency Law, the Central Bank and the Government of Russia have broad authority to regulate certain currency control matters, including purchases and sales of foreign securities by Russian residents. Regulatory restrictions may include both the mandatory use of special accounts and/or the creation of mandatory reserves in an amount calculated as a certain percentage of the value of the transaction for a certain period of time. For instance, the current Central Bank regulations prescribe the creation of reserves equal to 50 per cent. of the value of foreign securities acquired from foreign counterparties for a period of 15 days. Conversely, there are only a limited number of available Rouble-denominated instruments in which we may invest our excess cash. Should the implementation of the New Currency Law result in financially burdensome requirements to us, or in uncertainties or disputes regarding the interpretation of its requirements, there may be negative effects on our operations and business and our ability to make investments in foreign securities.

There is a lack of reliable official data

Official statistics and other data published by the Central Bank, federal, regional and local governments, and federal agencies are substantially less complete or transparent than those of Western countries, and there can be no assurance that the official sources from which certain of the information set forth herein has been drawn are reliable or complete. Official statistics may also be produced on the basis of methodologies different from those used in Western countries. Any discussion of matters relating to Russia herein may therefore be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

We could experience disruptions in our normal business activities as a result of problems associated with Russia’s physical infrastructure

Russia’s physical infrastructure largely dates back to Soviet times and has not been adequately funded or maintained over the past decade. Particularly affected are the power generation and transmission, communication systems, building stock and rail, road and pipeline networks. Breakdowns and failures of any part of Russia’s physical infrastructure may disrupt normal business activity. Road conditions throughout Russia are poor, with many roads not meeting minimum quality requirements. The Government of Russia is actively considering plans to reorganise the nation’s rail and electricity systems. These reorganisations may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems.

The continued deterioration of Russia’s physical infrastructure will harm the national economy, disrupt the transportation of goods and supplies, add costs to doing business in Russia and may interrupt business operations, all of which could have a material adverse effect on our business and the value of the Notes.

Risks Related to the Legal and Regulatory Environment in Russia

Russia’s developing legal system creates a number of uncertainties for our business

Russia is still developing the legal framework required by a market economy, and several fundamental Russian laws have only recently become effective. The recent nature of much Russian legislation and the rapid evolution of the Russian legal system in ways that may not always coincide with market developments place the enforceability and constitutionality of Russian laws in doubt and result in ambiguities, inconsistencies and anomalies in their application. In addition, Russian legislation often contemplates implementing regulations that have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. Among the risks of the current Russian legal system are the following:

- since 1991, Soviet law has been largely, but not entirely, replaced by a new legal regime as established by the 1993 federal Constitution, the Civil Code and by other federal laws, and by decrees, orders and regulations issued by the President, the Government of Russia and federal ministries, which are, in turn, complemented by regional and local rules and regulations. There may be inconsistencies between such laws, presidential decrees, government resolutions and ministerial orders, and between local, regional and federal legislation and regulations;

- decrees, resolutions and regulations may be adopted by governmental authorities and agencies without clear constitutional or legislative basis and with a high degree of discretion. There is a risk that the state may arbitrarily nullify or terminate contracts, withdraw licences, conduct sudden and unexpected tax audits, criminal prosecutions and civil actions and use common defects in accounting or share issuances and registration as pretexts for court claims and other demands to liquidate companies or invalidate such issuances and registrations and/or to void transactions;
- substantial gaps in the regulatory structure may be created by the delay or absence of regulations implementing certain legislation;
- there is a lack of judicial and administrative guidance on interpreting applicable rules and limited precedential value of judicial decisions;
- bankruptcy procedures are not well developed and are subject to abuse;
- Russia has a judiciary with limited experience in interpreting and applying market-oriented legislation and which is vulnerable to economic and political influence; and
- Russia has weak enforcement procedures for court judgments and there is no guarantee that a foreign investor will obtain effective redress in a Russian court.

All of these weaknesses could affect (i) our ability to enforce our rights under contracts or to defend ourselves against claims by others and (ii) the Trustee's ability to enforce its rights under the Guarantee, which may have an impact on payments to the Noteholders. Furthermore, there can be no assurance that regulators, judicial authorities or third parties will not challenge our compliance with applicable laws, decrees or regulations.

Lack of independence and experience of the judiciary, the difficulty of enforcing court decisions and governmental discretion in enforcing claims could prevent us from obtaining effective redress in a court proceeding

The independence of the judicial system and its immunity from economic, political and nationalistic influences in Russia remain largely untested. The court system is understaffed and underfunded. Judges and courts are generally inexperienced in the area of business and corporate law. Judicial precedents generally have no binding effect on subsequent decisions. Not all Russian legislation and court decisions are readily available to the public or organised in a manner that facilitates understanding. The Russian judicial system can be slow. Enforcement of court orders can in practice be very difficult in Russia. All of these factors make judicial decisions in Russia difficult to predict and effective redress uncertain. Furthermore, court claims are often used in furtherance of political aims. We may be subject to such claims and may not be able to receive a fair hearing. Additionally, court orders are not always enforced or followed by law enforcement agencies.

Russia's unpredictable acknowledgement and enforcement of foreign court judgments or arbitral awards give rise to significant uncertainties

Russia is not a party to any multilateral or bilateral treaties with most Western jurisdictions for the mutual enforcement of court judgments. Furthermore, no federal law providing for the recognition and enforcement of foreign court judgments has been adopted in Russia. Consequently, should a judgment be obtained from a court in any of such jurisdictions, it is unlikely to be given direct effect in Russian courts. However, Russia (as successor to the Soviet Union) is a party to the New York Convention. The Trust Deed (containing the Terms and Conditions) and the Intercompany Loan each contains a provision allowing for arbitration of disputes in a country that is also a party to the New York Convention. A foreign arbitral award obtained in a jurisdiction that is a party to the New York Convention should be recognised and enforced by a Russian court, subject to the qualifications provided for in the New York Convention and compliance with Russian rules of civil procedure and applicable Russian law. There is also a risk that Russian rules of civil procedure will be amended to introduce further grounds preventing foreign court judgments and arbitral awards from being recognised and enforced in Russia. In practice, reliance upon international treaties may meet with resistance or a lack of understanding on the part of Russian courts or other officials, thereby introducing delays and unpredictability into the process of enforcing any foreign judgment or any foreign arbitral award in Russia.

Unlawful or arbitrary government action may have an adverse effect on our business and the value of an investment in the Notes

Authorities of the Government of Russia exercise a high degree of discretion in Russia and may at times act without hearing or prior notice, or in a manner that is contrary to, or not directly within the scope of, Russian law. Moreover, the Government of Russia also has the power in certain circumstances, by regulation or government decree, to interfere with the performance of, nullify or terminate contracts. Unlawful or arbitrary governmental actions have included withdrawal of licences, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and regional government entities have also used common defects in matters surrounding share issuances and registration as pretexts for court actions, claims and other demands to invalidate such issuances and registrations and/or to void transactions, possibly for political purposes. Unlawful or arbitrary government action, if directed at us, could have a material adverse effect on our business, results of operations and financial condition and on the value of the Notes.

Russia's developing securities laws and regulations may limit our ability to attract future investment

The regulation and supervision of the securities market, financial intermediaries and issuers are considerably less developed in Russia than in the United States or Western Europe. Disclosure and reporting requirements, anti-fraud safeguards, insider trading restrictions and directors' duties are relatively new to Russia and are unfamiliar to most Russian companies and managers. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. In addition, Russian rules and regulations can change rapidly, and it is often unclear whether, or how, certain regulations, decisions and letters issued by the various regulatory authorities apply to us. These uncertainties may adversely affect our ability to conduct securities-related transactions in the future, including sales of additional debt securities, to the extent permitted under the Terms and Conditions. Further, we may be subject to fines or other enforcement measures despite our best efforts at compliance, which could cause our financial results to suffer.

Russian law may expose us to liability for actions taken by our subsidiaries or joint venture entities

We have a number of Russian subsidiaries. Under Russian law, we may be jointly and severally liable for any obligations of a subsidiary or joint venture entity under a transaction if we are able to give compulsory instructions to a subsidiary or joint venture entity and the liability arises pursuant to actions taken in accordance with our mandatory instructions. We may also have secondary liability for any obligations of a subsidiary or joint venture entity which becomes insolvent or bankrupt due to our actions or our failure to act. In either of these circumstances, the shareholders of the subsidiary or joint venture entity may seek compensation from us for the losses sustained by the subsidiary or a joint venture entity if we knew that the action taken pursuant to our instructions or the failure to act would result in losses. This type of liability could result in significant liabilities for us and could adversely affect our business.

Shareholder rights provisions under Russian law may impose additional costs on us, which could cause our financial results to suffer

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

- a reorganisation; and
- the approval by shareholders of a "major transaction" that involves property worth more than 50 per cent. of the book value of our assets, calculated in accordance with Russian accounting standards, regardless of whether the transaction is actually consummated.

Our obligation to purchase shares in these circumstances, which is limited to 10 per cent. of our net assets calculated according to the Russian accounting standards at the time the matter at issue is voted upon, could have an adverse effect on our cash flow and our ability to service our indebtedness.

Some transactions between us and interested parties or affiliated companies require the approval of disinterested directors or disinterested shareholders and our failure to obtain such approvals may lead to invalidation of transactions that are important for our business

Russian law requires a joint stock company that enters into transactions with certain related persons, referred to as “interested party transactions”, to comply with special approval procedures. Under Russian law, an “interested party” means: (i) any member of the board of directors (supervisory council) or the management board of the company, (ii) the CEO of the company or an external management company, (iii) any person that, together with its affiliates, owns at least 20 per cent. of the company’s voting shares or (iv) a person that is entitled to give mandatory instructions to the company, if any of the foregoing persons, or a close relative or affiliate of such person, is:

- a party to a transaction with the company, whether directly or as a representative or intermediary, or a beneficiary of the transaction;
- the owner of at least 20 per cent. of the shares in a company that is a party to a transaction with the company, whether directly or as a representative or intermediary, or a beneficiary of the transaction;
- a member of a governing body of a company that is a party to a transaction with the company, whether directly or as a representative or intermediary, or a beneficiary of the transaction or an officer of the managing organisation of such company; or
- otherwise deemed an “interested party” under the company’s charter.

Under applicable Russian law, in a joint stock company with 1,000 or less shareholders with a right to vote, interested party transactions must be approved by a majority vote of disinterested directors of the company, or by a majority vote of disinterested shareholders of the company, in the event that (i) the number of disinterested directors is less than the required quorum, (ii) the value of the transaction is equal to or exceeds 2 per cent. of the company’s assets as determined under Russian accounting standards according to the latest balance sheet of the company, or (iii) in case of certain share placements. If valid approval of the interested party transaction is not obtained, the transaction may be invalidated by a Russian court upon a motion by the company or any of its shareholders.

The concept of “interested parties” is defined by reference to the concepts of “affiliated persons” and “group of persons”, which are subject to different interpretations under Russian law. Moreover, the provisions of Russian law defining which transactions must be approved as “interested party transactions” are subject to different interpretations. We cannot be certain that our compliance with applicable requirements will not be subject to challenge. Any successful challenge could result in the invalidation of transactions that are important to our business.

The Russian tax system imposes substantial burdens on us and is subject to frequent change and significant uncertainty

We are subject to a broad range of taxes imposed at the federal, regional and local levels, including but not limited to VAT, import customs duties, profits tax, mineral resources extraction tax, corporate property tax and the unified social tax. In the six-month period ended 30 June 2004, we were subject to an effective current profit tax rate of 40 per cent. (calculated as a percentage of current profit tax, totalling RUB2,211 million, as a percentage of profit before profit tax) and a total current tax burden of 19 per cent. (calculated as tax expense to total sales; tax expense, totalling RUB6,675 million, includes current profit tax, unified social tax, extraction tax, property tax, tax penalties and other taxes and accruals and excludes import duties, non-recoverable VAT and royalty and ecology fund payments).

Laws related to these taxes have been in force for a relatively short period of time as compared to tax laws in more developed market economies and Russian tax legislation is subject to frequent change; as a result, implementation and enforcement of Russian tax laws and regulations is often unclear or inconsistent. It is not uncommon for differing opinions regarding legal interpretation to exist both between companies subject to such taxes and the ministries and organisations of the Government of Russia and between different branches of the Government of Russia such as the Federal Tax Service and its various local tax inspectorates, resulting in uncertainties and areas of conflict. Tax declarations, together with

other legal compliance areas including, but not limited to, customs and currency control matters, are subject to review and investigation by a number of tax authorities which are enabled by law to impose penalties and interest charges. The fact that a tax declaration has been audited by tax authorities does not bar that declaration, or any other tax declaration applicable to that year, from a further tax review by a superior tax authority during a three-year period. Consequently, the Russian tax system presents risks and uncertainties substantially more significant than those typically found in countries with more developed tax systems. These uncertainties expose us to risks of significant fines and penalties and to enforcement measures despite our efforts at compliance, and could result in greater than expected tax expenses. For a description of the status of recent tax claims against us, see “Our Business – Legal Matters – Tax Claims”.

Restrictive currency regulations may interfere with our ability to conduct routine business transactions

Over the past decade, the Rouble has at times fluctuated dramatically against the US Dollar. The Central Bank has from time to time imposed various currency control restrictions in attempts to support the Rouble, and it may take further action in the future. For example, the Central Bank regulations currently require Russian companies to convert 25 per cent. of their export proceeds into Roubles. The percentage of proceeds required to be converted into Roubles may be increased or decreased from time to time by the Russian authorities but cannot under current law exceed 30 per cent. The relative stability of the exchange rate of the Rouble against the US Dollar since 1999 has mitigated risks associated with mandatory conversion. However, this may change in the future. To the extent that we have difficulty converting the required percentage of our foreign currency revenues, we may not be able to comply with applicable currency regulations, which may subject us to fines and penalties. Restrictions on our ability to convert our Rouble revenues into foreign currencies, or to reconvert into foreign currencies the Roubles that we obtain under the mandatory conversion requirements, may adversely affect our business and results of operations.

Although the New Currency Law abolished the need for Russian companies to obtain transaction-specific licences from the Central Bank (with the exception of the requirement that the Central Bank must provide its consent for a corporate entity to open bank accounts outside Russia before June 2005), the law introduced generally applicable restrictions on currency control operations, such as the deposit of mandatory reserves with the Central Bank or authorised banks for certain currency operations, prior registration to open certain foreign currency accounts and to perform certain other currency operations, and special accounts for certain foreign currency operations. As a result, the Central Bank has issued regulations that introduce rules relating to depositing mandatory reserves and certain other regulations implementing the new currency control regime. However, no Central Bank practice has yet developed with respect to the application and enforcement of these new regulations.

Due to the fact that the Rouble is not convertible outside Russia and the CIS, the ability of companies operating in Russia to convert Roubles into other currencies may be subject to special account and/or mandatory reserve requirements from time to time. Because of the limited development of the foreign currency market in Russia, we, as well as any other company operating in Russia, may experience difficulties converting Roubles into other currencies. Furthermore, the Central Bank and the Government of Russia may impose from time to time additional requirements, such as restrictions on investments by Russian companies outside of Russia or on any grant by Russian companies of payment deferrals of more than 180 days for commodities exports.

Our limited ability to convert our Rouble earnings into foreign currency or inability (under the new regime) to purchase foreign currency on economically acceptable terms may adversely affect our ability to conduct routine transactions in foreign currencies, which may have a negative effect on our business.

The introduction of any such restrictions or exchange controls/regulation described above could prevent us from carrying on necessary business transactions, or from successfully implementing our business strategy.

Risk Related to an Investment in the Notes

Our substantial indebtedness could adversely affect our financial condition

We have incurred a substantial amount of debt. As of 30 June 2004 we had total net debt of RUB40,858 million (US\$1,407.4 million), primarily consisting of bank debt, the 2008 Notes and Rouble-denominated bonds. We anticipate that we will continue to maintain a considerable amount of debt for the foreseeable future. For the holders of Notes this has important consequences. Our substantial leverage poses the risk that:

- a significant portion of our cash flow from operations will have to be dedicated to servicing our debt obligations;
- our ability to obtain additional financing for working capital, capital expenditures or business opportunities may be limited by certain covenants associated with our debt obligations;
- our debt may put us at a competitive disadvantage and may make it difficult for us to pursue our business strategy and make us more vulnerable to general economic and industry conditions than competitors who have less debt;
- our debt level may make it more difficult to adequately plan for or react to changing market conditions and changes in the diamond mining industry; and
- we may have difficulty meeting our obligations under the Intercompany Loan or the Guarantee.

Our ability to make payments on and to refinance our debt, including the Intercompany Loan, will depend on our ability to generate cash in the future. The ability to generate cash is, to a certain extent, beyond our control. Accordingly, we cannot provide any assurance that we will generate sufficient cash from operations or additional financing activities to meet debt service obligations and liquidity needs in the future or that subsidiaries of ALROSA Ltd. will be able to transfer assets to ALROSA Ltd. for such debt obligations and liquidity needs. In addition, future borrowings may not be available to us in an amount sufficient to enable us to fund our liquidity needs or to make required payments on our debt in the future.

We may need to refinance all or a portion of our existing indebtedness, as well as the Notes, on or before maturity. We may not be able to refinance existing indebtedness and, even if we can, the terms of such refinancing might be less favourable than the terms of existing indebtedness, which could have a material adverse effect on our business, results of operations or financial condition.

Both ALROSA Ltd. and the Issuer are dependent on intercompany cash flow

The Issuer is a special purpose financing entity with no business operations other than the issuance of debt securities, including the Notes, and the lending of the proceeds of such offerings to us. The Intercompany Loan, the loan of the proceeds from the issuance of the 2008 Notes by the Issuer to ALROSA Ltd. in 2003 and similar agreements to be concluded in the future and payments by ALROSA Ltd. thereunder comprise the only significant assets of the Issuer. Accordingly, the Issuer will rely on payments ALROSA Ltd. must make under the Intercompany Loan to provide the necessary funds for it to pay principal and interest on the Notes and to pay its other expenses. Therefore, the Issuer is subject to all risks to which ALROSA Ltd. is subject, to the extent such risks could limit the ability of ALROSA Ltd. to satisfy its obligations under the Intercompany Loan and perform its obligations under the Guarantee.

In addition, although ALROSA Ltd. is an operating company, it derives a portion of its operating income from its subsidiaries. ALROSA Ltd.'s subsidiaries have no obligation, contingent or otherwise, to pay any amount owed under the Notes, the Intercompany Loan or the Guarantee or to make any funds available for such payment. Therefore, ALROSA Ltd.'s operating cash flow and ability to meet its debt obligations, including under the Intercompany Loan and the Guarantee, will depend in part on the cash flow provided by its subsidiaries in the form of loans, dividends or other payments to ALROSA Ltd. as a shareholder. The ability of ALROSA Ltd.'s subsidiaries to make such payments will depend on their earnings, as well as applicable tax considerations and legal restrictions. In the event of insolvency, liquidation, dissolution or reorganisation of any of ALROSA Ltd.'s subsidiaries, the creditors of each subsidiary would be entitled to payment in full from such subsidiary's assets.

After paying their own creditors, these subsidiaries may not have any remaining assets for distribution to ALROSA Ltd. as a shareholder and, consequently, none of these assets may be available for payment to the Issuer pursuant to the Intercompany Loan or the Noteholders pursuant to the Guarantee. In that event, the Issuer or the Guarantor, as the case may be, may be unable to meet its obligations to Noteholders. As of 30 June 2004, the consolidated subsidiaries of ALROSA Ltd. (other than the Issuer) had RUB13,772 million (US\$474.4 million) of external liabilities, all of which would have ranked structurally senior to ALROSA Ltd.'s obligations with respect to the Intercompany Loan and the Guarantee.

The Guarantee and the Intercompany Loan are effectively subordinated to secured obligations of ALROSA Ltd.

The Guarantee and the Intercompany Loan are effectively subordinated in right of payment to the existing and/or future secured indebtedness of ALROSA Ltd. As of 30 June 2004, we had indebtedness totalling RUB1,282 million (US\$44.2 million) secured with the assets of ALROSA Ltd., primarily related to loans secured by diamond production and receivables, as well as financing under which we have pledged aircraft, ships and real property. The foregoing amount of secured indebtedness does not include certain items of our indebtedness that are subject to guarantees and general security interests over our assets that, by their terms, do not identify any specific assets pledged, because we believe that, under applicable Russian law, it is likely that such indebtedness would be deemed to rank *pari passu* with our unsecured indebtedness, including the Notes. In addition, the Terms and Conditions will permit us to incur substantial additional secured indebtedness under some circumstances. See "Terms and Conditions of the Notes". If an event of default occurs under a secured credit facility, the lenders may foreclose upon the respective collateral. Additionally, in the event of a bankruptcy, liquidation, dissolution, reorganisation or similar proceeding, the holders of any secured indebtedness of ALROSA Ltd. will be entitled to proceed against the collateral that secures such indebtedness and such collateral will not be available for satisfaction of any amounts owed to the Issuer under the Intercompany Loan or payable pursuant to the Guarantee.

We will have the ability to incur substantially more debt, and this could increase the risks described above

We may decide to incur substantial additional debt in the future. While the Terms and Conditions contain certain restrictions on our ability to incur additional debt, they nonetheless permit us to incur substantial amounts of additional debt. In addition, debt permitted to be incurred by ALROSA Ltd.'s subsidiaries, other than the Issuer, will be structurally senior to the Notes. If new debt is added to our current debt levels, the magnitude of the related risks described above could increase, and the foregoing factors could have a material adverse effect on our ability to pay amounts due in respect of the Notes. Limitations on our ability to borrow and invest and to engage in certain transactions could impair our ability to expand or finance our future operations. The agreements that govern our debt instruments, including the Terms and Conditions, contain certain restrictions limiting our flexibility in operating our business. Such restrictions limit or may limit our ability to:

- borrow money;
- sell assets;
- make investments;
- engage in mergers or consolidations;
- enter into new lines of business;
- enter into transactions with affiliates other than on arm's-length terms; and
- pay dividends or make other distributions.

These restrictions could hinder our ability to carry out our business strategy, ALROSA Ltd.'s ability to make payments on the Intercompany Loan or the Guarantee and the Issuer's ability to make payments of principal or interest on the Notes.

In addition, a breach of the Terms and Conditions or the terms of other debt instruments could cause a default under the terms of our other financing arrangements, causing all debt under those financing arrangements to become due. We can offer no assurance that if the indebtedness under the Notes were to be accelerated, the assets of ALROSA Ltd. would be

sufficient to generate the funds necessary to repay the Notes in full in satisfaction of its obligations under the Intercompany Loan or the Guarantee.

Insolvency and administrative laws in Russia, The Netherlands and Luxembourg could negatively affect the ability of Noteholders to enforce their rights

Russian bankruptcy law may prohibit ALROSA Ltd. from making payments pursuant to the Guarantee or the Intercompany Loan under certain circumstances. Specifically, Russian bankruptcy law provides that transactions or payments entered into or made at or after the time when a company becomes unable to pay its debts may be declared void by a Russian bankruptcy court. After such time, the subject company is prohibited from paying any debts outstanding prior to the bankruptcy proceedings, subject to specified exceptions. After the company becomes insolvent, creditors of that company may not pursue any legal action to obtain an order for payment of indebtedness, to set aside a contract for non-payment or to enforce the creditor's rights against any asset of the debtor. Contractual provisions, such as those contained in the Terms and Conditions and the Intercompany Loan, which would accelerate the payment of the debtor's obligations upon the occurrence of certain bankruptcy events, are not enforceable under Russian law. In addition, an administrator may renounce or set aside executory contracts, including the Terms and Conditions.

Additionally, if a bankruptcy court orders a judicial reorganisation, it can prohibit the sale of an asset that it deems to be essential to the continued business of the debtor and can postpone the payment of debts owed by the debtor. Russian bankruptcy law assigns priority to the payment of certain creditors, including employees, secured creditors, the government, creditors on personal injury obligations and post-petition creditors. If any of these laws are applied to ALROSA Ltd., the amounts available to make payments under the Intercompany Loan and/or the Guarantee may decrease substantially and holders of the Notes may not be able to enforce their rights under the Guarantee.

The Issuer is incorporated under the laws of Luxembourg, and its corporate parent Alrosa Finance B.V. is incorporated under the laws of The Netherlands. Generally, insolvency and administrative laws in Luxembourg and The Netherlands could negatively affect the ability of Noteholders to enforce their rights under the Notes and the Guarantee in a manner similar to the Russian laws described above.

A court could invalidate or subordinate the Notes, the Guarantee or the Intercompany Loan pursuant to fraudulent conveyance laws

The Offering and sale of the Notes and the implementation of the Intercompany Loan may be subject to review under Russian law if a bankruptcy or reorganisation case or a lawsuit is commenced by or on behalf of unpaid creditors of ALROSA Ltd. If a court were to find that ALROSA Ltd. incurred indebtedness pursuant to this Offering with the intent to hinder, delay or defraud such creditors, then the issuance of the Notes, the Guarantee and the Intercompany Loan could be declared void, but only with respect to the creditors involved in such action. Similarly, if a court were to find, in connection with a bankruptcy, reorganisation or similar proceeding, that ALROSA Ltd.:

- received less than reasonably equivalent value for incurring indebtedness in connection with the Offering;
- was rendered insolvent at the time of or pursuant to the Offering;
- was engaged or was about to engage in a business or transaction for which the assets remaining constituted unreasonably small capital to carry on its business; or
- intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature,

then, in each such case, a Russian court could declare void, in whole or in part, the Notes, the Intercompany Loan or the Guarantee and take other action detrimental to the holders of these instruments, including, under certain circumstances, ordering the return of payments previously made thereunder. For purposes of the foregoing, ALROSA Ltd. would be considered insolvent if it is unable to settle its current liabilities from available assets.

Tax gross-up provisions under the Intercompany Loan may be unenforceable against ALROSA Ltd. under Russian law

In general, interest payments on borrowed funds made by a Russian entity to a non-resident are subject to Russian withholding tax at a rate of 20 per cent. If a lender is not an individual, unless such payments are reduced or eliminated pursuant to the terms of an applicable tax treaty. Based on professional advice we have received, we believe that interest payments made to the Issuer under the Intercompany Loan will not be subject to withholding tax under the terms of the double tax treaty between Russia and Luxembourg. However, there can be no assurance that such double tax treaty relief will be available.

If payments from ALROSA Ltd. under the Intercompany Loan are subject to any withholding of Russian tax (as a result of which the amounts received by the Issuer would be reduced by the amount of such withholding), ALROSA Ltd. is obliged, subject to certain conditions, to increase payments under the Intercompany Loan as may be necessary so that the net payments received by the Issuer, and consequently, the Noteholders, will be equal to the amounts they would have received in the absence of such withholding. However, there is some uncertainty under Russian law as to the enforceability of such gross-up provisions. To the extent that the tax gross-up provisions under the Intercompany Loan are deemed to be unenforceable, the net amount of the payments made by ALROSA Ltd. to the Issuer may be insufficient to permit the Issuer to make payment in full under the Notes.

No prior market for the Notes

Prior to the Offering, there was no public market for the Notes. Although application has been made to list the Notes on the Luxembourg Stock Exchange, an active trading market in the Notes may not develop or be maintained after listing. If an active trading market does not develop or cannot be maintained, this could have a material adverse effect on the liquidity and the trading price of the Notes. In addition, the stock markets, in recent years and, in particular, in recent months, have experienced significant price fluctuations. These fluctuations were often unrelated to the operating performance of the companies whose securities are traded on such stock markets. Market fluctuations as well as adverse economic conditions have negatively affected the market price of many securities and may affect the market price of the Notes.

Without compliance with currency control restrictions that may be imposed on the Guarantor from time to time, timely payments under the Guarantee cannot be ensured, which may have an impact on the value of the Notes

The New Currency Law does not specifically set out the currency control regime governing guarantees issued by Russian residents in favour of foreign creditors holding “external securities”, such as the Notes. However, the New Currency Law expressly authorises the Central Bank to impose currency control restrictions in relation to operations involving “the performance by residents of obligations under external securities”. The Central Bank may extend the application of this provision to cover guarantees issued by Russian residents in favour of foreign creditors holding “external securities”, and thus the Central Bank may require the Guarantor to create mandatory reserves and/or use a special account. The reserve requirement may take the form of a resident making a deposit in Roubles with a Russian authorised bank on an interest-free basis in the amount of up to 100 per cent. of the amount of payment for a period of up to 60 days. As of the date of this Offering Circular, no such restrictions have been introduced by the Central Bank. If such reserve requirements are introduced by the Central Bank, this may result in additional costs of funding and fund sourcing issues for the Guarantor in respect of the Guarantee, which may delay payments under the Guarantee.

Uncertainties relating to, and any interpretations of, the New Currency Law that result in additional or excessive regulation could have a negative impact on the Guarantor’s operations and the ability of the Guarantor to make timely payments under the Guarantee.

Risks Related to the Taxation of the Notes

Payments under the Guarantee may be subject to Russian withholding tax

Payments under the Guarantee to a Noteholder who is not a tax resident of Russia might, due to the lack of clarity in the law, be characterised as Russian source income that would be

subject to a 30 per cent. withholding tax (if a holder is an individual) or 20 per cent. withholding tax (if a holder is not an individual) at source of payment in Russia. It is not expected that the Trustee will, or will be able to, claim a withholding tax exemption under any double tax treaty. In addition, while it may be possible for some Noteholders who are eligible for withholding tax relief under Russian double tax treaties to claim a refund of tax withheld, there would be considerable practical difficulties in obtaining any such refund.

The Issuer may, at its option, redeem the Notes if: (i) the Issuer (or, if the Guarantee was called, ALROSA Ltd.) has or will become obliged to pay additional amounts, as provided or referred to in the Terms and Conditions, as a result of any change in, or amendment to, the laws or regulations of Luxembourg or Russia or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the issue date of the Notes and (ii) such obligation cannot be avoided by the Issuer (or ALROSA Ltd., as the case may be) taking reasonable measures available to it. If the Issuer redeems the Notes under such circumstances, the redemption price will be equal to 100 per cent. of the principal amount of the Notes plus any interest and additional amounts due. See Condition 7 – “Redemption and Purchase” – in “Terms and Conditions of the Notes” and “Taxation”.

Tax might be withheld on dispositions of our Notes, reducing their value

If an individual tax non-resident Noteholder sells Notes to a resident of Russia, there is a risk that the proceeds from such disposal may be subject to an income tax on any gain realised, subject to any available treaty relief. There is no assurance that advance double tax treaty relief would be granted, and obtaining a refund can involve considerable practicable difficulties. The withholding tax rate applicable to proceeds from the sale of Notes to a purchaser within Russia by an individual tax non-resident holder is 30 per cent. The imposition or possibility of imposition of this withholding tax could adversely affect the value of the Notes. See “Taxation – Russian Federation”.

Use of Proceeds

The net proceeds from this Offering, after payment of commissions related to the Offering, will be approximately US\$295,983,000. This figure does not include expenses related to the Offering, estimated to be approximately US\$2,000,000, which will be paid directly by the Guarantor. We expect to use the net proceeds of this Offering to repay short and medium-term indebtedness.

Issuer of the Notes

General

The Issuer was incorporated on 17 April 2003 as a *société anonyme* with limited liability under the laws of Luxembourg, and registered with the Trade and Companies Register, Luxembourg, under number B93147. The principal purpose of the Issuer is to finance the business operations of ALROSA Ltd. and its subsidiaries, as described in this Offering Circular.

The Issuer has conducted no operations since it was established. It has no subsidiaries or significant business other than the issuance of the Notes and, potentially, other debt securities in the future and is not expected to produce any income except payments received from ALROSA Ltd. under the Intercompany Loan (and under any similar agreements which may be entered into upon any future debt issuances by the Issuer). The only assets of the Issuer available to meet the claims of the Noteholders will be the obligations owed to the Issuer under the Intercompany Loan and any amounts representing its issued and paid-up capital. Pursuant to the Intercompany Loan, operating and other expenses of the Issuer are payable by ALROSA Ltd.

The Issuer has its registered office at 8-10, rue Mathias Hardt, L-1717, the Grand Duchy of Luxembourg. The share capital of the Issuer is €31,000 divided into 310 ordinary shares with a par value of €100 each. The Issuer has issued a total of 310 ordinary shares, all of which have been one-quarter paid. The Issuer has no other authorised or issued securities.

Shareholders

Alrosa Finance B.V., a Dutch company wholly owned by ALROSA Ltd., owns 309 of the Issuer's shares and Shapburg Limited, a nominee company established under the laws of the British Virgin Islands, owns one share.

Statutes

Pursuant to article three of the Issuer's articles of incorporation, the Issuer's purpose is the holding of participations, in any form whatsoever, in Luxembourg and foreign companies and any other form of investment, the acquisition by purchase, subscription or in any other manner as well as the transfer by sale, exchange or otherwise of securities of any kind and the administration, control and development of its portfolio; the Issuer may further guarantee, grant loans or otherwise assist the companies in which it holds a direct or indirect participation or which form part of the same group of companies as the Issuer; and the Issuer may carry out commercial, industrial or financial activities which it may deem useful in accomplishment of this purpose. The by-laws of the Issuer have been published in the *Memorial, Journal Officiel du Grand Duché de Luxembourg, Recueil des Sociétés et Associations* on 16 May 2003. Any person interested in inspecting them may do so at the Register of Commerce and Companies of Luxembourg City. In connection with the listing of the Notes on the Luxembourg Stock Exchange, the constitutional documents of the Issuer and a legal notice relating to the issue of the Notes have been deposited prior to the listing with the Trade and Companies Register, where such documents may be examined and copies obtained free of charge.

Management

The board of directors of the Issuer consists of Shapburg Limited, Quenon Investments Limited and Liftwood Investments Limited, nominee companies established under the laws of the British Virgin Islands, each of whom was appointed by the shareholders of the Issuer. The directors have elected domicile at the registered office address of the Issuer.

Auditors

The auditors of the Issuer are PricewaterhouseCoopers Sarl, with their registered office at 400 route d'Esch, L-1471, the Grand Duchy of Luxembourg.

Financial Year

The Issuer's financial year begins on 1 January and ends on 31 December. The Issuer prepares and publishes annual audited non-consolidated financial statements. The Issuer does not prepare or publish any other financial statements.

Capitalisation

Capitalisation of ALROSA Ltd.

The following table shows the consolidated capitalisation of ALROSA Ltd. as of 30 June 2004, on an actual basis and as adjusted to reflect the application of the net proceeds of this Offering, as described under "Use of Proceeds". You should read this table in conjunction with the consolidated financial information included elsewhere in this Offering Circular.

	As at 30 June 2004		As Adjusted ⁽¹⁾
	(unaudited)		
	(amounts in millions)		
	(RUB)	(US\$) ⁽²⁾	(US\$) ⁽²⁾
Short-term loans and current portion of long-term debt ⁽³⁾	25,171	867	571
Grant ⁽⁴⁾	9,994	344	344
Long-term debt ⁽⁵⁾	26,883	926	1,222
Shareholder's Equity			
Share capital ⁽⁶⁾	11,491	396	396
Retained earnings	52,688	1,815	1,815
Total shareholders equity	64,179	2,211	2,211
Total capitalisation	126,227	4,348	4,348

Notes:

- (1) Adjusted to give effect to receipt of the Intercompany Loan, but not adjusted to give effect to any other changes subsequent to 30 June 2004.
- (2) Solely for the convenience of the reader, the US Dollar amounts shown above have been translated from the Rouble amounts at the rate of RUB29.03 to US\$1.00, which was the official rate at 30 June 2004.
- (3) Short-term loans and current portion of long-term debt includes RUB17,849 million (US\$614.8 million) of bank debt, RUB384 million (US\$13.2 million) of commercial paper, RUB5,235 million (US\$180.3 million) representing the current portion of long-term debt and RUB1,703 million (US\$58.7 million) of other debt. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources".
- (4) The Grant is recorded at the carrying values of assets granted to ALROSA Ltd. pursuant to the Lease Agreement, which are reflected in property, plant and equipment. See "Our Business – Regulatory and Environmental Matters – Lease Agreement".
- (5) Long-term debt includes RUB14,289 million (US\$492.2 million) of the 2008 Notes, RUB8,423 million (US\$290.1 million) of bank debt, RUB193 million (US\$6.6 million) of commercial paper, RUB3,151 million (US\$108.5 million) of non-convertible bonds and RUB827 million (US\$28.5 million) of other long-term indebtedness. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources".
- (6) Authorised share capital consisted of 200,000 ordinary shares at RUB57,455 (US\$1,979.2) par value per share (RUB13,503 historical par value per share), all of which have been issued and fully paid.

Except as indicated above and elsewhere in this Offering Circular, there has been no material change in the share capital or consolidated short-term and long-term debt of ALROSA Ltd. since 30 June 2004, other than, as at 30 September 2004, a RUB4.7 billion net increase in our long-term debt and a RUB7.2 billion net decrease in our short-term debt. For a description of some of our indebtedness, other than the Intercompany Loan incurred since 30 June 2004, see "Description of Existing Material Agreements – Material Financing Agreements".

Capitalisation of the Issuer

The Issuer was incorporated on 17 April 2003. The following table shows the Issuer's capitalisation as of 30 June 2004, on an actual basis and as adjusted to reflect the application of the net proceeds of this Offering:

	As at 30 June 2004	
	Historical	As Adjusted
	(unaudited) (€)	
Total debt.....	428,038,940	656,121,702
Shareholders' equity ⁽¹⁾	205,932	205,932
Total capitalisation	<u>428,244,872</u>	<u>656,327,634</u>

Note:

(1) The authorised share capital component of the Issuer's shareholders' equity consisted of 310 ordinary shares of €100 par value each. All of the shares have been issued and one-quarter paid.

In the above table US Dollar amounts relating to the principal of the 2008 Notes have been translated into euro at a conversion rate of €1.00 to US\$1.1822, US Dollar amounts relating to the accrued interest on the 2008 Notes have been translated at a conversion rate of €1.00 to US\$1.2173 and US Dollar amounts relating to the principal of the Notes have been translated into euro at a conversion rate of €1.00 to US\$1.2977. No representation is made that such Dollar amounts could be converted into euro at this rate.

Except as indicated above and elsewhere in this Offering Circular, there has been no material change in the capitalisation of the Issuer since 30 June 2004.

Selected Financial Information

The following table contains historical financial information derived from the audited consolidated financial statements of ALROSA Ltd. as at and for the three years ended 31 December 2003, 2002 and 2001, which were prepared in accordance with IFRS. The interim consolidated financial statements of ALROSA Ltd. as at and for the six-month periods ended 30 June 2004 and 2003 were prepared in accordance with IFRS, but are unaudited. The unaudited interim results for the six-month period ended 30 June 2004 are not necessarily indicative of the results that may be expected for the year ended 31 December 2004. The unaudited interim consolidated financial statements include all adjustments which our management considers necessary for a fair presentation of our consolidated financial position and results of operations for these periods.

You should read the following selected consolidated financial information in conjunction with the information contained in "Summary Consolidated Financial Information", "Capitalisation", "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes thereto appearing elsewhere in this Offering Circular.

Our reporting currency is the Rouble. Until 1 January 2003, the Rouble was considered a hyperinflationary currency under IFRS and we have, accordingly, prepared our financial statements in accordance with IAS 29. As a result, the financial information contained in this Offering Circular for the periods prior to 1 January 2003, unless otherwise stated, is presented in terms of the general purchasing power of the Rouble at 31 December 2002. Effective from 1 January 2003, the Rouble is no longer deemed to be a hyperinflationary currency under IFRS, and our financial statements for periods after 31 December 2002 are not subject to inflationary adjustment.

Solely for the convenience of the reader, certain information derived from the consolidated financial statements included herein has been translated into US Dollars using the exchange rate of RUB29.03 to US\$1.00, which was the exchange rate quoted by the Central Bank on 30 June 2004. The US Dollar amounts set forth below were not included in our annual consolidated financial statements or our unaudited interim consolidated financial statements. No representation is made that such Rouble or US Dollar amounts could have been or could be converted into US Dollars or Roubles, respectively, at this exchange rate or at any other rate. See "Currencies and Exchange Rates" for further information regarding rates of exchange between the Rouble and the US Dollar. For a discussion of the effects of fluctuating exchange rates on our results of operations, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Certain Factors Affecting Our Results of Operations – Exchange Rates and Inflationary Accounting".

	For the six months ended 30 June				For the year ended 31 December			
	2004		2003		2003		2002	2001
	(unaudited)		(unaudited)		(unaudited)		(unaudited)	(unaudited)
	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(RUB)
Statement of Income Data:								
Sales ⁽¹⁾	34,768	1,198	28,030	966	60,004	2,067	59,119	67,048
Cost of sales	(17,362)	(598)	(12,771)	(440)	(29,818)	(1,027)	(31,106)	(31,879)
Royalty ⁽²⁾	(4,346)	(150)	(4,627)	(159)	(9,096)	(313)	(8,166)	(10,504)
General and administrative expenses	(1,460)	(50)	(1,482)	(51)	(2,881)	(99)	(3,101)	(2,519)
Other operating income	982	34	1,024	35	2,238	77	1,953	1,716
Other operating expenses of which:	(5,539)	(191)	(4,501)	(155)	(10,294)	(355)	(10,079)	(9,033)
Taxes other than profit tax and extraction tax ⁽³⁾	(1,196)	(41)	(1,044)	(36)	(2,240)	(77)	(3,617)	(2,741)
Social costs ⁽⁴⁾	(1,118)	(39)	(1,247)	(43)	(2,695)	(93)	(1,758)	(2,010)
Other non-operating gains and losses:								
Finance costs, net	(2,071)	(71)	(2,083)	(72)	(4,103)	(141)	(4,914)	(5,004)
Income from associated undertakings	240	8	163	6	400	14	497	289
Monetary gain	—	—	—	—	—	—	3,702	3,792
Exchange gains/(losses), net	305	11	1,067	37	1,910	66	(813)	(856)
Profit tax ⁽⁵⁾	(1,248)	(43)	(295)	(10)	(1,718)	(59)	(4,274)	(1,804)
Minority interest	(194)	(7)	(37)	(1)	(286)	(10)	(327)	(293)
Net profit ⁽⁶⁾	4,075	140	4,488	155	6,356	219	2,491	10,953

	As of 30 June		As of 31 December		As of 31 December		As of 31 December	
	2004		2003		2003		2002	2001
	(unaudited)		(unaudited)		(unaudited)		(unaudited)	(unaudited)
	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(RUB)
Balance Sheet Data:								
Investments ⁽⁷⁾	1,742	60	2,087	72	2,328	2,888		
Property, plant and equipment	108,754	3,746	104,443	3,598	96,440	84,072		
Other non-current assets	3,188	110	2,679	92	1,876	2,267		
Total current assets	38,692	1,333	27,160	936	25,967	24,967		
Total shareholders equity of which: ⁽⁶⁾	64,179	2,211	61,304	2,112	55,648	53,795		
Share capital	11,491	396	11,491	396	11,491	11,491		
Retained earnings	52,688	1,815	49,813	1,716	44,157	42,304		
Grant ⁽⁸⁾	9,994	344	10,498	362	11,560	12,798		
Minority interest	3,094	107	3,035	105	2,974	2,563		
Liabilities:								
Long-term debt, excluding current portion	26,883	926	24,684	850	15,903	7,651		
Provision for restoration liability ⁽⁹⁾	6,116	211	5,394	186	2,743	3,047		
Other long-term liabilities	4,153	143	5,644	194	5,454	3,116		
Total current liabilities	37,957	1,308	25,810	889	32,329	31,224		

	For the six months ended 30 June				For the year ended 31 December			
	2004		2003		2003		2002	2001
	(unaudited)		(unaudited)		(unaudited)		(unaudited)	(unaudited)
	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(RUB)
Statement of Cash Flows Data:								
Net cash provided by operating activities	1,896	65	896	31	9,997	344	11,584	10,520
Net cash used for investing activities	(5,811)	(200)	(5,490)	(189)	(10,317)	(355)	(16,537)	(11,370)
Net cash provided by financing activities	11,390	392	5,977	206	670	23	6,569	1,538
Other Financial Data:⁽¹⁰⁾								
Adjusted EBITDA ⁽¹¹⁾	11,168	385	8,402	289	16,446	567	15,450	18,577
Gross interest expense ⁽¹²⁾	2,164	75	2,421	83	4,728	163	5,248	5,230
Net interest expense ⁽¹³⁾	2,071	71	2,083	72	4,103	141	4,914	5,004
Adjusted EBITDA/gross interest expense ^{(11)/(12)}	5.16		3.47		3.48		2.94	3.55
Adjusted EBITDA/net interest expense ^{(11)/(13)}	5.39		4.03		4.01		3.14	3.71
Net debt/Adjusted Annual EBITDA ⁽¹⁴⁾	N/A		N/A		2.12		2.10	1.34
Total debt ⁽¹⁵⁾	52,054	1,793	42,563	1,466	38,567	1,329	35,873	26,946
Net debt ⁽¹⁶⁾	40,858	1,407	37,655	1,297	34,880	1,202	32,468	24,831

Notes:

- (1) Sales includes revenue from diamond sales and ancillary services, including transport, trading, construction, social infrastructure and exploration activities.
- (2) Royalty expense represents payments made to Yakutia pursuant to the Lease Agreement.
- (3) Taxes other than profit tax and extraction tax include property tax, ecology fund expense, tax penalties and other taxes and accruals.
- (4) Social costs represent expenses related to maintenance of social infrastructure and charity.
- (5) Profit tax includes current profit tax and deferred profit tax.
- (6) Totals may not add due to rounding.

- (7) Investments is defined as equity accounted investments and available-for-sale investments classified as non-current assets in the balance sheet as at 30 June 2004 and at 31 December 2003, 2002 and 2001.
- (8) Grant is recorded at the carrying values of assets granted to ALROSA Ltd. pursuant to the Lease Agreement, which are reflected in property, plant and equipment. See "Our Business – Regulatory and Environmental Matters – Lease Agreement".
- (9) Provision for restoration liability is defined as the estimated net present value of the production assets that are to be returned to Yakutia at the expiration of the Lease Agreement in January 2018.
- (10) All line items in this table are unaudited with the exception of "Total debt" and "Net debt" as of 31 December 2003, 2002 and 2001 and "Gross interest expense" and "Net interest expense" for the year ended 31 December 2003, 2002 and 2001.
- (11) Adjusted EBITDA is defined as operating profit plus depreciation expense reduced for amortisation of the Grant plus the net impairment provisions for bad debts, property, plant and equipment, available-for-sale investments, inventory obsolescence and loss on disposal of property, plant and equipment. Adjusted EBITDA is included because management believes it is a useful indicator of its ability to incur and service its indebtedness. Adjusted EBITDA should not be considered as a substitute for operating earnings, net income, cash flow or other statements of operations or cash flow data computed in accordance with IFRS or as a measure of our results of operations or liquidity. Funds depicted by this measure may not be available for management's discretionary use (due to covenant restrictions, debt service payments and other commitments). Because all companies do not calculate adjusted EBITDA identically, this presentation of adjusted EBITDA may not be comparable to similarly titled measures of other companies.

The following table sets forth our calculation of adjusted EBITDA:

	For the six months ended 30 June				For the year ended 31 December			
	2004		2003		2003		2002	2001
	(unaudited)							
	(amounts in millions)							
	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(US\$)	(RUB)	(RUB)
Operating profit.....	7,043	243	5,673	195	10,153	350	8,620	14,829
Depreciation	3,000	103	2,699	93	5,487	189	4,642	4,945
Amortisation of Grant.....	(504)	(17)	(490)	(17)	(1,062)	(37)	(1,238)	(1,142)
Write down (reversal) of inventory.....	177	6	157	5	235	8	141	(326)
Bad debt expense	187	6	427	15	693	24	1,371	767
Impairment (reversal) of property, plant and equipment.....	667	23	—	—	(74)	(3)	627	—
Provision for impairment (reversal) of available-for- sale investments.....	263	9	(112)	(4)	(30)	(1)	543	(498)
Loss on disposal of property, plant and equipment	335	12	48	2	1,044	36	744	2
Adjusted EBITDA ⁽⁶⁾	11,168	385	8,402	289	16,446	567	15,450	18,577

- (12) Gross interest expense is defined as interest expense on bank loans, commercial paper, bonds, provision for restoration liability and other interest.
- (13) Net interest expense is defined as gross interest expense less interest income.
- (14) This ratio is our net debt divided by our adjusted EBITDA for a twelve month period.
- (15) Total debt is defined as short-term bank loans and other loans, the current portion of long-term debt, short-term commercial paper, short-term non-convertible bonds, long-term bank loans and other loans, long-term commercial paper, long-term non-convertible bonds and the 2008 Notes.
- (16) Net debt is defined as total debt less cash, cash equivalents and cash equivalents restricted as to withdrawal under the terms of certain borrowings and other contractual obligations.

The following table sets forth our calculation of Adjusted Consolidated Cash Flow, Fixed Charges and Fixed Charge Coverage Ratio. In order to incur indebtedness, other than permitted indebtedness (as defined in the Terms and Conditions of the 2008 Notes and the Notes, respectively), we are required to have a Fixed Charge Coverage Ratio of at least 3.5 to one. This requirement applies to both the 2008 Notes and the Notes. This is a debt incurrence rather than a debt maintenance requirement; therefore, the issuance of the Notes indicates that we are in compliance with this debt incurrence requirement.

	As of, and for the twelve months ended, 30 June 2004 ⁽¹⁾	
	Pro forma ⁽²⁾ <i>(amounts in RUB millions, except certain ratios)</i>	
Adjusted Consolidated Cash Flow ⁽³⁾	19,774	
Fixed Charges ⁽⁴⁾	4,155	
Fixed Charge Coverage Ratio ⁽⁵⁾	4.76	

Notes:

- (1) Calculated based on information derived from management accounts.
- (2) Calculated to give effect to incurrence and repayment of indebtedness through 30 September 2004 and the issuance of the Notes in an aggregate principal amount of US\$300 million, as set forth under "Terms and Conditions of the Notes – Definitions – Fixed Charge Coverage Ratio".
- (3) Represents cash flows from operating activities without adjustment for changes in working capital and profit tax paid (amongst other things) as defined in the Terms and Conditions. See "Terms and Conditions of the Notes".
- (4) Represents interest expense adjusted for interest costs on debt incurred and repaid through 30 September 2004 and the issuance of the Notes as defined in the Terms and Conditions. See "Terms and Conditions of the Notes".
- (5) Fixed Charge Coverage Ratio is defined in the Terms and Conditions and understood for purposes of this calculation as the ratio of Adjusted Consolidated Cash Flow of ALROSA Ltd. to the Fixed Charges of ALROSA Ltd. and its subsidiaries for the two consecutive six-month fiscal periods ending on or prior to the date of determination. See "Terms and Conditions of the Notes".

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations covers the years ended 31 December 2003, 2002 and 2001 and the six months ended 30 June 2004 and 2003. The financial information presented in this discussion has been extracted or derived from ALROSA Ltd.'s audited consolidated IFRS financial statements for the years ended 31 December 2003, 2002 and 2001 and the unaudited consolidated IFRS financial statements for the six months ended 30 June 2004 and 2003. This section should be read together with the IFRS financial statements and the notes thereto as well as the other financial information included elsewhere in this Offering Circular. For periods prior to 1 January 2003, all Russian Rouble amounts are expressed in constant Roubles based on the purchasing power of the Russian Rouble as at 31 December 2002, except as otherwise noted.

Overview

We are the second largest diamond mining company in the world by diamond production, measured as a multiple of average market prices. In 2003, we produced approximately 19.0 per cent. of the world's rough diamond output, measured as a multiple of average market prices for the year. Our principal mining operations are located in Yakutia, in northeastern Siberia. We also hold a 32.8 per cent. interest in Catoca Mining Ltd., a diamond mining company in Angola, and a 92.4 per cent. interest in Severalmaz. We are also engaged in diamond exploration throughout north eastern Russia. We produce rough gem diamonds and near-gem diamonds, which are cut and used primarily in jewellery, and non-gem diamonds used primarily as industrial abrasives. During 2003 and the six months ended 30 June 2004, sales of gem and near-gem diamonds, including polished diamonds, accounted for approximately 99.4 per cent. and 99.5 per cent. of our total diamond sales, respectively. We are one of Russia's largest industrial enterprises by revenue, with 2003 total revenues of RUB60.0 billion (US\$2.1 billion), and total revenues for the six months ending 30 June 2004 of RUB34.8 billion (US\$1.2 billion).

Our business activities are conducted primarily through one business segment, which is engaged in diamond production and sales. We are also involved in ancillary activities, including exploration, research and development, diamond polishing, gold production, construction and trading and supporting operations, such as transportation and supply of fuel, electricity and water. These ancillary activities are not considered as reportable segments under IAS 14 "Segment Reporting".

Acquisitions

As discussed in more detail below, we acquired significant controlling or strategic interests in several companies during the six months ended 30 June 2004 and in 2003, 2002 and 2001. We accounted for each of our acquisitions in accordance with IAS 22 (revised) "Business Combinations" using the benchmark treatment. Under this treatment, the identifiable assets and liabilities of acquired subsidiaries were recognised at the aggregate of their fair market value, as of the date of acquisition, taking into account the acquirer's ownership interest and the minority's portion of the pre-acquisition carrying amounts of the assets and liabilities at the date of acquisition.

We made the following significant acquisitions during 2003, 2002, 2001 and the six months ended 30 June 2004:

- **OOO GRK Aldanzoloto**

In February 2004, OAO Investment Group ALROSA, a subsidiary of the Group, acquired 91 per cent. of the share capital of OOO GRK Aldanzoloto ("Aldanzoloto"), a gold-mining company located in Yakutia, for the total consideration of RUB916 million, which represented the fair value of the acquired net assets of Aldanzoloto, chiefly consisting of property, plant and equipment. Aldanzoloto contributed revenues of RUB533 million (including RUB464 million of gold sales) and net profit of RUB12 million to the Group for the six months ended 30 June 2004, and its assets and liabilities at 30 June 2004 were RUB1,265 million and RUB308 million, respectively.

- *Severalmaz*

In 2000, we increased our shareholding in Severalmaz from 12 per cent. to 39 per cent. This investment was originally recorded under the equity method; however, in December 2001, we increased our shareholding in this company to 71.9 per cent., and since that date, we have consolidated Severalmaz as a subsidiary. As of 31 December 2001, our total investment in Severalmaz was RUB2,263 million and at the date of the acquisition, we consolidated identifiable assets totalling RUB2,573 million and assumed liabilities totalling RUB308 million. In June 2003, we increased our shareholding in Severalmaz from 71.9 per cent. to 91.1 per cent. through an additional cash contribution of RUB302 million. In November 2003, we further increased our shareholding to 92.4 per cent. through an additional cash contribution of RUB108 million. As of 30 June 2004, our balance sheet included RUB7,143 million and RUB4,644 million related to the identifiable assets and assumed liabilities of Severalmaz, respectively. For a detailed description of Severalmaz, see "Our Business – Our Severalmaz Subsidiary".

- *OAo Vilyuiskaya GES-3*

OAo Vilyuiskaya GES-3 ("Vilyuiskaya") is engaged in the construction of a hydroelectric power station on the Vilyui River near the village of Svetly. The station is expected to supply 27.0 million kilowatt hours of electricity in 2004 for distribution in the western province of Yakutia and will increase its capacity to up to 1.2 billion kilowatt hours of electricity by 2012. On 11 May 2000, we entered into an agreement to purchase a 66 per cent. voting share in Vilyuiskaya from Yakutskenergo for a total consideration of RUB980 million (US\$33.8 million). This amount included commercial paper of ALROSA Ltd. and settlements of accounts receivable. In July 2000, this transaction was completed and we recognised in our balance sheet the identifiable assets of Vilyuiskaya totalling RUB1,830 million, assumed liabilities totalling RUB360 million and recorded minority interests totalling RUB490 million. In July 2003, we increased our shareholding in Vilyuiskaya from 66 per cent. to 71.5 per cent. through an additional cash contribution of RUB730 million (US\$25.1 million); in December 2003, we further increased our shareholding to 72.2 per cent. through an additional contribution of RUB114 million (US\$3.9 million). As of 30 June 2004, our balance sheet included RUB7,540 million, RUB4,877 million and RUB592 million related to the identifiable assets, assumed liabilities and the minority interests of Vilyuiskaya, respectively. Through the acquisition of Vilyuiskaya and completion of the hydroelectric power station, we expect to decrease our electricity expenses and to provide an uninterrupted electricity supply to our operations. The first electricity generating unit at the hydroelectric power station began operating on 8 September 2004. We expect construction to be completed by 2010 and estimate that the cost of completing the station will be approximately RUB2,781 million (US\$95.8 million). See "Our Business – Supporting Operations – Supply of Energy and Water – Electricity".

Certain Factors Affecting Our Results of Operations

Our results of operations have been affected by various external factors which exist in our industry and operating environment. Because our primary exploration and production activities are conducted in Russia, certain of these factors are attributable to the special characteristics of the Russian economy and legal environment. These include current government regulations and the Secrecy Law, inflation, the fluctuation of exchange and interest rates and a relatively high tax burden.

Government Regulations and the Secrecy Law

We are subject to laws that significantly influence our core operating activities. These laws include the following:

- *The Secrecy Law*

The Secrecy Law was enacted in 1993. Prior to 20 February 2004, information about volumes of diamond reserves, as well as information about extraction, production, delivery and consumption of rough diamonds were considered state secrets under the Secrecy Law. With effect from 20 February 2004, the above information was replaced in the Secrecy Law's list of state secret data with information about reserves of rough diamonds held with the State Fund for Precious Metals and Precious Stones of the Russian Federation and the Central Bank,

as well as information about volumes of reserves, extraction, production and consumption of strategic mineral resources specifically identified by the Government of Russia. As of the date of this Offering Circular, the Government of Russia has not identified diamonds as a “strategic mineral resource”. However, under the Secrecy Law the President of Russia has the authority to approve a list of data that is a state secret based on the list set out in the Secrecy Law.

In addition, the 1995 Presidential Decree specifically provides for secrecy as to deposits of precious stones (including diamonds) in Russia, certain production data relating to the Russian state diamond reserves and data relating to deposits of diamonds in excess of 25 million carats. The 1995 Presidential Decree has not been revised following the enactment of the above mentioned amendments to the Secrecy Law. See “Industry Overview – Russian Diamond Industry and Regulation – The Secrecy Law”. As a result, pending waiver of secrecy with respect to the relevant information set out in the 1995 Presidential Decree, we are prohibited from disclosing such information to you. See “Risk Factors – Risks Related to Our Business – We are prohibited from disclosing our Russian diamond reserves and other information which may be considered material by investors”.

Our management considers our reserve and production information when assessing the recoverability and amortisation of production asset costs and in planning our investment programme. In conducting this assessment, reserve estimates are verified by representatives of the State Reserves Committee of the Ministry of Natural Resources of Russia. However, based on the interpretation of existing laws, we are unable to obtain an independent valuation of our reserves.

- *Annual quotas for the export of diamonds*

The maximum quantity of diamonds that we can export each year, by carat volume, is determined pursuant to a periodic export quota set by the Government of Russia. Historically, we have been granted annual export quotas. However, the 2002 Decree authorised the Government of Russia to grant multi-year export quotas and, in February 2003, we were granted a five-year quota for the export of diamonds, under which we may export up to US\$1.3 billion of diamonds annually (based on average market prices for the six months ended 30 June 2004). The quota amounts, as expressed in carats, are protected as state secrets, and therefore are not disclosed in this Offering Circular.

In September 2004, our subsidiary ALROSA-Nyurba was also granted an export quota and export licence for 2004 under which it plans to export up to US\$65 million of diamonds (based on average market prices for the nine months ended 30 September 2004) by the end of 2004, which will constitute up to 65 per cent. of its 2004 export quota. Thereafter, ALROSA-Nyurba must procure a new export quota and export licence for 2005 and the following periods. See “Our Business – Regulatory and Environmental Matters – Regulation of Diamond Sales” and “Risk Factors – Risks Related to Our Business – Failure or delay in obtaining separate export quotas and export licences by our subsidiaries could negatively affect domestic prices, force us to revise our financial forecasts and negatively affect our results of operations”.

Seasonality of Our Business

We have seasonal working capital requirements as a result of the remote location of our mining operations and the extreme climatic conditions in our principal operating regions.

Certain of our areas of operations can be reached by water only during a relatively short navigation period (May to September). During that time we amass stocks of consumables and production materials for production and consumption by the local communities to last until the next summer. Thus, we experience seasonal working capital requirements as most of the year’s supplies must be purchased in the second quarter of the year and transported to their destination prior to the end of September. Further, most employees in Yakutia are entitled to 57 vacation days per year, for which they may request to be paid in advance. Also, once every two years we are required to reimburse employees for vacation air travel. Because most of our employees accumulate such benefits during the winter, spring and fall and take vacations in the summer, we experience increased cash requirements during the summer for the payment of salary advances and travel expenses. Additional factors contributing to the seasonality of our operations include a decrease in ore processing capacity in summer as a result of routine maintenance of certain ore treatment plants. The temporary reduction in

production is partially offset by an increase in the volume of ore processed at our Nyurba and Anabar ore treatment plants during the same period. Due to the Anabar division's northern location, ore processing takes place between June and October.

Transition from Open-pit to Underground Mining

As some of our open-pit mines have matured and reached their target depths and some are close to maturity and are reaching their target depths, we are in the process of shifting to underground mining in order to continue extracting diamonds from the deposits related to these open-pit mines. We now conduct underground mining at our International mine, have launched a pilot mining phase at our Aikhal underground mine and are constructing an underground mine to continue the extraction of ore at our Mir mine, where open-pit mining has ceased. In addition, we are currently completing feasibility studies relating to the underground mining of our Udachny deposit.

Underground mines typically have lower ore production volumes than open-pit mines because the volume of ore that can be extracted is limited by the need to use access shafts to transport ore to the surface. In addition, underground mining is generally more capital-intensive than open-pit mining. Due to the above factors, where we replace open-pit mining with underground mining, the historical operating and financial results of the replaced open-pit mines will not necessarily be indicative of the operating and financial results that may be achieved in the future with underground mining. Transition from open-pit to underground mining will also lead to increased capital expenditure and increased operating expenses to maintain the more complex extraction infrastructure of underground mines, although we expect that capital expenditures and operating expenses will be offset, to an extent, by our continued use of existing mining infrastructure and ore treatment plants. In addition, we believe that the change in the extraction method from open-pit to underground mining will result in the average diamond content of ore being higher than that of the ore that we currently extract from open-pit mines. See "Risk Factors – Risks Related to Our Business – As our open-pit mines mature, we must increasingly rely on underground mining, which is more capital-intensive and subjects us to additional risks".

Taxation

We are subject to numerous taxes at the federal, regional and local levels and are one of the largest sources of tax revenue for the federal authorities in Russia, as well as to the regional and local authorities within the areas of our operations. We contribute a majority of Yakutia's total annual tax revenues. Russian tax laws are and have been subject to varying interpretations and frequent changes. Given the relative size of our activities in Russia, our tax burden is largely determined by the taxes payable in Russia.

In addition to profit tax, we have also been subject to VAT, mineral extraction taxes, unified social taxes, road users taxes and property taxes. The high tax rates to which we are subject and the often-changing tax regime constitute a particularly difficult operating environment. See "Risk Factors – Risks Related to the Legal and Regulatory Environment in Russia".

In August 2000, the Federal Law on Profits Tax on Enterprises and Organisations was amended to increase the maximum statutory profit tax rate to 35 per cent., effective 1 January 2001. In August 2001, the Russian Tax Code was further amended to include a new chapter for profits tax and changes to the law were effective from 1 January 2002. The amendment reduced the maximum profit tax rate for income received from ordinary activities from 35 per cent. to 24 per cent. Current tax expense has not been significantly affected by the reduction in tax rates due to the fact that investment tax concessions, which were previously used to offset profit tax charges by up to 50 per cent., were abolished by the August 2001 change in the Russian Tax Code. In prior periods, we received significant benefits for investment tax concessions related to our on-going construction projects. Our deferred tax liability was also significantly reduced by the reduction in the tax rate.

We expect that our current tax charge will continue to increase in line with our growth in operations and operating margins in the future. However, the impact of deferred taxes on our effective tax rate has been and will continue to be significant. Deferred tax is significantly impacted by changes in law and other factors that are difficult to predict and largely outside of our control.

Road users tax was reduced from 2.5 per cent. to 1 per cent. during the period from 2000 to 2001 and was abolished effective 1 January 2003.

Effective 1 January 2004, the VAT rate was reduced from 20 per cent. to 18 per cent.

In July 2004 the Constitutional Court of the Russian Federation made publicly available a recently issued interpretation of existing VAT legislation. This interpretation may have the effect of deferring the point at which we are able to offset input VAT to the extent that such VAT is deemed to be attributable to the utilisation of funds other than own funds (e.g., borrowings) or denying the recovery of input VAT to the extent that such VAT is deemed to be attributable to the utilisation of funds received free of charge (e.g., contribution to charter capital of subsidiaries). In the event that local tax authorities follow this decision and we are unsuccessful in defending our position, this could have a material adverse impact on the Group's financial condition.

Interest Rates

We have significant short-term and long-term debt obligations with both fixed and variable interest rates. See “– Liquidity and Capital Resources – Debt obligations” and “– Liquidity and Capital Resources – Other Commitments”. Fluctuations in interest rates can have a significant impact on our operating results and we currently do not engage in any hedging activities related to interest rate exposure.

Exchange Rates and Inflationary Accounting

Accounting for the effects of hyperinflation

For periods prior to 31 December 2002, our financial results, including comparatives, have been restated for changes in the general purchasing power of the Rouble in accordance with IAS 29.

The effects of restating our financial information for periods prior to 31 December 2002 in terms of the purchasing power of the Rouble as of 31 December 2002 were to:

- restate the value of transactions recorded in our statement of income by the average rate of inflation for the period in order to state them in terms of the purchasing power of the Rouble as of the balance sheet date (i.e., using an average inflation factor of 1.0638 for all relevant transactions in the year ended 31 December 2002);
- restate our period-end non-monetary assets and liabilities and shareholders' equity, including share capital, in terms of the purchasing power of the Rouble as of the period ended 31 December 2002; and
- restate comparatives for the year 2001, including both monetary and non-monetary items, in terms of the purchasing power of the Rouble as of 31 December 2002.

The restatement of comparatives for the year 2001, in particular, had a significant impact on our reported sales and operating profit. For example, sales expressed in constant Roubles decreased because increases in our nominal prices were lower than inflation or increased less than might otherwise have been expected even when increases in nominal prices were higher than inflation. As a result, our comparative reported sales in each period were higher than they would have been if calculated on the basis of the average of the prices we actually received, when they are expressed in nominal terms. By comparison, our costs, which are mainly in Roubles, tended to increase in line with the rate of inflation in 2002 and 2001.

In addition, the restatement of all comparatives had a significant impact on our debt balances. For example, even though our net borrowing position increased during the years ended 31 December 2001 and 2002 in nominal terms, the restatement of our comparatives for the year 2001 based upon the purchasing power of the Rouble as at 31 December 2002 reduced the increase in debt at each period end. This trend was reinforced by the effect of a substantial amount of our debt being denominated in US Dollars and the exchange rate increasing below the rate of inflation.

Impact of inflation and changes in exchange rates on export sales and operating margins

More than 90 per cent. of our sales (net of VAT and export duties) for the six months ended 30 June 2004 and 91 per cent. for the years ended 31 December 2003, 2002 and 2001, were denominated in US Dollars, while most of our costs were denominated in Roubles. As a result, the relative movements of inflation and exchange rates significantly affect the financial results

of our operations. In particular, our operating margins are generally adversely affected by a real appreciation of the Rouble against the US Dollar, because this generally causes our costs to increase in real terms relative to our sales revenues. Conversely, our operating margins are generally positively affected by a real devaluation of the Rouble against the US Dollar, because this causes our costs to decrease in real terms relative to our sales revenues.

The following table sets forth the rates of inflation in Russia, the rates of nominal appreciation and devaluation of the Rouble against the US Dollar and the rates of real change in the value of the Rouble against the US Dollar for the periods shown:

	For the six months ended 30 June		For the year ended 31 December		
	2004	2003	2003	2002	2001
	<i>(in per cent.)</i>				
Inflation (based on the Consumer Price Index)	6.1	7.9	12.0	15.1	18.8
Nominal (appreciation) devaluation (Rouble vs. US Dollar)	(1.5)	(4.5)	(7.3)	5.4	7.0
Real appreciation (Rouble vs. US Dollar)	7.7	13.0	20.8	9.2	11.0

Period-to-period comparisons of our export sales revenues, as restated in constant Roubles for 2002 and 2001, have been significantly affected by the real change in the value of the Rouble against the US Dollar. If our actual realised US Dollar prices and the related sales for any periods being compared are the same, but between the periods the Rouble has appreciated in real terms against the US Dollar, the related sales expressed in constant Roubles will decline from one period to the next. If the real appreciation of the Rouble is sufficiently higher, our export prices and sales, expressed in constant Roubles, will decline from one period to the next, even when our actual realised US Dollar prices and the related sales have increased. Conversely, if the Rouble depreciates in real terms against the US Dollar, our prices and the related sales expressed in constant Roubles will increase from one period to the next if our actual realised US Dollar prices and related sales remain unchanged, and may increase even if our realised US Dollar prices and related sales decline.

Impact of monetary effects

Our results of operations were also substantially affected by the impact of nominal appreciation/devaluation and inflation on the value of our monetary assets and liabilities. Nominal devaluation of the Rouble against the US Dollar during 2002 and 2001 has generally resulted in foreign exchange gains on monetary assets denominated in foreign currencies and foreign exchange losses on monetary liabilities denominated in foreign currencies. These gains and losses were recorded on a net basis in our statements of income under the caption "exchange gains (losses), net". Inflation has resulted in purchasing-power gains on monetary liabilities and purchasing power losses on monetary assets. Because our financial statements for the periods up to 31 December 2002 were restated for changes in purchasing power, these gains and losses were recorded on a net basis in our statements of income under the caption "monetary gain".

The following table sets forth our net monetary realised gain and net exchange results for the six-month periods ended 30 June 2004 and 2003 and for the years ended 31 December 2003, 2002 and 2001:

	For the six months ended 30 June		For the year ended 31 December		
	2004	2003	2003	2002	2001
	(unaudited)				
	(amounts in RUB millions)				
Monetary gain	—	—	—	3,702	3,792
Exchange gains (losses), net.....	305	1,067	1,910	(813)	(856)

Diamond Prices and Sales Dynamics in 2003 and the First Six Months of 2004

2003 and the first six months of 2004 were characterised by an increase in average US Dollar sales prices for rough diamonds in the international markets that resulted generally from a favourable balance of supply and demand. Continued economic recovery in OECD countries and expansion of the luxury goods markets in Eastern Europe, China, India and other Southeast Asian countries fostered increased demand, which was not matched by a corresponding increase in supply as production at new and existing deposits did not fully compensate for the progressive depletion of older deposits and several international sellers, including De Beers, completing a reduction of inventories from historically much higher levels. Assuming that there is continued modest growth and no significant disruption in the world economy, we expect this overall trend in the supply and demand balance to continue to favour gradual increases in diamond prices over the next several years.

The favourable impact of an increase in average US Dollar sales prices of rough diamonds in 2003 was offset, in part, by a decrease in the carat volume of export sales caused by increased demand of Russian polishers for rough diamonds, resulting from the relative shortage of polished diamonds in the international markets. The carat volume of our export sales increased in the first six months of 2004, as compared to the same period in 2003, as a result of our decision to sell more diamonds on the international markets due to higher export prices, as well as increased international demand, as further described below.

The share of lower-quality diamonds ("Indian goods") in our domestic sales increased in 2003 due to increased demand on the domestic market, resulting in lower domestic average prices, but a higher carat volume of domestic sales.

In 2003 we began to increase the scope and size of our inventory of high-quality rough diamonds in order to, amongst other things, improve the range and consistency of diamonds that we can offer to domestic and international retail customers and to be less dependent on the quality of diamonds that we produce in a particular period. See "Our Business – Strategy". This policy has reduced the value of the diamonds that we sold during 2003 and the first six months of 2004.

The product mix of our domestic sales changed in the first half of 2004. Unlike in 2003, the demand for Indian goods increased in the international market, as the demand for luxury goods in India, China and other Southeast Asian countries continued to rise. As a result, we shifted our sales of Indian goods to the international market and sold more better-quality diamonds domestically, resulting in a decrease in overall carat volume of domestic sales, which was offset by an increase in domestic prices. We also sold domestically the diamonds produced by our subsidiary Alrosa-Nyurba, which was unable to export its production during the first six months of 2004, as it did not receive an export quota and licence until September 2004. As a result, while the carat volume of our domestic sales decreased in the first six months of 2004, the average prices of our diamonds sold domestically increased.

Sales

Our rough diamonds are primarily sold through one of the following methods:

- *Export sales*

In 2003 and for the first six months of 2004, exports accounted for approximately 50 per cent. and 49 per cent., respectively, of our diamond sales. These exports were primarily made through sales to De Beers. The prices paid by De Beers for our rough diamonds are based on a schedule of prices agreed between De Beers and ourselves. This schedule of prices is set forth in the De Beers Trade Agreement and is amended from time to time. Pending resolution of the Statement of Objections with respect to the De Beers Trade Agreement, we have made ad hoc sales to De Beers at prices agreed between the parties on the basis of our past commercial relationship and by reference to current market prices. See "Risk Factors – Risks Related to Our Business – The De Beers Trade Agreement has been challenged by the European Commission's Directorate-General for Competition and at least some limitation on our sales to De Beers is likely in the coming months. A final decision or settlement requiring an overly rapid or extensive reduction or a termination of our sales to De Beers could have an adverse impact on our sales, operating results and financial condition" and "Risk Factors – Risks Related to Our Business – The announcement of a European Commission decision or settlement requiring a significant reduction or termination of sales to De Beers may have an adverse impact on the market price of the Notes". Under the 2002 Decree, we are permitted to export diamonds outside the CIS to companies other than De Beers and have begun to do so. As a result, the volume of our sales to purchasers other than De Beers is increasing. See "Our Business – Strategy" and "Our Business – Sales of Rough and Polished Diamonds".

- *Domestic sales*

We sell a significant portion of our diamond production to domestic purchasers, primarily cutting and polishing companies operating in Russia that finish the diamonds for use in jewellery. The prices at which we sell diamonds on the domestic market are set with reference to the Price List maintained by the Ministry of Finance of Russia, although we are not required to strictly follow the prices noted in the Price List. We attempt to manage domestic demand to achieve prices for our diamonds that are comparable to, or higher than, the prices established under the De Beers Trade Agreement. See "Our Business – Sales of Rough and Polished Diamonds – Domestic Sales of Rough Diamonds". Except for those diamonds that are polished by Brillianty ALROSA, we are required to sell diamonds having a weight of 10.8 or more carats only through government-authorised auctions to Russian and foreign purchasers.

- *Sales to the Governments of Russia and Yakutia*

Pursuant to the licences and the Lease Agreement under which we operate, the Governments of Russia and Yakutia have the right to acquire diamonds from us. In addition, the Government of Russia has an exclusive right to purchase from us, at agreed market prices, all rare diamonds having "special gemological qualities", such as unique colours, or weighing more than 50 carats.

Sales of polished diamonds through Brillianty ALROSA

We cut and polish some of our rough diamond production through our Brillianty ALROSA division and sell these stones as finished diamonds. In addition, we sell polished diamonds through Orel-ALROSA and ALROSA-Neva, companies under our control. Sales by these subsidiaries are included in our consolidated sales.

Sales of industrial diamonds

We also sell industrial diamonds. Exports of industrial diamonds have until recently been conducted almost exclusively through Almaziuvlirexport, a government-owned diamond exporter. Under the 2002 Decree, which liberalised the Russian diamond market, we are permitted to sell our industrial diamonds directly to third party purchasers outside Russia.

For a detailed description of our diamond sales, see "Our Business – Sales of Rough and Polished Diamonds".

The following table sets forth our inflation-adjusted diamond sales, net of VAT and export duties in Roubles, through each of the following channels for the years ended 31 December 2002 and 2001 based on the purchasing power of the Rouble as at 31 December 2002 and the nominal revenue for the six months ended 30 June 2004 and 2003 and year ended 31 December 2003:

	For the six months ended 30 June		For the year ended 31 December		
	2004	2003	2003	2002	2001
	<i>(unaudited)</i>				
	<i>(amounts in RUB millions)</i>				
Sales of rough diamonds:					
Export through De Beers	7,493	8,749	18,152	21,196	29,485
Sales within Russia.....	11,084	12,076	21,445	22,365	22,716
Auction sales, including ⁽¹⁾	1,283	747	1,715	2,149	1,411
domestic market sales.....	768	747	1,617	2,149	1,411
export sales.....	515	—	98	—	—
Sales through Almaziuvelirexport ⁽²⁾ ..	823	543	1,281	1,480	1,985
Export outside CIS (excluding De Beers).....	4,408	912	3,102	—	—
Export to CIS	245	278	778	648	511
Sales through consolidated subsidiaries ⁽³⁾	3,987	480	4,486	2,468	252
Sales of polished diamonds:					
Brillianty Alrosa	1,892	1,919	3,809	3,468	4,536
domestic market sales.....	43	21	24	108	84
export sales.....	1,849	1,898	3,785	3,360	4,452
Sales through consolidated subsidiaries ⁽⁴⁾	13	7	23	94	88
Total	31,228	25,711	54,791	53,868	60,984
Including sales of industrial diamonds ⁽⁵⁾	153	147	316	219	233

Notes:

- (1) Represents sales of diamonds weighing at least 10.8 carats, which must be sold by auction. These stones accounted for approximately 4 per cent. of our total diamond sales, by value, and represented less than 1 per cent. of our diamond sales in carats during the six months ended 30 June 2004.
- (2) Represents the sale on the international market of "control parcels" of diamonds extracted from the diamonds we set aside for purchase by De Beers. These control parcels are sold in order for the Government of Russia to be able to determine whether the prices we receive from De Beers are consistent with international diamond prices.
- (3) Represents sales of diamonds by ALROSA-Nyurba and Almazy Anabara on the domestic market.
- (4) Represents sales of polished diamonds by ALROSA-Neva and Orel-ALROSA.
- (5) This category of diamonds accounts for less than 1 per cent. of our total diamond sales, by value, and represented more than one-third of our diamond sales in carats.

The following table sets forth our historical diamond sales in US Dollars, net of VAT and including export duties excluding the application of inflationary accounting for:

	For the six months ended 30 June		For the year ended 31 December		
	2004	2003	2003	2002	2001
	<i>(unaudited)</i>				
	<i>(amounts in US\$ millions)</i>				
Sales of rough diamonds:					
Export through De Beers	279	300	635	677	868
Sales within Russia.....	385	386	698	668	623
Auction sales, including ⁽¹⁾	45	24	56	69	43
domestic market sales.....	27	24	53	69	43
export sales.....	18	—	3	—	—
Sales through Almazuvelirexport ⁽²⁾ ..	31	19	45	47	58
Export outside CIS (excluding De Beers).....	165	32	110	—	—
Export to CIS	9	9	27	20	14
Sales through consolidated subsidiaries ⁽³⁾	138	15	149	74	7
Sales of polished diamonds:					
Brillianty Alrosa	65	62	124	110	131
domestic market sales.....	1	1	1	3	2
export sales.....	64	61	123	107	129
Sales through consolidated subsidiaries ⁽⁴⁾	—	—	—	3	3
Total	1,117	847	1,844	1,668	1,747
including sales of industrial diamonds ⁽⁵⁾	5	5	10	7	8

Notes:

- (1) Represents sales of diamonds weighing at least 10.8 carats, which must be sold by auction. These stones account for approximately 4 per cent. of our total diamond sales, by value, and represented less than 1 per cent. of our diamond sales in carats during the six months ended 30 June 2004.
- (2) Represents the sale on the international market of "control parcels" of diamonds extracted from the diamonds we set aside for purchase by De Beers. These control parcels are sold in order for the Government of Russia to be able to determine whether the prices we receive from De Beers are consistent with international diamond prices.
- (3) Represents sales of diamonds by ALROSA-Nyurba and Almazu Anabara on the domestic market.
- (4) Represents sales of polished diamonds by ALROSA-Neva and Orel-ALROSA.
- (5) This category of diamonds accounts for less than 1 per cent. of our total diamond sales, by value, and represented more than one-third of our diamond sales in carats.

Sales on behalf of Russia and Yakutia

In addition to the sale of rough and polished diamonds, we are also responsible for diamond sales on behalf of the Governments of Russia and Yakutia. We receive a commission of 1.3 per cent. (including VAT) on sales for Russia and 1.3 per cent. (net of VAT) on sales for Yakutia. These commissions include our fees for sorting the diamonds being sold. Our sales on behalf of Russia and Yakutia for the years ended 31 December 2002 and 2001, based on the purchasing power of the Rouble as at 31 December 2002 for the years ended 31 December 2002 and 2001, and the nominal sales for the six months ended 30 June 2004 and 2003 and the year ended 31 December 2003, were as follows:

	For the six months ended 30 June		For the year ended 31 December		
	2004	2003	2003	2002	2001
	<i>(unaudited)</i>				
	<i>(amounts in RUB millions)</i>				
Sales on behalf of Russia	—	—	—	—	1,046
Sales on behalf of Yakutia	—	—	505	634	5,698
Total	—	—	505	634	6,744

Recent Developments

Angola

We have recently begun to implement plans to increase our activities and investments in Angola through our participation in new projects and the ongoing development of Catoca Mining Ltd., a company in which we participate with Endiama E.P. ("Endiama"), Odebrecht Mining Services, Inc. and Daumonti Financing Company B.V. Catoca Mining Ltd. is engaged in mining the Catoca diamond pipe in Angola and has begun construction of a new processing facility which will significantly increase its production capacity. This project was financed by revenues of Catoca Mining Ltd.

In addition to the construction of a new processing facility for the Catoca mine, our subsidiary, ALROSA-Vneshstroy Ltd, started construction of a hydroelectric station. The construction is being conducted by Hydroshikapa Ltd., a joint venture between ALROSA Ltd. and the Government of Angola in which we hold a 55 per cent. interest. This project is expected to cost approximately US\$45 million and we have guaranteed the financing of the project. Once the hydroelectric station comes into operation, it will supply electricity to Catoca and we intend to change its financing to project finance basis without recourse to us.

Additionally, we have an indirect 20 per cent. interest in Kamachia-Kamagiku Ltd., a joint venture between certain entities controlled by the Government of Angola (55 per cent.) and Escom Alrosa (45 per cent.), a joint venture between us and Escom Mining. We hold a 44 per cent. interest in Escom Alrosa. It is planned that Kamachia-Kamagiku Ltd. will mine the Lour diamond deposit in Angola. We estimate that total capital expenditures for this project will be approximately US\$100 million. We have reached a preliminary agreement with Escom Mining contemplating that Escom Mining will finance US\$100 million of the expected capital expenditures for this project through an 8.5 year loan to Kamachia-Kamagiku Ltd. bearing interest at the London inter-bank offered rate ("LIBOR") plus 2 per cent. We will pledge our 44 per cent. interest in Escom Alrosa as security for this loan and there will be no further recourse to us in respect of this project.

Critical Accounting Policies

Our consolidated financial statements were prepared in accordance with IFRS. The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as at the date of the consolidated financial statements, and the reported amount of revenues and operating costs during the reporting period. We believe that the following are the most significant accounting policies that currently affect our financial condition and results of operations.

Leased Assets

We record the production assets leased from Yakutia in 1993 under the Lease Agreement at an historical amount adjusted for the effects of inflation, with a corresponding credit reflected as a "Grant" in our consolidated financial statements. The Grant is amortised in line with the reduction in the carrying value of the assets and the amortised portion is recorded as an increase in income during the period.

Social assets received under the Lease Agreement are not reflected in our financial statements, because the majority of these assets have been or will be transferred, without consideration, to the Government of Yakutia as part of our continuing divestiture of these assets.

Property, Plant and Equipment

Property, plant and equipment consist of costs incurred in developing our business operations, as well as the costs related to the construction and acquisition of mining assets. Expenditures related to geophysical analysis are charged to expense until it is considered probable that an economically recoverable reserve exists.

Impairment of Assets

At each reporting date, management assesses whether there is any indication of impairment of property, plant and equipment and other assets. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's net selling price and its value in use. The carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) in the consolidated statement of income. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

Provisions

We re-assess provisions on a quarterly basis and annually in our consolidated financial statements. We recognise provisions in our consolidated financial statements when we have present legal or constructive obligations, based on the result of past events for which it is probable that an outflow of resources embodying economic benefits will be required to settle such obligations and a reliable estimate of the amount of the obligation can be made. Provisions are included in our consolidated financial statements at their expected net present values using discount rates appropriate for the economic environment of Russia at each balance sheet date.

The provision for restoration liability is based on the terms of the Lease Agreement (see note 9 to the consolidated financial statements for the six months ended 30 June 2004) and is recorded as a long-term liability on the balance sheet, with a corresponding amount recorded as part of property, plant and equipment in accordance with IAS 16, "*Property, Plant and Equipment*" (revised 1998). The capitalised amount for our restoration liability, which is included in property, plant and equipment, is amortised over the shorter of the term of the Lease Agreement and the useful life of the relevant property.

Changes in the provision for restoration liability resulting from the passage of time are reflected in the consolidated statement of income for each period under "finance costs, net". Other changes in the provision relating to a change in the discount rate applied, in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change. The effects of such changes are added to, or deducted from, the cost of the related asset.

Inventories

Inventories of diamonds, extracted ore and concentrates, mining and construction stores and consumable supplies are valued at the lower of their weighted average cost or net realisable value. The cost of extracted ore and concentrates is calculated using the quantities determined based on surveyors' measurements of the volumes of ore and concentrates remaining at the end of the relevant period. The costs included in inventories are those directly attributable to mining diamonds, extracting ore and producing concentrates, as well as those directly attributable to bringing mining and construction stores and consumable supplies to their present location.

Deferred Tax

Tax laws in Russia are subject to varying interpretations and frequent changes. We calculate deferred tax at rates enacted or substantively enacted at the relevant balance sheet date, using the liability method, for all temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Deferred tax assets attributable to temporary differences, unused tax losses and credits are recognised only to the

extent that it is probable that future taxable profit will be available against which they can be utilised.

Revenue Recognition

Sales are recognised for financial reporting purposes when goods are shipped to customers, as this is the date on which the risks and rewards of ownership are transferred to the customers. Sales are stated net of VAT and export duties.

Six Months Ended 30 June 2004 compared to Six Months Ended 30 June 2003

Revenues

The following table sets forth our revenues for the six months ended 30 June 2004 and 2003 for each of the categories of revenues indicated below, net of VAT and export duties:

	For the six months ended 30 June			
	2004		2003	
	(unaudited)			
	(amounts in RUB (per cent. of millions)	revenues)	(amounts in RUB (per cent. of millions)	revenues)
Revenue from diamond sales:				
Export sales.....	15,333	44	12,380	44
Domestic sales ⁽¹⁾	15,895	46	13,331	48
Total revenue from diamond sales.....	31,228	90	25,711	92
Other ⁽²⁾	3,540	10	2,319	8
Total revenues.....	34,768	100	28,030	100

Notes:

(1) Includes sales within Russia and Yakutia.

(2) Includes revenues generated from transportation services, trading, construction, social infrastructure and exploration activities and, for the six months ended 30 June 2004, gold sales.

The following table sets forth our US Dollar-denominated revenues from diamond sales, net of VAT and export duties:

	For the six months ended 30 June	
	2004	2003
	<i>(unaudited)</i> <i>(amounts in US\$ millions)</i>	
Revenue from diamond sales:		
Export sales.....	534	398
Domestic sales	551	426
Total revenues from diamond sales	1,085	824

References to changes in prices and carats sold relate to gem, near-gem and industrial diamonds only, and do not include sales of polished diamonds, except where specifically indicated. Changes in sales revenues result from a number of factors, including price, carat volumes sold, inflation, exchange rates and product mix.

Sales of diamonds represented 90 per cent. of our total revenues in the six months ended 30 June 2004 and 92 per cent. of our total revenue in the six months ended 30 June 2003, the remainder comprising revenue from construction work, transportation services, trading and, for the six months to 30 June 2004, gold sales. All diamond sales, including domestic

sales, are either US Dollar-denominated or US Dollar-linked. Total diamond sales revenues increased by 21 per cent., or RUB5,517 million, to RUB31,228 million during the six months ended 30 June 2004 as compared to RUB25,711 million during the six months ended 30 June 2003. Diamond sales revenues include revenues from rough diamonds and polished diamonds.

Revenues from rough diamond sales increased by 23 per cent., or RUB5,538 million, from RUB23,785 million for the six months period ended 30 June 2003 to RUB29,323 million for the corresponding period of 2004. This increase was due to a 28 per cent. increase in average US Dollar sales prices for diamonds and an increase in the volume of diamonds sold in carats by 6 per cent., which was due to commencement of production at our Nyurba operations as well as increased demand, the combined effect of which was partially offset by a decline of 8 per cent. in the average US Dollar/Rouble exchange rate from the six months ended 30 June 2003 to the six months ended 30 June 2004. See “– Certain Factors Affecting Our Results of Operations – Diamond Prices and Sales Dynamics in 2003 and the First Six Months of 2004” and “– Certain Factors Affecting Our Results of Operations – Exchange Rates and Inflationary Accounting”.

Our polished diamond sales remained relatively constant during the period, decreasing by 1 per cent., or RUB21 million, from RUB1,926 million to RUB1,905 million for the six-month periods ended 30 June 2003 and 30 June 2004, respectively.

Export sales increased by 24 per cent., or RUB2,953 million, to RUB15,333 million during the six months ended 30 June 2004 as compared to RUB12,380 million during the six months ended 30 June 2003. Export sales of rough diamonds increased by 29 per cent., or RUB3,002 million, from RUB10,482 million in the first six months of 2003 to RUB13,484 million in the first six months of 2004. This increase is primarily due to a 20 per cent. increase in the average US Dollar export prices for rough diamonds and to a 20 per cent. increase in the carat volume of export sales, the combined effect of which was partially offset by an 8 per cent. decrease resulting from the change in exchange rates. Our polished diamond export sales decreased by 3 per cent., or RUB49 million, from RUB1,898 million in the first six months of 2003 to RUB1,849 million in the first six months of 2004 due to fluctuations in sales volumes during the periods. See “– Certain Factors Affecting Our Results of Operations – Diamond Prices and Sales Dynamics in 2003 and the First Six Months of 2004” and “– Certain Factors Affecting Our Results of Operations – Exchange Rates and Inflationary Accounting”.

Domestic diamond sales increased by 19 per cent., or RUB2,564 million, to RUB15,895 million during the six months ended 30 June 2004 as compared to RUB13,331 million during the six months ended 30 June 2003. This change was mainly due to an 11 per cent. decrease in the carat volume of domestic sales resulting from our decision to shift sales volumes of diamonds from the domestic to the international market, and the 41 per cent. increase in average US Dollar prices principally due to the better quality of diamonds being sold on the domestic market. The cumulative impact of these factors was partially offset by an 8 per cent. decrease resulting from the change in exchange rates. See “– Certain Factors Affecting our Results of Operations – Diamond Prices and Sales Dynamics in 2003 and the first six months of 2004” and “– Certain Factors Affecting our Results of Operations – Inflationary Accounting and Exchange Rates”.

Other sales increased by 53 per cent., or RUB1,221 million, to RUB3,540 million during the six months ended 30 June 2004 as compared to RUB2,319 million during the six months ended 30 June 2003. The increase was primarily due to the operations of Aldanzoloto, our new subsidiary, which sells gold to third parties. The remainder of the increase is due to the increase in the number of passengers transported by our transportation divisions and the increase in our transportation tariffs.

Cost of Sales

Our total cost of sales increased by 36 per cent., or RUB4,591 million, for the six months ended 30 June 2004 to RUB17,362 million from RUB12,771 million for the six months ended 30 June 2003, primarily as a result of a significant increase in the costs associated with wages, salaries and other staff costs as well as expenses related to materials, extraction tax and fuel and energy.

As a percentage of revenues, cost of sales increased from 46 per cent. for the six months ended 30 June 2003 to 50 per cent. for the six months ended 30 June 2004.

The following table sets forth our cost of sales for the six months ended 30 June 2004 and for the six months ended 30 June 2003:

	For the six months ended 30 June	
	2004	2003
	<i>(unaudited)</i> <i>(amounts in RUB millions)</i>	
Wages, salaries and other staff costs.....	6,080	4,509
Depreciation	3,000	2,699
Fuel and energy	2,960	2,260
Materials	2,646	1,709
Extraction tax	2,404	1,579
Services.....	899	815
Transport	365	680
Other costs.....	199	230
Write down of inventory.....	177	157
Movement in inventories.....	(1,368)	(1,867)
Total cost of sales	17,362	12,771

Wages, salaries and other staff costs

Wages and salaries increased by 35 per cent., or RUB1,571 million, to RUB6,080 million during the six months ended 30 June 2004 from RUB4,509 million for the six months ended 30 June 2003. The increase in payroll costs was due to significant increases in salary and bonus levels since 30 June 2003 commensurate with an increase in the cost of living and to reward our employees for the achievement of production and financial targets. This increase in wages and salaries caused a corresponding increase in pension expenses.

Depreciation

Depreciation charges increased by 11 per cent., or RUB301 million, to RUB3,000 million during the six months ended 30 June 2004 as compared to RUB2,699 million during the six months ended 30 June 2003. This increase is primarily a result of depreciation changes associated with the construction of significant fixed assets in the Irillyakh oil field and the construction and upgrading of fixed assets at our Aikhal, Nyurba and Mirny divisions.

Fuel and energy

Fuel and energy costs increased by 31 per cent., or RUB700 million, from RUB2,260 million for the six months ended 30 June 2003 to RUB2,960 million for the six months ended 30 June 2004. This increase was primarily due to rises in electricity tariffs as well as fuel and gas prices in 2004. The volume of electricity and fuel consumption also increased marginally due to the commencement of our Nyurba operations in late 2003 and of a new ore treatment plant commencing ore processing at the Istok field in 2004.

Materials

The cost of materials increased by 55 per cent., or RUB937 million, from RUB1,709 million for the six months ended 30 June 2003 to RUB2,646 million during the six months ended 30 June 2004. The increase in the cost of materials is principally explained by the growth in our overall consumption of materials that resulted from, amongst other things, the expanded scope of our underground mining activities, a slight increase in the average levels of prices and the inclusion of the results of our new subsidiary Aldanzoloto, which uses a significant amount of materials for gold extraction purposes, in our consolidated financial statements.

Extraction tax

Extraction tax expense increased by 52 per cent., or RUB825 million, from RUB1,579 million for the six months ended 30 June 2003 to RUB2,404 million for the six months ended 30 June 2004. The increase was primarily due to a RUB136 million increase associated with the change in average diamond sales price (which was partially offset by the decrease in Rouble/US Dollar

exchange rate) and a RUB549 million increase in the tax base of ALROSA-Nyurba due to a significant increase in its diamond production volume as the Nyurba mine and Ore Treatment Plant No. 16 becoming fully operational.

Services

Costs related to services increased by 10 per cent., or RUB84 million, from RUB815 million for the six months ended 30 June 2003 to RUB899 million for the six months ended 30 June 2004. The increase in the cost of services was primarily due to expenses incurred for blasting operations and electrical installation works to support the growing volume of ore extracted from the Nakyn field at the Nyurba division.

Transport

Our transport expenditures decreased by 46 per cent., or RUB315 million, from RUB680 million for the six months ended 30 June 2003 to RUB365 million for the six months ended 30 June 2004 due to a decrease in automobile transportation tariffs set by third-party carriers and a decline in the volume of air transportation.

Other costs

Other costs, which decreased by RUB31 million from RUB230 million for the six months ended 30 June 2003 to RUB199 million for the six months ended 30 June 2004, include insurance expenditure and miscellaneous costs (such as the costs associated with purchasing software and ensuring work safety). The 13 per cent. decrease in these expenses in the first six months of 2004 is explained primarily by the fact that, unlike in the first half of 2003, we did not incur expenses for consultation services concerning tax accounting and software installation.

Write down of inventory

Write down of inventory increased by 12.7 per cent., or RUB20 million, from RUB157 million in the first six months of 2003 to RUB177 million in the first six months of 2004. In accordance with our accounting practices, a provision for impairment is created for mining and construction inventory and consumables that are more than two years old. Therefore, the increase in the amount of inventory written-off is explained by the amount of mining and construction inventory and consumables that was on our balance sheet as of 30 June 2004, which was older than two years.

Movement in inventories

Movement in inventories changed by RUB499 million, to RUB(1,368) million during the six months ended 30 June 2004 from RUB(1,867) million for the six months ended 30 June 2003. The change was primarily due to the increase in the volume of high-quality diamonds held in our inventory as at 30 June 2004 compared to 31 December 2003, as well as an increase in the cost per carat resulting from an increase in various production costs. The movement reflects the deferral of costs that is expensed at the time of the sale of related diamonds.

Royalty and Ecology Fund Payments

We pay royalty fees in connection with the Lease Agreement. The Lease Agreement has a term of 25 years and gives us the right to use certain sites, as well as production and non-production assets for exploring, mining and operating diamond deposits. According to the Lease Agreement, we are subject to royalties and other payments in respect of the right to use land and logging sites, disposal and burial of waste and contaminated materials and the use of mineral resources and water for industrial purposes.

Pursuant to the terms of the Lease Agreement, we also make ecology fund payments. The basis for ecology fund payments is the amount of royalty payments under the Lease Agreement; consequently, royalty payments and ecology fund payments are discussed together below. However, in our consolidated statement of income ecology fund payments are included in "Other operating expenses" as "taxes other than profit tax and extraction tax".

Pursuant to the Lease Agreement, the royalty and ecology fund payments are renegotiated periodically.

The following table sets forth our royalty and ecology fund payments, including the non-recoverable component of VAT for the six months ended 30 June 2004 and 30 June 2003:

	For the six months ended 30 June	
	2004	2003
	<i>(unaudited)</i> <i>(amounts in RUB millions)</i>	
Royalty payments	4,346	4,627
Ecology fund payments	460	454
Total	4,806	5,081

For the six months ended 30 June 2004, royalty and ecology fund payments decreased by 5 per cent., or RUB275 million, to RUB4,806 million from RUB5,081 million for the six months ended 30 June 2003, with royalty payments decreasing by RUB281 million, or 6 per cent., from RUB4,627 million for the six months ended 30 June 2003 to RUB4,346 million for the six months ended 30 June 2004, and the ecology fund payments increasing by RUB6 million, or 1 per cent., from RUB454 million to RUB460 million for the same period. Royalty payment expense includes the expense associated with VAT, which cannot be recovered, in the amount equal to the proportion of domestic diamond sales to total diamond sales. The decrease in the royalty expense is a result of the statutory decrease in the VAT rate from 20 per cent. in 2003 to 18 per cent. in 2004 and an increase in export sales, the effect of which was to decrease the share of unrecoverable VAT to be included in royalty payment expenses.

Pursuant to an addendum to the Lease Agreement dated 17 September 2003, the 2004 royalty and ecology fund payments (including VAT) are fixed at RUB10,500 million.

General and Administrative Expenses

The following table sets forth our general and administrative expenses, which consist of administrative costs, including salaries paid to administrative employees and head-office expenses, and bad debt expense:

	For the six months ended 30 June	
	2004	2003
	<i>(unaudited)</i> <i>(amounts in RUB millions)</i>	
Administrative expenses	1,273	1,055
Bad debt expenses	187	427
Total general and administrative expenses	1,460	1,482

General and administrative expenses decreased by 1 per cent., or RUB22 million, to RUB1,460 million for the six months ended 30 June 2004 from RUB1,482 million for the six months ended 30 June 2003. Administrative expenses increased by RUB218 million, or 21 per cent., from RUB1,055 million for the six months ended 30 June 2003 to RUB1,273 million for the six months ended 30 June 2004 as a result of a significant increase in salaries and bonuses for administrative personnel and charges from third party banks. The impact of this increase was more than offset by a decline in our bad debt expense by RUB240 million, or 56 per cent., from RUB427 million for the six months ended 30 June 2003 to RUB187 million for the six months ended 30 June 2004 due to improved credit control policies.

Other Operating Income

Other operating income consists of the income recognised as a result of the amortisation of the Grant recorded in respect of assets leased from Yakutia, together with other miscellaneous income from our non-core activities. See “– Critical Accounting Policies – Leased Assets”. The following table sets forth amortisation of the Grant and other income for the six months ended 30 June 2004 and 30 June 2003:

	For the six months ended 30 June	
	2004	2003
	<i>(unaudited)</i> <i>(amounts in RUB millions)</i>	
Amortisation of Grant	504	490
Other	478	534
Total other operating income	982	1,024

For the six months ended 30 June 2004, other operating income decreased by 4 per cent., or RUB42 million, to RUB982 million from RUB1,024 million for the six months ended 30 June 2003. The increase in the income associated with the amortisation of the Grant by 3 per cent., or RUB14 million, was fully offset by the effect of a 10 per cent. or RUB56 million decrease in other operating income. Other operating income primarily consists of income from our financial subsidiaries, such as MAK Bank, Almaznaya Osen pension fund and Investment Group ALROSA, and income from non-core activities, such as the sale of materials, fuel and other miscellaneous items.

Other Operating Expenses

The following table sets forth our other operating expenses for the six months ended 30 June 2004 and the six months ended 30 June 2003:

	For the six months ended 30 June	
	2004	2003
	<i>(unaudited)</i> <i>(amounts in RUB millions)</i>	
Social costs	1,118	1,247
Taxes other than profit tax and extraction tax	1,196	1,044
Exploration expenses	843	551
Selling and marketing expenses	568	515
Impairment of fixed assets	667	—
Loss on disposal of property, plant and equipment	335	48
Provision for (reversal of) impairment of available-for-sale investments, net	263	(112)
Provision for guarantee given	45	927
Other	504	281
Total other operating expenses	5,539	4,501

Social costs

Social costs consist primarily of expenses associated with the provision of housing and public utilities, charitable donations and the maintenance of hospitals and educational institutions. During the six months ended 30 June 2004, social costs decreased by 10 per cent., or RUB129 million, to RUB1,118 million from RUB1,247 million for the six months ended 30 June 2003. This decrease mainly reflected the significant charitable contributions made in the first six

months of 2003 in support of the regional development programme in Mirny, payments to the Arkhangelsk local administration relating to social programmes and contributions made to the St. Petersburg local administration in connection with the city's tricentennial. This decrease was partially offset by increased expenditures on education due to the continuation of a special financial aid programme for students and payments for education of employees.

Taxes other than profit tax and extraction tax

The following table sets forth our taxes, other than profit tax and extraction tax, for the six months ended 30 June 2004 and for the six months ended 30 June 2003:

	For the six months ended 30 June	
	2004	2003
	<i>(unaudited)</i> <i>(amounts in RUB millions)</i>	
Property tax.....	495	518
Ecology fund	460	454
Tax penalties.....	11	18
Other taxes and accruals	230	54
Taxes other than profit tax and extraction tax.....	1,196	1,044

Taxes other than profit tax and extraction tax increased by 15 per cent., or RUB152 million, for the six months ended 30 June 2004 to RUB1,196 million, compared to RUB1,044 million for the six months ended 30 June 2003. The increase was largely due to a 326 per cent. increase in other taxes and accruals from RUB54 million in the six months ended 30 June 2003 to RUB230 million in the six months ended 30 June 2004. This increase resulted from larger miscellaneous tax payments, such as local ecology tax, tax on advertisements and rent payments for land.

For a discussion of ecology fund payments see “– Cost of Sales – Royalty and Ecology Fund Payments”.

Property tax decreased 4 per cent. from RUB518 million for the six months ended 30 June 2003 to RUB495 million for the six months ended 30 June 2004, due to the decrease in our property tax base because of changes in property tax legislation. These changes in legislation resulted in the exclusion of a number of items from our tax base in 2004.

Exploration expenses

The 53 per cent. increase in exploration expenses, from RUB551 million for the six months ended 30 June 2003 to RUB843 million for the six months ended 30 June 2004, is a result of our continuous and expanding exploration efforts to ensure the maintenance and growth of our diamond reserves.

Selling and marketing expenses

Selling and marketing expenses increased by 10 per cent., or RUB53 million, from RUB515 million for the six months ended 30 June 2003 to RUB568 million for the six months ended 30 June 2004. The increase was due to a rise in the salaries of employees involved in the sale and distribution of diamonds as well as higher insurance expenses.

Impairment of fixed assets

We recognised an expense of RUB667 million in relation to the impairment of fixed assets in the six months ended 30 June 2004. There was no such expense in the six months ended 30 June 2003. The expense was incurred in relation to certain construction projects which were either suspended or impaired during the period. The most significant of these projects were a boiler station and a school in the Aikhal-Udachny branch of our capital construction division. We currently do not intend to complete these construction projects and, accordingly, have recorded the impairment charge.

Loss on disposal of property, plant and equipment

The loss on disposal of property, plant and equipment increased by 598 per cent., or RUB287 million, from RUB48 million in the six months ended 30 June 2003 to RUB335 million in the six months ended 30 June 2004. The loss on disposal recognised in 2004 primarily relates to write-offs of obsolete fixed assets and the expenses associated with the transfer of flats and certain other assets to employees and local authorities, either free of charge or at prices below their net book value.

Provision for (reversal of) impairment of available-for-sale investments, net

In the six months ended 30 June 2003, we recognised a RUB112 million gain as a result of a reduction in a provision for impairment of available-for-sale investments. In the same period in 2004, we recognised a RUB263 million expense relating to a reduction in our interest in Sobinbank. This reversal from gain to loss was a result of our choice not to participate in a further issuance of shares by Sobinbank.

Provision for guarantee given

In 2003, we accrued a RUB927 million provision relating to a guarantee given by us to Investment Bank Trust in connection with a loan to ZAO "Nazymkaya Oil and Gas Research Expedition". See "– Year Ended 31 December 2003 compared to the Year Ended 31 December 2002 – Other Operating Expenses – Provisions for guarantee given". The expense of RUB45 million recognised in the six months ended 30 June 2004 represents the accrued interest on the principal amount of the loan that we guaranteed.

Finance Costs, Net

The following table sets forth our net finance costs for the six months ended 30 June 2004 and comparative expenses for the six months ended 30 June 2003:

	For the six months ended 30 June	
	2004	2003
	<i>(unaudited)</i> <i>(amounts in RUB millions)</i>	
Interest on bank loans	942	1,396
Interest on commercial paper	47	70
Interest on non-convertible bonds	343	505
Interest on Eurobonds	622	195
Change in provision for restoration liability	203	193
Interest on other borrowings	7	62
Total interest expense	2,164	2,421
Interest income	(93)	(338)
Total	2,071	2,083

Our net finance costs decreased by 1 per cent., or RUB12 million, from RUB2,083 million for the six months ended 30 June 2003 to RUB2,071 million for the six months ended 30 June 2004. There were a number of offsetting factors which affected our finance costs. In May 2003 we issued the 2008 Notes, the proceeds from which were used to replace short-term and medium-term bank loans. This significantly reduced our finance costs, as the interest rate on the 2008 Notes is lower than that on the retired debt. However, this change was more than offset by the increase, during the six months ended 30 June 2004, in the amount of our short-term US Dollar-denominated fixed rate bank loans as compared to prior periods, by RUB11 billion. This increased our overall debt level and our finance costs. Also, during the six months ended 30 June 2003 we recognised interest income in the amount of RUB225 million as a result of reversal of long-term VAT recoverable discounting. There was no similar reversal in 2004.

Interest on bank loans decreased from RUB1,396 million for the six months ended 30 June 2003 to RUB942 million for the six months ended 30 June 2004. This 33 per cent. decrease was primarily due to the repayment of bank loans with the proceeds of the 2008 Notes and a general decline in interest rates charged by Russian banks. As we obtained most of our new short-term loans at the end of the six-month period ended 30 June 2004, their impact on our interest expense was not as significant as that of similar loans obtained during the six-month period ended 30 June 2003.

Interest expense on outstanding commercial paper decreased by 33 per cent. from RUB70 million for the six months ended 30 June 2003 to RUB47 million for the six months ended 30 June 2004 due to the repayment of a substantial portion of our outstanding commercial paper.

Interest on non-convertible bonds decreased by RUB162 million, or 32 per cent., from RUB505 million for the six months ended 30 June 2003 to RUB343 million for the six months ended 30 June 2004 due to the partial redemption of our outstanding non-convertible bonds during the year ended 31 December 2003 and the six months ended 30 June 2004.

Interest expense on Eurobonds increased by 219 per cent. from RUB195 million in the six months ended 30 June 2003 to RUB622 million in the six months ended 30 June 2004 as a result of the issue of the 2008 Notes in May 2003.

Interest income decreased by 72 per cent. from RUB338 million for the six months ended 30 June 2003 to RUB93 million for the six months ended 30 June 2004, mainly due to the non-recurring reversal of a discount related to long-term VAT receivables during the six-month period ended 30 June 2003.

Exchange Gains/Losses

Our exchange gains decreased by 71 per cent. from RUB1,067 million in the six months ended 30 June 2003 to RUB305 million in the six months ended 30 June 2004. These exchange gains primarily related to the revaluation of our US Dollar-denominated bank loans. During the six months ended 30 June 2003 the Rouble appreciated by 4.5 per cent. relative to the US Dollar while in the six months ended 30 June 2004 the Rouble appreciated by only 1.5 per cent. relative to the US Dollar. See “– Qualitative and Quantitative Disclosures about Market Risks”.

Profit Tax

Our profit tax expense increased by 323 per cent. from RUB295 million for the six months ended 30 June 2003 to RUB1,248 million for the six months ended 30 June 2004. Total profit tax consists of current profit tax of RUB2,211 million incurred for the six months ended 30 June 2004 and RUB1,634 million for the six months ended 30 June 2003, as well as a deferred profit tax benefit of RUB963 million for the six months ended 30 June 2004 and RUB1,339 million for the six months ended 30 June 2003. The increase in current profit tax in the six months ended 30 June 2004 was a result of the increase in our taxable profits when calculated in accordance with Russian tax legislation. We recorded a deferred tax benefit in both the six-month periods ended 2003 and 2004, primarily due to a decrease in the deferred tax liability attributable to the difference between the IFRS valuation of our diamond inventory and its value under Russian statutory tax legislation (primarily due to the different classification of direct and indirect expenses related to diamond and ore extraction and processing under IFRS and Russian tax accounting) and an increase in the deferred tax assets recognised in connection with the difference between the IFRS and Russian tax accounting of property, plant and equipment.

Year Ended 31 December 2003 compared to the Year Ended 31 December 2002

Revenues

The following table sets forth our revenues for the year ended 31 December 2002, based on the purchasing power of the Rouble as at 31 December 2002, and the revenues for the year ended 31 December 2003 for each of the categories of revenues indicated below, net of VAT and export duties:

	For the year ended 31 December			
	2003		2002	
	(amounts in RUB (per cent. of millions) revenues)		(amounts in RUB (per cent. of millions) revenues)	
Revenue from diamond sales:				
Export.....	27,196	45	26,684	45
Domestic sales ⁽¹⁾	27,595	46	27,184	46
Total revenue from diamond sales.....	54,791	91	53,868	91
Other ⁽²⁾	5,213	9	5,251	9
Total revenues.....	60,004	100	59,119	100

Notes:

(1) Includes sales within Russia and Yakutia.

(2) Includes revenues generated from transportation services, trading, construction, social infrastructure and exploration activities.

The following table sets forth our historical revenues (in both Roubles and US Dollars) from diamond sales without the application of inflationary accounting, net of VAT and export duties:

	For the year ended 31 December			
	2003		2002	
	(RUB)	(amounts in millions) (US\$)	(RUB)	(US\$)
Revenue from diamond sales:				
Export.....	27,196	890	25,084	805
Domestic sales.....	27,595	901	25,553	817
Total revenue from diamond sales.....	54,791	1,791	50,637	1,622

References to changes in prices and carats sold relate to gem, near-gem and industrial diamonds only, and do not include sales of polished diamonds, except where specifically indicated. Changes in sales revenues result from a number of factors, including price, carat volumes sold, inflation, exchange rates and product mix.

Sales of diamonds represented 91 per cent. of our total revenues in each of 2003 and 2002, the remainder consisting of revenues from construction work, transportation services and trading. All diamond sales, including both export and domestic sales, are either US Dollar-denominated or US Dollar-linked. Total revenues from diamond sales increased by 2 per cent., or RUB923 million, to RUB54,791 million for the year ended 31 December 2003 as compared to RUB53,868 million for the year ended 31 December 2002, due to an 18 per cent. increase in average US Dollar sales prices for diamonds, which was largely offset by a 7 per cent. decrease resulting from the reduction in the volume of export sales in carats and a change in the product mix of domestic sales toward lower-quality, lower-priced diamonds, the effect of the 6 per cent. inflation adjustment of 2002 figures and a decline of 2 per cent. in the average US Dollar/Rouble exchange rate from 2002 to 2003. See “– Certain Factors Affecting Our Results of Operations – Diamond Prices and Sales Dynamics in 2003 and the first six

months of 2004" and "-- Certain Factors Affecting our Results of Operations – Exchange Rates and Inflationary Accounting".

Export sales increased by 2 per cent., or RUB512 million, to RUB27,196 million for the year ended 31 December 2003 as compared to RUB26,684 million for the year ended 31 December 2002, primarily due to a 33 per cent. increase in the average US Dollar export prices. However, this increase was offset by a 23 per cent. decrease in the carat volume of export sales due to our decision to sell a greater volume of diamonds on the international markets and to increase our inventory of high-quality rough diamonds, a 6 per cent. decrease resulting from the application of inflationary accounting to the results of the year ended 31 December 2002 and a change of 2 per cent. in the Rouble/US Dollar exchange rate. See "-- Certain Factors Affecting Our Results of Operations – Diamond Prices and Sales Dynamics in 2003 and the First Six Months of 2004" and "-- Certain Factors Affecting Our Results of Operations – Exchange Rates and Inflationary Accounting".

Domestic diamond sales increased by 2 per cent., or RUB411 million, to RUB27,595 million for the year ended 31 December 2003 as compared to RUB27,184 million for the year ended 31 December 2002. Although the carat volume of domestic sales increased by 44 per cent. in 2003, the increase in domestic sales revenues of 2 per cent. did not reflect the general market increase in average US Dollar diamond prices because of an increase in the share of Indian goods in our domestic sales. The 44 per cent. increase in carats was offset by a 32 per cent. decrease in average US Dollar sales prices, a 6 per cent. decrease resulting from inflationary accounting during the year ended 31 December 2002 and a change of 2 per cent. in the Rouble/US Dollar exchange rate. See "-- Certain Factors Affecting Our Results of Operations – Diamond Prices and Sales Dynamics in 2003 and the First Six Months of 2004" and "-- Certain Factors Affecting Our Results of Operations – Exchange Rates and Inflationary Accounting".

Other sales decreased by 1 per cent., or RUB38 million, to RUB5,213 million for the year ended 31 December 2003 as compared to RUB5,251 million for the year ended 31 December 2002. The decrease was primarily due to a significant decline in sales of construction services to local administrations in the year ended 31 December 2003, which was offset, in part, by increased revenues from transportation services and trade. During the year ended 31 December 2002, we performed a significant amount of road construction and repair services for local authorities, principally in respect of the dam in Lensk that was damaged as a result of flooding in 2001.

Cost of Sales

Our total cost of sales decreased by 4 per cent., or RUB1,288 million, for the year ended 31 December 2003, to RUB29,818 million from RUB31,106 million for the year ended 31 December 2002, primarily as a result of the deferral of a portion of production costs arising from the increase in the value of our diamond inventory as at 31 December 2003. This increase reflects an increase in the average value of the diamonds in our inventory, which was a consequence of our decision to build up our inventory of high-quality rough diamonds and an increase in cost per carat.

As a percentage of revenues, cost of sales decreased from 53 per cent. for the year ended 31 December 2002 to 50 per cent. for the year ended 31 December 2003. The following table sets forth our cost of sales for the year ended 31 December 2003 and for the year ended 31 December 2002:

	For the year ended 31 December	
	2003	2002
	<i>(amounts in RUB millions)</i>	
Wages, salaries and other staff costs.....	10,809	10,869
Depreciation	5,487	4,642
Fuel and energy	4,626	4,262
Materials	4,861	4,655
Extraction tax	3,878	4,460
Services.....	1,207	795
Transport	1,066	1,027
Other costs.....	441	505
Write down of inventory.....	235	141
Movement in inventories.....	(2,792)	(250)
Total cost of sales	29,818	31,106

Wages, salaries and other staff costs

Wages and salaries decreased by 1 per cent., or RUB60 million, to RUB10,809 million for the year ended 31 December 2003 from RUB10,869 million for the year ended 31 December 2002. Wages, salaries and bonuses increased in the year ended 31 December 2003, but the increase was more than offset by the application of inflationary accounting to the salary expenses incurred in 2002.

Depreciation

Depreciation charges increased by 18 per cent., or RUB845 million, to RUB5,487 million during the year ended 31 December 2003 as compared to RUB4,642 million for the year ended 31 December 2002. This increase was mainly attributable to the depreciation charge associated with new fixed assets being put into operation at the Nyurba division (e.g., Ore Treatment Plant No. 16, diesel electricity generating station and stone drivages) as well as the International underground mine buildings and land works. In addition, increased production of diamonds at the International mine resulted in a higher depreciation charge, which is calculated in accordance with the unit of production method.

Fuel and energy

Fuel and energy costs increased by 9 per cent., or RUB364 million, from RUB4,262 million for the year ended 31 December 2002 to RUB4,626 million for the year ended 31 December 2003. This increase was mainly due to a significant rise in the electricity tariffs in 2003, as well as an increase in fuel prices.

Materials

The cost of materials increased by 4 per cent., or RUB206 million, from RUB4,655 million for the year ended 31 December 2002 to RUB4,861 million for the year ended 31 December 2003. The increase in the cost of materials reflected primarily the increase in the volume of materials we used during the year ended 31 December 2003 for maintenance and repairs.

Extraction tax

Extraction tax expense decreased by 13 per cent., or RUB582 million, from RUB4,460 million for the year ended 31 December 2002 to RUB3,878 million for the year ended 31 December 2002. The decline was primarily due to a decrease in the level of extraction tax, which was a consequence of a change in the applicable tax base, effective from 1 January 2002, from the amount of diamonds sold to the amount of diamonds produced; as a consequence of this

change, in the year ended 31 December 2002, we recognised an additional tax liability of RUB615 million which was attributable to diamonds produced in 2001 but sold in 2002.

Services

Costs related to services increased by 52 per cent., or RUB412 million, from RUB795 million for the year ended 31 December 2002 to RUB1,207 million for the year ended 31 December 2003. The increase in the cost of services was primarily related to increases in services provided to us by contractors in connection with repairs of our primary production facilities and a slight increase in repairs.

Other costs

Other costs primarily consist of insurance expenditure and various costs relating to our production facilities. For the year ended 31 December 2003, such costs decreased by 13 per cent., or RUB64 million, to RUB441 million from RUB505 million for the year ended 31 December 2002, reflecting continued implementation of cost reduction policies at our production facilities.

Write down of inventory

A provision for impairment is created for inventory that is more than two years old. The expense associated with the impairment of inventory increased by 67 per cent. or RUB94 million, from RUB141 million for the year ended 31 December 2002 to RUB235 million for the year ended 31 December 2003. This increase was due to the higher volumes of non-diamond inventory that was more than two years old as at 31 December 2003, primarily spare parts for electric equipment that were purchased in 2001.

Movement in inventories

Movement in inventories changed by RUB2,542 million to RUB(2,792) million for the year ended 31 December 2003 from RUB(250) million for the year ended 31 December 2002. The change was primarily the result of periodic imbalances between our sales and production. The closing balance of diamonds in inventory as at 31 December 2003 increased as compared to the balance as at 31 December 2002 because we retained more high-quality rough diamonds in our inventory and our cost per carat increased (due to the increase in various production costs). The movement totalling RUB(2,792) million in 2003 reflects the deferral of costs that will be expensed at the time of the sale of the related diamonds.

Royalty and Ecology Fund Payments

For a description of our royalty and ecology fund payment obligations, see “– Six Months Ended 30 June 2004 compared to Six Months Ended 30 June 2003 – Royalty and Ecology Fund Payments”.

The following table sets forth our royalty and ecology fund payments, including the non-recoverable component of VAT for the years ended 31 December 2003 and 31 December 2002:

	For the year ended 31 December	
	2003	2002
	<i>(amounts in RUB millions)</i>	
Royalty payments	9,096	8,166
Ecology fund payments	856	734
Total	9,952	8,900

For the year ended 31 December 2003, royalty and ecology fund payments increased by 12 per cent., or RUB1,052 million, to RUB9,952 million from RUB8,900 million for the year ended 31 December 2002, with royalty payments increasing by RUB930 million, or 11 per cent., from RUB8,166 million for the year ended 31 December 2002 to RUB9,096 million for the year ended 31 December 2003 and ecology fund payments increasing by RUB122 million, or 17 per cent., from RUB734 million to RUB856 million for the same period. These increases were made

pursuant to the terms of an addendum to the Lease Agreement dated 22 December 2002, in which we agreed with the Government of Yakutia that the 2003 royalty payments, including ecology fund payments and VAT, will amount to RUB10,680 million.

General and Administrative Expenses

The following table sets forth our general and administrative expenses for the years ended 31 December 2003 and 31 December 2002:

	For the year ended 31 December	
	2003	2002
	<i>(amounts in RUB millions)</i>	
Administrative expenses	2,188	1,730
Bad debt expenses	693	1,371
Total general and administrative expenses	2,881	3,101

General and administrative expenses decreased by 7 per cent., or RUB220 million, to RUB2,881 million for the year ended 31 December 2003 from RUB3,101 million for the year ended 31 December 2002. Administrative expenses increased by RUB458 million, or 26 per cent., in the year ended 31 December 2003 due to an increase in the salaries of administrative employees, but the impact of this increase was more than offset by a decline in bad debt expense by RUB678 million or 49 per cent. The decrease in the bad debt expense in 2003 was due to significant provisions made in 2002 against the debt of the local Yakutian administration related to the construction of the dam in Lensk and certain doubtful debts of our related parties for diamonds purchased on credit in 2002, as well as other debt which has been non-performing for more than two years.

Other Operating Income

The following table sets forth the amortisation of the Grant and other income for the years ended 31 December 2003 and 31 December 2002:

	For the year ended 31 December	
	2003	2002
	<i>(amounts in RUB millions)</i>	
Amortisation of Grant	1,062	1,238
Other	1,176	715
Total other operating income	2,238	1,953

For the year ended 31 December 2003, other operating income increased by 15 per cent., or RUB285 million, to RUB2,238 million from RUB1,953 million for the year ended 31 December 2002. Of this increase, RUB 190 million is related to a VAT refund received in 2003 in respect of utility services provided by some of our divisions to third parties in 2001 and 2002, which was recognised after we reached a final settlement with the tax authorities. The remainder of the increase primarily relates to higher income in our financial subsidiaries, such as MAK Bank, Almaznaya Osen pension fund and Investment Group ALROSA, and to the income from non-core activities, such as sales of materials, spare parts and fuel. The increase relating to the VAT refund and higher income from non-core activities was partially offset by a decrease in the income recognised in respect of the amortisation of the Grant, which fell by 14 per cent. or RUB176 million due to the disposal of some of the assets leased under the Lease Agreement, as many of them became obsolete or fully depreciated in the year ended 31 December 2003.

Other Operating Expenses

The following table sets forth our other operating expenses for the years ended 31 December 2003 and 31 December 2002:

	For the year ended 31 December	
	2003	2002
	(amounts in RUB millions)	
Social costs.....	2,695	1,758
Taxes other than profit tax and extraction tax	2,240	3,617
Exploration expenses	1,308	1,105
Selling and marketing expenses	1,199	1,207
(Reversal of) impairment of fixed assets	(74)	627
Loss on disposal of property, plant and equipment.....	1,044	744
(Reversal of) provision for impairment of available-for-sale investments, net.....	(30)	543
Provision for guarantee given.....	972	—
Provision for legal claim	243	—
Other.....	697	478
Total other operating expenses	10,294	10,079

Social costs

For the year ended 31 December 2003, social costs increased by 53 per cent., or RUB937 million, to RUB2,695 million from RUB1,758 million for the year ended 31 December 2002. This increase was the result of significant charitable contributions made in 2003 in support of the regional development programme in Mirny, payments to the Arkhangelsk local administration relating to social programmes and contributions to the St. Petersburg local administration relating to the city's tricentennial.

Taxes other than profit tax and extraction tax

The following table sets forth our taxes, other than profit tax and extraction tax, for the years ended 31 December 2003 and 31 December 2002:

	For the year ended 31 December	
	2003	2002
	(amounts in RUB millions)	
Property tax.....	1,125	946
Ecology fund	856	734
Road users tax	—	613
Tax penalties.....	128	1,128
Other taxes and accruals	131	196
Total taxes other than profit tax and extraction tax	2,240	3,617

Taxes other than profit tax and extraction tax decreased by 38 per cent., or RUB1,377 million, for the year ended 31 December 2003 to RUB2,240 million, compared to RUB3,617 million for the year ended 31 December 2002. The decrease was largely due to an 89 per cent. decrease in tax penalties, from RUB1,128 million in the year ended 31 December 2002 to RUB128 million in the year ended 31 December 2003, as, in 2002, we recognised an aggregated additional liability of RUB1,195 million for potential tax penalties for the taxable years 1999, 2000 and 2001 as a result of a tax audit by the Yakutian tax authorities, and the abolishment of the road users tax effective 1 January 2003.

For a discussion of ecology fund payments see “– Royalty and Ecology Fund Payments”.

Property tax increased by 19 per cent., from RUB946 million for the year ended 31 December 2002 to RUB1,125 million for the year ended 31 December 2003, due to an increase in our property tax base as a result of ongoing construction projects and improvements made to our production facilities.

Exploration expenses

The 18 per cent. increase in exploration expenses, from RUB1,105 million for the year ended 31 December 2002 to RUB1,308 million for the year ended 31 December 2003, related to our continuous and expanding exploration efforts to ensure the maintenance and growth of our diamond reserves.

Selling and marketing expenses

Selling and marketing expenses decreased by 1 per cent., or RUB8 million, from RUB1,207 million in the year ended 31 December 2002 to RUB1,199 million in the year ended 31 December 2003.

(Reversal of) impairment of fixed assets

We recognised a RUB627 million expense in relation to the impairment of fixed assets in the year ended 31 December 2002, and in 2003 we recognised a reversal of RUB(74) million. In 2002 we provided for a number of suspended or impaired construction-in-progress items, including a hotel in Yakutsk and a number of other construction projects. A small portion of this balance was reversed in 2003 due to a decision to complete some previously suspended projects.

Loss on disposal of property, plant and equipment

The loss on disposal of property, plant and equipment increased by 40 per cent., or RUB300 million, from RUB744 million in the year ended 31 December 2002 to RUB1,044 million in the year ended 31 December 2003. The increase was primarily due to the losses recognised when transferring housing to employees and administrative buildings to the local authorities, either free of charge or at prices below their net book value.

(Reversal of) provision for impairment of available-for-sale investments, net

In the year ended 31 December 2002, we recognised a RUB543 million expense in respect of a provision for the impairment of available-for-sale investments; in the year ended 31 December 2003 we partially reversed this expense. In 2002, a provision of RUB525 million was created against an investment in the shares of Sobinbank. In 2003, the net assets of Sobinbank increased slightly, which caused a reversal of a small portion of the provision.

Provision for guarantee given

In 2003 we issued a guarantee in respect of ZAO “Nazymyskaya Oil and Gas Research Expedition” in connection with a loan obtained by that entity from Investment Bank “Trust”. We accrued a provision against the guaranteed amount due to the insolvency of the borrower and our expectations that we would be required to make a payment under this guarantee. See “– Six Months Ended 30 June 2004 compared to Six Months Ended 30 June 2003 – Other Operating Expenses – Provision for guarantee given”.

Provision for legal claim

During the period, Bateman filed an arbitration claim against us for an alleged breach of contract relating to construction of an ore treatment plant at our Nyurba operations. Following a ruling of the arbitration tribunal, which we are appealing, a provision of RUB243 million was recognised in respect of this claim. See “Risk Factors – Risks Related to Our Business – We are currently appealing a damages award in an arbitration claim relating to certain ore treatment technologies used at our Nyurba operations” and “Our Business – Legal Matters – Litigation”.

Finance Costs, Net

The following table sets forth our net finance costs for the years ended 31 December 2003 and the comparative expenses for the year ended 31 December 2002:

	For the year ended 31 December	
	2003	2002
	<i>(amounts in RUB millions)</i>	
Interest on bank loans.....	2,244	2,329
Interest on commercial paper	258	1,249
Interest on non-convertible bonds	912	875
Interest on Eurobonds	835	—
Change in provision for restoration liability.....	385	295
Interest on other borrowings.....	94	500
Total interest expense.....	4,728	5,248
Interest income.....	(625)	(334)
Total.....	4,103	4,914

Overall, the changes in the net finance costs we incurred in the year ended 31 December 2003 as compared to the year ended 31 December 2002 were in line with changes in the respective balances of our bank loans, commercial paper and bonds. Our net finance costs decreased by 17 per cent., or RUB811 million, from RUB4,914 million for the year ended 31 December 2002 to RUB4,103 million for the year ended 31 December 2003, due to the repayment of certain high-interest loans and our ability to obtain short-term and long-term loans at lower interest rates.

Interest on our bank loans decreased slightly by 4 per cent., or RUB85 million, from RUB2,329 million for the year ended 31 December 2002 to RUB2,244 million for the year ended 31 December 2003. The decrease was primarily due to the repayment of high-interest short-term bank loans with the proceeds from the issue of the 2008 Notes. The decrease was partially offset by the amount of interest expense on a significant amount of new bank loans received towards the end of 2002 and in the first half of 2003.

Interest paid on outstanding commercial paper decreased by 79 per cent., or RUB991 million, from RUB1,249 million for the year ended 31 December 2002 to RUB258 million for the year ended 31 December 2003, due to the redemption of a substantial amount of our outstanding commercial paper.

Interest on non-convertible bonds and Eurobonds increased by 100 per cent., or RUB872 million, from RUB875 million for the year ended 31 December 2002 to RUB1,747 million for the year ended 31 December 2003. This increase was due to the issuance of new non-convertible bonds in the fourth quarter of 2002 and the 2008 Notes in 2003.

Interest income increased by 87 per cent., or RUB291 million, to RUB625 million for the year ended 31 December 2003 as compared to RUB334 million for the year ended 31 December 2002, primarily due to the combined effect of higher rates of interest earned on deposits with Russian banks in 2003 and higher cash balances; also during the year ended 31 December 2003 we recognised interest income in the amount of RUB278 million as a result of the reversal of long-term VAT recoverable discounting.

Monetary Gain

Effective from 1 January 2003, the Russian economy was no longer considered hyperinflationary and, consequently, we are no longer subject to the provisions of IAS 29. Accordingly, no gain or loss on the net monetary position was recognised in our statement of income for the year ended 31 December 2003. The gain recognised in 2002 reflected the effect of inflation on the net monetary liabilities of the Group.

Exchange Gains/Losses

The reversal of an exchange loss in 2002 to an exchange gain of RUB1,910 million in the year ended 31 December 2003 primarily reflects the impact of the changes in exchange rates on our US Dollar-denominated bank loans. During the year ended 31 December 2003 the Rouble appreciated relative to the US Dollar by 8 per cent. This appreciation affects the carrying value of our US Dollar-denominated loan balances. See “– Qualitative and Quantitative Disclosures about Market Risks”.

Profit Tax

Our total profit tax expense decreased by 60 per cent., or RUB2,556 million, from RUB4,274 million for the year ended 31 December 2002 to RUB1,718 million for year ended 31 December 2003. Total profit tax reflects both current profit tax of RUB3,438 million for the year ended 31 December 2003 and RUB2,650 million for the year ended 31 December 2002, as well as a deferred profit tax benefit of RUB1,720 million for the year ended 31 December 2003 and a deferred profit tax charge of RUB1,624 million for the year ended 31 December 2002. The increase in current profit tax in 2003 was a result of the increase in our taxable profits when calculated in accordance with Russian tax legislation for the year ended 31 December 2003. In the year ended 31 December 2003 we recorded a deferred tax benefit, primarily due to a decrease in the deferred tax liability attributable to the difference between IFRS value of the Group’s property, plant and equipment and their value under Russian tax accounting (primarily due to a higher depreciation charge under IFRS than under Russian tax accounting) and an increase of deferred tax assets related to the difference between the IFRS and Russian tax accounting values of provisions for the impairment of inventory.

Year Ended 31 December 2002 Compared to the Year ended 31 December 2001

Revenues

The following table sets forth our revenues for the years ended 31 December 2002 and 31 December 2001, based on the purchasing power of the Rouble as at 31 December 2002, net of VAT and export duties:

	For the year ended 31 December			
	2002		2001	
	(amounts in RUB (per cent. of millions) revenues)		(amounts in RUB (per cent. of millions) revenues)	
Revenue from diamond sales:				
Export.....	26,684	45	36,433	54
Domestic sales ⁽¹⁾	27,184	46	24,551	37
Total revenue from diamond sales	53,868	91	60,984	91
Other ⁽²⁾	5,251	9	6,064	9
Total revenues.....	59,119	100	67,048	100

Notes:

(1) Includes sales within Russia and Yakutia.

(2) Includes revenues generated from transportation services, trading, construction, social infrastructure, exploration activities and other activities.

The following table sets forth our historical revenues (in both Roubles and US Dollars) from diamond sales without the application of inflationary accounting. Sales are represented net of VAT and export duties:

	For the year ended 31 December			
	2002		2001	
	(RUB)	(amounts in millions) (US\$)	(RUB)	(US\$)
Revenue from diamond sales:				
Export.....	25,084	805	29,373	1,010
Domestic sales.....	25,553	817	19,956	678
Total revenue from diamond sales.....	50,637	1,622	49,329	1,688

References to changes in prices and carats sold relate to gem, near-gem and industrial diamonds only, and do not include sales of polished diamonds, except where specifically indicated. Changes in sales revenues result from a number of factors, including prices, carat volumes sold, inflation, exchange rates and product mix.

Sales of diamonds represented 91 per cent. of total sales in both 2002 and 2001. Total revenues from diamond sales decreased by 12 per cent., or RUB7,116 million, to RUB53,868 million in 2002 as compared to RUB60,984 million in 2001. The change was due, in part, to a 14 per cent. decrease in inflation rates that were used for the application of inflationary accounting, which was partially offset by a 7 per cent. increase in the exchange rate in 2002 as compared to 2001. The residual movements reflect a 6 per cent. change relating to an increase in sales volumes without any material changes in the allocation of sales between industrial and gem diamonds, and an 11 per cent. decrease in average US Dollar prices in 2002 compared to 2001. The decrease in prices was primarily due to a decrease in world diamond market prices following the terrorist attacks in the United States on 11 September 2001.

Export sales decreased by 27 per cent., or RUB9,749 million, to RUB26,684 million for the year ended 31 December 2002 as compared to RUB36,433 million for the year ended 31 December 2001, primarily due to a 20 per cent. decrease resulting from lower average US Dollar export prices and a 1 per cent. decrease resulting from lower export sales volume in carats. The residual movement reflects a 14 per cent. decrease relating to the impact of inflationary accounting and a 7 per cent. increase resulting from changes in the exchange rate. The decrease in the US Dollar prices of our diamonds was consistent with a general decrease in the price of diamonds on the international market.

Domestic diamond sales increased by 11 per cent., or RUB2,633 million, to RUB27,184 million for the year ended 31 December 2002 as compared to RUB24,551 million for the year ended 31 December 2001. Approximately 36 per cent. of the increase is attributable to the effect of an increase in sales volumes in carats and a 20 per cent. decrease in lower average US Dollar prices. The change in revenues also reflects the combined effect of a 7 per cent. increase in exchange rate and a 14 per cent. decrease relating to the impact of inflationary accounting.

Other sales decreased by 13 per cent., or RUB813 million, to RUB5,251 million for the year ended 31 December 2002 as compared to RUB6,064 million for the year ended 31 December 2001. This change was primarily due to a significant decline in sales of our exploration services to the Government of Yakutia. In 2001, we were entitled to receive reimbursement of a part of the extraction tax expense by providing exploration services to the Government of Yakutia. This effective partial reimbursement of exploration costs was discontinued in 2002 due to changes in Russian tax legislation.

Cost of Sales

Our cost of sales decreased by 2 per cent., or RUB773 million, for the year ended 31 December 2002 to RUB31,106 million from RUB31,879 million for the year ended 31 December 2001. As a percentage of revenues, our cost of sales increased from 48 per cent. for the year ended 31 December 2001 to 53 per cent. for the year ended 31 December 2002, primarily due to the fact that our cost of sales did not decrease consistently with the decrease in sales for the period. The following table sets forth our cost of sales, based on the purchasing power of the Rouble as at 31 December 2002:

	For the year ended 31 December	
	2002	2001
	<i>(amounts in RUB millions)</i>	
Wages, salaries and other staff costs.....	10,869	9,489
Depreciation	4,642	4,945
Fuel and energy	4,262	4,484
Materials	4,655	5,421
Extraction tax	4,460	6,312
Services.....	795	401
Transport	1,027	977
Other costs.....	505	289
Write down (reversal) of inventory	141	(326)
Movement in inventories.....	(250)	(113)
Total cost of sales	31,106	31,879

Wages, salaries and other staff costs

Wages and salaries increased by 15 per cent., or RUB1,380 million, to RUB10,869 million for the year ended 31 December 2002 from RUB9,489 million for the year ended 31 December 2001. This increase was due to a 19 per cent. increase in average salary payments, as well as an increase in the cost of employees' travel reimbursements. These increases were largely offset by the application of inflationary accounting.

Depreciation

Depreciation charges decreased by 6 per cent., or RUB303 million, to RUB4,642 million for the year ended 31 December 2002 from RUB4,945 million for the year ended 31 December 2001. The principal reason for this decrease was the transfer of a certain portion of machinery and equipment from our main production to our construction operations in 2002, which resulted in a decrease in the depreciation charge of RUB470 million. Depreciation on equipment used in construction during 2002 was capitalised, while in 2001 it was expensed as part of production costs. This decrease in depreciation charge was partially offset by an additional depreciation charge totalling RUB167 million, which related principally to fixed assets acquired in 2002.

Fuel and energy

Fuel and energy costs decreased by 5 per cent., or RUB222 million, from RUB4,484 million for the year ended 31 December 2001 to RUB4,262 million for the year ended 31 December 2002. This decrease was primarily due to fuel and energy prices increasing at a rate slower than inflation while consumption remained virtually unchanged between periods.

Materials

The cost of materials decreased by 14 per cent., or RUB766 million, from RUB5,421 million for the year ended 31 December 2001 to RUB4,655 million for the year ended 31 December 2002. The decrease in the cost of materials primarily reflects a slower growth rate in the prices of such items as compared with the general rate of inflation.

Extraction tax

Extraction tax expense decreased by RUB1,852 million, or 29 per cent. to RUB4,460 million for the year ended 31 December 2002 from RUB6,312 million for the year ended 31 December 2001. This decrease was a result of changes in legislation. Effective 1 January 2002, the resource recovery tax and the non-recoverable resource tax were replaced by an extraction tax, which is calculated as 8 per cent. of the estimated realisable value of extracted diamonds.

Services

Costs related to services increased by 98 per cent., or RUB394 million, from RUB401 million for the year ended 31 December 2001 to RUB795 million for the year ended 31 December 2002. The increase in service costs related primarily to costs incurred, following the flooding in Lensk in 2001, in connection with a new flood-control dam constructed for the local administration.

Transport

Our transport expenditures increased by 5 per cent., or RUB50 million, from RUB977 million for the year ended 31 December 2001 to RUB1,027 million for the year ended 31 December 2002. This increase was primarily due to an increase in air transportation tariffs.

Other costs

Other costs increased by 75 per cent., or RUB216 million, to RUB505 million for the year ended 31 December 2002 from RUB289 million for the year ended 31 December 2001. The increase is attributable to other costs incurred by newly consolidated subsidiaries and to the commencement of extraction at the Nyurbinskaya mine in 2002.

Write down (reversal) of inventory

In accordance with our accounting practices, a provision for impairment is created for inventory that is more than two years old. The RUB141 million provision for impairment for the year ended 31 December 2002 was due to an increase in the level of non-diamond inventory that was more than two years old. These increased non-diamond inventory levels were the result of advance inventory purchases made in 2000 primarily in connection with the construction of a gas pipeline.

Movement in inventories

There was no significant change in inventory balances in 2002 as compared to 2001. The movement in inventories included in cost of sales represents the net effect of any change in the inventory balance during the period.

Royalty and Ecology Fund Payments

The following table sets forth our royalty and ecology fund payments, including the non-recoverable component of VAT for the years ended 31 December 2002 and 31 December 2001:

	For the year ended 31 December	
	2002	2001
	<i>(amounts in RUB millions)</i>	
Royalty payments	8,166	10,504
Ecology fund payments	734	983
Total	8,900	11,487

For the year ended 31 December 2002, royalty payments decreased by 22 per cent. from RUB10,504 million for the year ended 31 December 2001 to RUB8,166 million and ecology fund payments declined by 25 per cent. from RUB983 million to RUB734 million due to the fact that, pursuant to an amendment to the Lease Agreement, such payments were fixed for 2002 at a level that was below payments collected during 2001. Lease Agreement payments

were revenue-based in 2001, whereas they are fixed in the Lease Agreement for periods after 31 December 2001.

General and Administrative Expenses

The following table sets forth general and administrative expenses for the years ended 31 December 2002 and 31 December 2001:

	For the year ended 31 December	
	2002	2001
	<i>(amounts in RUB millions)</i>	
Administrative expenses	1,730	1,752
Bad debt expenses	1,371	767
Total general and administrative expenses	3,101	2,519

General and administrative expenses increased by 23 per cent., or RUB582 million, to RUB3,101 million for the year ended 31 December 2002 from RUB2,519 million for the year ended 31 December 2001, mainly reflecting additional provisions for receivables from local authorities primarily in relation to the dam rebuilt by us and transferred to local authorities after the 2001 flood in Lensk.

Other Operating Income

The following table sets forth the amortisation of the Grant and other income for the years ended 31 December 2002 and 31 December 2001:

	For the year ended 31 December	
	2002	2001
	<i>(amounts in RUB millions)</i>	
Amortisation of Grant	1,238	1,142
Gain on restructuring of tax debt.....	—	243
Other.....	715	331
Total other operating income	1,953	1,716

The income recognised as a result of the amortisation of the Grant recorded in respect of assets leased from the Government of Yakutia for the year ended 31 December 2002 increased by 8 per cent. as compared to the year ended 31 December 2001, to RUB1,238 million from RUB1,142 million. This increase is due to our reassessment in 2002 of the useful lives of certain categories of fixed assets.

Other items of income increased by RUB384 million, or 116 per cent., from RUB331 million for the year ended 31 December 2001 to RUB715 million for the year ended 31 December 2002. The increase primarily related to RUB325 million of income related to sales of Caterpillar spare parts recognised in 2002 and a RUB85 million insurance premium received by one of our subsidiaries related to the Lena River flood.

In 2001, a significant amount of taxes payable by our subsidiary Viluygesstroy was restructured pursuant to an agreement with the local tax authorities for a payment period of between seven and ten years.

Other Operating Expenses

The following table sets forth our other operating expenses for the years ended 31 December 2002 and 31 December 2001:

	For the year ended 31 December	
	2002	2001
	<i>(amounts in RUB millions)</i>	
Social costs	1,758	2,010
Taxes other than profit tax and extraction tax	3,617	2,741
Exploration expenses	1,105	966
Selling and marketing expenses	1,207	1,270
Impairment of fixed assets	627	—
Loss on disposal of property, plant and equipment	744	2
Provision for (reversal of) impairment of available-for-sale investments, net	543	(498)
Loss from flooding in Lensk	—	2,194
Other	478	348
Total other operating expenses	10,079	9,033

Social costs

Social costs decreased by 13 per cent., or RUB252 million, to RUB1,758 million for the year ended 31 December 2002 from RUB2,010 million for the year ended 31 December 2001. This decrease was primarily a result of the failure of such costs to rise in line with general inflation. For a discussion of our social services and our social cost reduction policy, see “Our Business – Non-Mining Activities – Social Services”.

Taxes other than profit tax and extraction tax

The following table sets forth our tax expense, other than profit tax and extraction tax expense, for the years ended 31 December 2002 and 31 December 2001:

	For the year ended 31 December	
	2002	2001
	<i>(amounts in RUB millions)</i>	
Property tax	946	881
Ecology fund	734	983
Road users tax	613	655
Tax penalties	1,128	187
Other taxes and accruals	196	35
Total taxes other than profit tax and extraction tax	3,617	2,741

Taxes other than profit tax and extraction tax increased by 32 per cent., or RUB876 million, for the year ended 31 December 2002, to RUB3,617 million from RUB2,741 million for the year ended 31 December 2001. The increase is mainly attributable to an increase in tax penalties, from RUB187 million to RUB1,128 million, which was brought about by the recognition in 2002 of an aggregate additional liability for potential tax penalties relating to 1999, 2000 and 2001 as a result of a tax audit by the tax authorities.

For a discussion of ecology fund payments see “– Royalty and Ecology Fund Payments.”

Property tax increased 7 per cent., from RUB881 million for the year ended 31 December 2001 to RUB946 million for the year ended 31 December 2002, due to an increase in our property

tax base as a result of ongoing construction projects and improvements made to our production facilities.

Exploration expenses

Exploration expenses increased by RUB139 million, or 14 per cent., to RUB1,105 million for the year ended 31 December 2002 from RUB966 million for the year ended 31 December 2001. This increase was the result of our continuous and expanding exploration efforts to ensure the maintenance and growth of our diamond reserves.

Selling and marketing expenses

Selling and marketing expenses decreased by RUB63 million, or 5 per cent., from RUB1,270 million for the year ended 31 December 2001 to RUB1,207 million for the year ended 31 December 2002. These expenses are comprised mainly of wages and salaries for our trading companies. The decrease in selling and marketing expenses was due to the application of inflationary accounting, as the rate of the increase in wages and salaries during 2002 was lower than the inflation rate during that year.

Impairment of fixed assets

We recognised an impairment loss in 2002 in respect of certain suspended construction projects in the amount of RUB627 million.

Loss on disposal of property, plant and equipment

The loss associated with the disposal of property, plant and equipment increased in 2002 to RUB744 million. The comparative figure for the year ended 31 December 2001 was RUB2 million, reflecting a large gain recognised in that year in respect of previously impaired property.

Provision for (reversal of) impairment of available-for-sale investments, net

The changes in provisions for impairment of available-for-sale investments for the years ended 31 December 2001 and 2002 reflect management estimates of the recoverable amount of investments in Sobinbank and other investments.

Finance Costs, Net

The following table sets forth our net finance costs for the periods indicated:

	For the year ended 31 December	
	2002	2001
	<i>(amounts in RUB millions)</i>	
Interest on bank loans	2,329	1,979
Interest on commercial paper	1,249	2,305
Interest on non-convertible bonds	875	457
Change in provision for restoration liability	295	139
Interest on other borrowings	500	350
Total interest expense	5,248	5,230
Interest income	(334)	(226)
Total	4,914	5,004

The 18 per cent. increase in interest paid on bank loans from RUB1,979 million for the year ended 31 December 2001 to RUB2,329 million for the year ended 31 December 2002 reflects the additional long-term loans incurred in 2002. Interest paid on our bonds increased from RUB457 million for the year ended 31 December 2001 to RUB875 million for the year ended 31 December 2002 as a result of the issuance of new bonds in 2002. These increases in interest expense were offset, in part, by the 46 per cent. decrease in interest paid on outstanding commercial paper from RUB2,305 million for the year ended 31 December 2001

to RUB1,249 million for the year ended 31 December 2002, which resulted from a reduction in outstanding commercial paper and a decrease in the applicable interest rates.

The 48 per cent. increase in interest income was the result of an increase in interest recognised on impaired receivables (primarily reimbursed royalty payments) due to the passage of time.

Monetary Gain

Monetary gains decreased by 2 per cent., or RUB90 million, from RUB3,792 million for the year ended 31 December 2001 to RUB3,702 million for the year ended 31 December 2002. The decrease was primarily attributable to the decrease in the rate of inflation, which was partially offset by an increase in our net monetary liabilities position. The increase in our net monetary liabilities position was due to our increased borrowings in 2002.

Exchange Gains/Losses

Net exchange losses did not change significantly during the period, decreasing from RUB856 million for the year ended 31 December 2001 to RUB813 million for the year ended 31 December 2002.

Profit Tax

Our profit tax expense increased by 137 per cent. from RUB1,804 million for the year ended 31 December 2001 to RUB4,274 million for the year ended 31 December 2002. Total profit tax reflects the current profit tax of RUB2,650 million for the year ended 31 December 2002 and RUB4,069 million for the year ended 31 December 2001, as well as a deferred tax charge of RUB1,624 million for the year ended 31 December 2002 and a deferred tax benefit of RUB2,265 million for the year ended 31 December 2001. The net decrease in current profit tax resulted from the reduction in the applicable profit tax rate from 35 per cent. in 2001 to 24 per cent. in 2002. There was also a decrease in taxable profits as a result of diminished profitability due to lower diamond prices. Deferred profit tax changed significantly as a result of a decrease in taxable temporary differences related to property, plant and equipment associated with the revaluation of fixed assets performed for statutory accounting purposes and the decrease in the profit tax rate from 35 per cent. to 24 per cent. between these periods. See “– Critical Accounting Policies – Property, Plant and Equipment”.

Liquidity and Capital Resources

Our management believes that our working capital is sufficient for our present requirements and that we will have adequate access to funding for such working capital on commercially reasonable terms should such funding be required.

The following table summarises our statements of cash flows for the six months ended 30 June 2004 and 2003 and for the years ended 31 December 2003, 2002 and 2001:

	For the six months ended 30 June		For the year ended 31 December		
	2004	2003	2003	2002	2001
	(unaudited)				
	(amounts in RUB millions)				
Net cash provided by operating activities	1,896	896	9,997	11,584	10,520
Net cash used in investing activity	(5,811)	(5,490)	(10,317)	(16,537)	(11,370)
Net cash provided by financing activity	11,390	5,977	670	6,569	1,538

Our consolidated cash flows for 2002 and 2001 reflected the effects of operating in a hyperinflationary economy. As a consequence, the cash flows reflected in our financial statements for 2002 and 2001 were adjusted for price level changes, as well as the effects of currency fluctuations. Effective from 1 January 2003, the Russian economy ceased to be treated as a hyperinflationary economy for the purposes of IAS 29 and all amounts for 2004 and 2003 have been stated at their nominal value. See “– Certain Factors Affecting Our Results of Operations – Exchange Rates and Inflationary Accounting”.

Net Cash provided by Operating Activities

Net cash provided by operating activities increased by 112 per cent., or RUB1,000 million, to RUB1,896 million for the six months ended 30 June 2004 from RUB896 million for the six months ended 30 June 2003 as a result of significantly higher cash flows from operations that were only partly offset by higher profit tax payments.

Net cash provided by operating activities decreased by 14 per cent., or RUB1,587 million, to RUB9,997 million for the year ended 31 December 2003 from RUB11,584 million for the year ended 31 December 2002. This decrease was primarily due to an increase in profit tax payments while the sales revenue and cash used to cover operating expenses remained approximately the same.

Net cash provided by operating activities increased by 10 per cent., or RUB1,064 million, to RUB11,584 million for the year ended 31 December 2002 from RUB10,520 million for the year ended 31 December 2001. This increase was primarily due to a decrease in profit tax paid and changes in our working capital position due to a smaller increase in inventories and a greater increase in accounts payable between the periods and the repayment of deferred royalties in 2001. These factors were offset by the decrease in margins generated by diamond sales and a decrease in taxes payable in 2002, as compared with taxes payable in 2001.

Net Cash used in Investing Activities

Net cash used in investing activities was RUB5,811 million for the six months ended 30 June 2004 as compared to RUB5,490 million for the six months ended 30 June 2003. This represents an increase of 6 per cent., or RUB321 million, which was primarily due to an increase in capital expenditures for the development of the Botuobinskaya pipe, Mir underground mine and construction of a pipeline by ALROSA-Gas during the six months ended 30 June 2004.

Net cash used in investing activities was RUB10,317 million for the year ended 31 December 2003, as compared to RUB16,537 million for the year ended 31 December 2002. The 38 per cent., or RUB6,220 million, decrease in net cash used in investing activities is due to the reduction in the volume of construction expenditures, in particular the reduction in capital expenditures for development of the Nyurbinskaya deposit as a result of the completion of construction of the Nyurba mine.

Net cash used in investing activities was RUB16,537 million for the year ended 31 December 2002, as compared to RUB11,370 million for the year ended 31 December 2001. The 45 per cent., or RUB5,167 million, increase in net cash used in investing activities for 2001 compared to 2002 was due to greater capital expenditures for construction in connection with the development of the Nyurbinskaya and other mines.

Net Cash provided by Financing Activities

Net cash provided by financing activities was RUB11,390 million for the six months ended 30 June 2004, as compared to RUB5,977 million for the six months ended 30 June 2003. This represents an increase of 91 per cent., or RUB5,413 million, which was primarily a result of an increase in net cash inflows from loans.

Net cash provided by financing activities was RUB670 million for the year ended 31 December 2003 as compared to RUB6,569 million for the year ended 31 December 2002. This 90 per cent., or RUB5,899 million, decrease was due to the fact that in 2002 we actively obtained loans and issued bonds in the Russian market for the purpose of funding capital expenditures and in 2003 we reduced our cash outflows for investment activities, and used the proceeds of the 2008 Notes to refinance a significant portion of outstanding indebtedness.

Net cash provided by financing activities was RUB6,569 million for the year ended 31 December 2002, as compared to RUB1,538 million for the year ended 31 December 2001, an increase of 327 per cent. The increase was primarily due to the issuance of long-term non-convertible bonds and the incurrence of significant additional bank borrowings. This increase, which helped to finance higher investing, was partially offset by outflows for repayment of loans and commercial paper during the period.

Capital Expenditures

Capital expenditures for the six months ended 30 June 2003 and 2004 and the years ended 31 December 2003 and 2002 (excluding those acquisitions described under “– Acquisitions”) were as follows:

	For the six months ended 30 June		For the year ended 31 December	
	2004	2003	2003	2002
	<i>(unaudited)</i>			
	<i>(amounts in RUB millions)</i>			
Capital expenditures:				
Mining operations	5,177	6,957	11,973	15,640
Non-mining operations	1,136	954	1,777	2,553
Social infrastructure	1,117	774	1,899	1,923
Total	7,430	8,685	15,649	20,116
Geological exploration	794	480	1,161	898
R&D expenditure	49	71	158	207
Total	843	551	1,319	1,105

Capital expenditures for the year ended 31 December 2002 have been restated in accordance with IAS 29 to remove the effect of hyperinflation.

Our business requires a significant amount of capital expenditures in order to maintain our existing operations. Substantial capital expenditures are required for the continuous replacement of fully depreciated fixed assets, mining operations in our Mirny, Aikhal and Nyurba divisions and for the development of underground mining. See “– Certain Factors Affecting Our Results of Operations – Transition from Open-pit to Underground Mining”. We may also make capital investments in the social infrastructure of communities in Yakutia, including the construction of houses, schools, cultural centres and medical units. Capital expenditures in non-mining operations primarily include investments in construction of a gas pipeline linking Mirny, Aikhal and Udachny and Vilyuiskaya hydroelectric power station. See “Our Business – Supporting Operations – Supply of Energy and Water.”

We plan to finance our capital expenditures through funds generated from our operations and/or through project financing. Implementation of capital projects is subject to a variety of uncertainties, including, but not limited to, our ability to generate sufficient funds, delays in competition, cost overruns and defects in design or construction. We expect that our capital expenditures, including expenditures for mining and non-mining operations and social costs will be RUB12,188 million in 2004 and RUB14,241 million in 2005. Our budget for subsequent years is currently being approved internally. See “Risk Factors – Risks Related to Our Business – We may be unable to implement some of the projects envisioned by our strategy”.

Debt Obligations

Our debt obligations, including short- and long-term borrowings, amounted to RUB52,054 million as of 30 June 2004, and RUB38,567 million, RUB35,873 million and RUB26,946 million as of 31 December 2003, 2002 and 2001, respectively. The figures for periods prior to 1 January 2003 have been restated in accordance with IAS 29 to compensate for the effects of hyperinflation.

The overall increase in our borrowings over the past few years was attributable to a net increase in both our short-term and long-term borrowings. The percentage of total borrowings constituted by short-term borrowings was 48 per cent. as of 30 June 2004, and 36 per cent., 56 per cent. and 72 per cent. as of 31 December 2003, 2002 and 2001, respectively. This trend reflects, in part, our strategy of refinancing short-term borrowings with long-term debt, except for the 30 June 2004 increase in the short-term debt portion due to seasonality and additional borrowings taken to insulate us from disruptions in the Russian banking system in the summer of 2004. See “– Certain Factors Affecting Our Results of

Operations – Seasonality of Our Business” and “Risk Factors – We are only able to conduct banking transactions with a limited number of creditworthy Russian banks as the Russian banking system remains underdeveloped”. The new borrowings were primarily used to finance long-term investments, to increase capital expenditures for new construction, to support current production facilities and to construct the gas pipeline linking Mirny, Aikhal and Udachny and Vilyuiskaya hydroelectric power station. The proceeds of the new borrowings were also used to finance increases in our working capital requirements, principally consisting of inventory items. Some of our debt instruments contain restrictions on our activities and our ability to increase our indebtedness.

Our debt obligations amounted to RUB52,054 million at 30 June 2004 compared to RUB38,567 million at 31 December 2003, an increase of 35 per cent. Short-term borrowings increased as a portion of total debt from 36 per cent. at 31 December 2003 to 48 per cent. at 30 June 2004 though there was also an associated increase in our cash and cash equivalent balance as at 30 June 2004. Our long-term debt balance at 30 June 2004 increased primarily due to the redemption of old loans and bonds and receipt of new long-term bank loans payable in more than one year. During the six months ended 30 June 2004 we redeemed a considerable portion of the commercial paper issued in prior years. On 9 March and 9 April 2004 our subsidiary Severalmaz received a loan in the total amount of US\$150 million from ING Bank N.V. This loan is due in 2006. At 30 June 2004 a portion of our long-term loans was secured through the pledge of our assets and receivables in respect of our diamond production.

Our total debt obligations amounted to RUB38,567 million at 31 December 2003, compared to RUB35,873 million at 31 December 2002, an increase of 8 per cent. Consistent with our strategy of replacing short-term borrowings with long-term borrowings, we decreased short-term borrowings as a proportion of total debt from 56 per cent. at 31 December 2002 to 36 per cent. as at 31 December 2003. Our long-term debt balance at 31 December 2003 increased primarily as a result of the issue of the 2008 Notes, although this increase was partially offset by the redemption of a portion of our US Dollar-denominated long-term debt. The majority of our long-term loans were secured by our assets and receivables in respect of our diamond production.

Our debt obligations secured by pledges of our assets and receivables in respect of diamond production were RUB1,282 million at 30 June 2004, RUB8,108 million at 31 December 2003, RUB18,376 million at 31 December 2002 and RUB9,247 million at 31 December 2001.

The following table sets forth our short-term and long-term borrowings, including bonds and commercial paper outstanding as of the dates indicated:

	As of 30 June 2004	As of 31 December		
		2003	2002	2001
	(unaudited)			
	(amounts in RUB millions)			
Short-term bank borrowings:				
RUB-denominated borrowings.....	2,788	2,640	1,649	1,387
Foreign currency-denominated borrowings..	19,223	8,621	13,341	10,767
Non-convertible bonds.....	1,000	1,051	1,404	576
Commercial paper	384	450	1,675	4,904
Other	1,776	1,121	1,901	1,661
Total short-term debt obligations	25,171	13,883	19,970	19,295
Long-term bank borrowings (excluding current portion):				
RUB-denominated borrowings.....	400	2,530	2,962	1,382
Foreign currency-denominated borrowings..	8,023	3,262	6,844	2,283
Eurobonds.....	14,289	14,463	—	—
Non-convertible bonds.....	3,151	3,819	5,316	1,957
Commercial paper	193	235	440	432
Other	827	375	341	1,597
Total long-term debt obligations.....	26,883	24,684	15,903	7,651
Total debt obligations	52,054	38,567	35,873	26,946

The following table sets forth the repayment schedule for the aggregate principal amount of borrowings outstanding as of 30 June 2004:

	As of 30 June 2004
	unaudited (amounts in RUB millions)
Due for repayment:	
Within one year.....	25,171
Between one and two years.....	11,219
Between two and three years	390
Between three and four years.....	14,625
After four years	649
Total	52,054

For a description of our current outstanding indebtedness see "Description of Existing Material Agreements – Material Financing Agreements".

Other Commitments

At 30 June 2004, we had contractual commitments for capital expenditures of approximately RUB1,408 million as compared to approximately RUB1,364 million at 31 December 2003.

As at 30 June 2004, we had guaranteed US Dollar-denominated loans issued by the National Bank of the Republic of Belarus to Rosbank totalling RUB726 million. Our management does not expect us to incur any outflow of economic resources or economic benefits in connection with these guarantees.

Qualitative and Quantitative Disclosures about Market Risks

We are exposed to market risk from changes in foreign currency exchange rate and commodity prices. We are exposed to foreign exchange risk to the extent that our sales revenues and costs are denominated in currencies other than the Rouble, as well as changes in interest rates that may affect the cost of our financing. We do not use financial instruments, such as foreign exchange forward contracts, foreign currency options, interest rate swaps and forward rate agreements, to manage our foreign currency and interest rate market risks exposures because the market for these types of financial instruments in Russia is not well developed and the costs of these instruments are relatively high. We also do not hold or issue derivative or other financial instruments for trading purposes.

We are monitoring developments in the market for these instruments and will consider their use if the related costs become lower.

Foreign Currency Risk

Our principal exchange rate risk involves changes in the value of the Rouble relative to the US Dollar. As of 30 June 2004, RUB42,284 million of our borrowings were denominated in US Dollars (out of RUB52,054 million of total borrowings at that date). Decreases in the value of the Rouble relative to the US Dollar will increase the carrying value in Roubles of our US Dollar-denominated borrowings, and increase the interest expense associated with servicing these borrowings. Conversely, any increase in the value of the Rouble relative to US Dollar will decrease both the carrying value in Roubles of our US Dollar-denominated borrowings, and reduce the interest expense associated with servicing these borrowings. We believe that the risks associated with our foreign currency exposure are mitigated by the fact that a significant portion of our revenues (approximately 90 per cent. for the six months ended 30 June 2004, are US Dollar-denominated). During the six months ended 30 June 2004 the Rouble appreciated against the US Dollar by 1.5 per cent. We are currently considering hedging arrangements that would reduce our exposure to foreign currency risk.

Interest Rate Risk

We are exposed to interest rate risk in our borrowings that bear interest at variable rates. As of 30 June 2004, we had RUB52,054 million in outstanding indebtedness, of which RUB41,336 million bore interest at fixed rates and RUB5,990 million bore interest at variable rates determined mostly by reference to LIBOR for US Dollar deposits. The remaining RUB4,728 million was represented by discounted non-interest bearing commercial paper and certain non-convertible bonds, the return on which is linked to certain indicators, such as the Central Bank refinancing rate, yields on government bonds or the Rouble/US Dollar exchange rate set by the Central Bank. See Notes 10 and 11 of the IFRS Consolidated Interim Financial Statements for the six months ended 30 June 2004 and the IFRS Consolidated Financial Statements for the years ended 31 December 2003, 2002 and 2001.

We have not entered into agreements to hedge risks associated with the movement of interest rates. Russian legislation effectively prohibits us from acquiring instruments denominated in foreign currencies, which prevents us from economically hedging against interest rate risks that may exist under our current or future indebtedness.

The following table sets forth our debt profile by interest rate and currency exposure:

	30 June	31 December		
	2004	2003	2002	2001
<i>(amounts in RUB millions and per cent.)</i>				
Long-term borrowings:				
Fixed interest rate borrowings	23,860	24,466	11,700	5,434
Weighted average interest rates for fixed rate borrowings.....	9.69%	10.65%	13.18%	17.20%
Variable interest rate borrowings	3,914	2,843	3,496	1,321
Weighted average interest rates for variable rate borrowings.....	5.2%	5.1%	6.8%	6.9%
Non-convertible bonds ⁽¹⁾	4,151	4,870	6,720	1,957
Weighted average interest rates for non-convertible bonds.....	14.5%	14.0%	19.3%	23.3%
Total long-term borrowings	31,925	32,179	21,916	8,712
RR-denominated borrowings.....	7,453	10,208	10,694	5,749
Foreign currency-denominated borrowings	24,472	21,971	11,222	2,963
Total long-term borrowings	31,925	32,179	21,916	8,712
Less: current portion of long-term borrowings	(5,235)	(7,730)	(6,615)	(1,493)
Add: long-term commercial paper, net of discount	193	235	602	432
Average discount on commercial paper	44.9%	35.3%	30.2%	36.0%
Total long-term debt obligations	26,883	24,684	15,903	7,651
Short-term borrowings:				
Fixed interest rate borrowings	17,476	5,555	11,060	11,629
Weighted average interest rates for fixed rate borrowings.....	7.90%	8.25%	11.87%	12.93%
Variable interest rate borrowings	2,076	148	782	693
Weighted average interest rates for variable rate borrowings.....	5.8%	6.2%	6.4%	10.9%
Non-convertible bonds ⁽¹⁾	—	—	—	576
Weighted average interest rates for non-convertible bonds.....	0.0%	0.0%	0.0%	24.6%
Total short-term borrowings	19,552	5,703	11,842	12,898
RR-denominated borrowings.....	1,740	1,157	1,905	2,002
Foreign currency-denominated borrowings	17,812	4,546	9,937	10,896
Total short-term borrowings	19,552	5,703	11,842	12,898
Plus: Current portion of long-term borrowings	5,235	7,730	6,615	1,493
Short-term commercial paper, net of discount	384	450	1,513	4,904
Average discount on commercial paper	18%	23%	29%	38%
Total short-term debt obligations	25,171	13,883	19,970	19,295
Total debt obligations	52,054	38,567	35,873	26,946

Note:

(1) Non-convertible bonds of ALROSA Ltd. of the 19th series and non-convertible bonds of Vilyuiskaya have fixed coupon rates of 16 per cent. and 19 per cent., respectively. Non-convertible bonds of other series cannot be classified with certainty as fixed or variable rate. See "Description of Existing Material Indebtedness – Material Financing Agreements – Rouble-Denominated Bonds". In April 2004 Vilyuiskaya redeemed its non-convertible bonds.

Commodity Risk

The value of our diamond sales are strongly linked to the US Dollar and worldwide demand for diamonds. Significant movements in the US Dollar to Rouble exchange rate or changes in economic environment or worldwide demand could adversely effect our operations. We do not use any derivative instruments to hedge our production in order to decrease our price risk exposure.

Future Trends

Appreciation of the Rouble

In 2004, the Rouble strengthened against the US Dollar in both real and nominal terms. In light of the strong Russian economy and significant Central Bank liquid reserves, we expect that the Rouble will continue to appreciate against the US Dollar. This may have some negative effect on our operating margins, as our revenues are US Dollar-denominated and a significant portion of our costs is Rouble-denominated. However the negative effect may be mitigated by increasing revenues. See “– Certain Factors Affecting Our Results of Operations – Exchange Rates and Inflationary Accounting – Impact of inflation and changes in exchange rates on export sales and operating margins”. We are also currently considering hedging arrangements that would reduce our exposure to Rouble/US Dollar fluctuations.

Diamond Prices and Demand for Diamonds

Diamond prices on the export and domestic market continued to increase in the third quarter of 2004 due to continuing growth in the world economy and increased demand. See “– Certain Factors Affecting Our Results of Operations – Diamond Prices and Sales Dynamics in 2003 and the First Six Months of 2004”. Assuming continued modest growth in the world economy, we expect this overall trend in the supply and demand balance to continue to favour gradual increases in diamond prices and demand for diamonds over the next several years.

In addition, given that no significant diamond deposits have recently been discovered, and even if such sources are discovered in the near future, it may take up to 8 years to develop them, we expect that diamonds will continue to be mined at existing mines, with a continuing transition from open-pit to underground mining. Thus, we believe that volumes of diamonds offered on the market are unlikely to change significantly in the next 8 to 10 years. Diamond production in the future will gradually increase; however we believe that any such increase is unlikely to match the increase in demand for diamond jewellery due to economic growth in China, India, Russia and Eastern Europe.

We also expect that diamond polishers currently operating in Belgium, Israel and the United States of America may gradually transfer their operations to subsidiaries operating in areas with lower labour costs, such as India and China. Operating in areas with lower labour costs is likely to allow diamond polishers to increase their profit margins and the range of their products, which, in turn, will positively affect demand and prices for rough diamonds.

Growth of demand for diamonds at a higher rate than diamond production is also likely to lead to increases in prices of polished diamonds and diamond jewellery.

The Government of Russia may, in the future, abolish export quotas. If such quotas are abolished, foreign customers of Russian polishing companies will be able to purchase diamonds directly from us, which is likely to lead to increased export sales and to domestic diamond prices matching export prices.

Changes in Inventories

We expect both our export and domestic sales volumes to be affected by further increases in our inventory of high-quality rough diamonds. We expect our inventory of diamonds to increase by approximately US\$200 million over the next two to five years. We may, however, sell a portion of our inventory at any time in order to finance our operations.

Seasonality of Our Business

We currently have seasonal working capital requirements due to the remote locations of our mining operations. See “– Certain Factors Affecting Our Results of Operations – Seasonality of Our Business”. However, the Government of Russia has announced plans to build a railroad in Yakutia in the next five years. If such a railroad is built, we expect that it will improve the

accessibility of our mining operations throughout the year, significantly reducing our seasonal working capital requirements and having a positive effect on our debt profile.

Cost of Sales – Fuel Prices

We expect domestic fuel prices to continue to rise through 2004 and 2005. We were able to mitigate risks relating to the increase in fuel prices in 2004 by entering into one-year fuel supply contracts at set prices earlier in the year, but we are exposed to rising domestic fuel prices thereafter.

Other Operating Expenses – Selling and Marketing Expenses

In light of the decreasing role of De Beers in the world diamond market, we expect that diamond producers, including us, will have to increase their marketing and brand promotion, leading to an increase in related expenses. See “Industry Overview – Marketing and Role of the Diamond Trading Company”. We also expect increased vertical integration, *i.e.* diamond producers increasing production of polished diamonds and jewellery.

Other Operating Expenses – Loss on Disposal of Property, Plant and Equipment

We plan to continue to transfer flats to employees and administrative buildings in Mirny to local authorities, either free of charge or at prices below their book value. Consequently, we expect to continue to incur losses on disposal of property, plant and equipment in the near future. However, where such disposals are made, we will no longer incur expenses relating to maintenance of the property transferred to employees and local authorities.

Royalty Payments

Pursuant to an addendum to the Lease Agreement dated 17 September 2003, we and the Government of Yakutia agreed that the annual royalty payments including ecology fund payments and VAT for 2004 are fixed at RUB10,500 million. The amount of payments under the Lease Agreement for subsequent periods has not yet been agreed, we do not expect such payments to rise above the current level. The Lease Agreement expires in January 2018.

Our Business

We are the second largest diamond mining company in the world by diamond production, measured as a multiple of average market prices. In 2003 we produced approximately 19.0 per cent. of the world's rough diamond output, measured as a multiple of average market prices. Our principal mining operations are located in Yakutia, in northeastern Siberia. In addition, we hold a 32.8 per cent. interest in Catoca Mining Ltd., a diamond mining company in Angola, and a 92.4 per cent. interest in Severalmaz. We are also engaged in diamond exploration throughout northeastern Russia. We produce rough gem diamonds and near-gem diamonds, which are cut and used primarily in jewellery, and non-gem diamonds used primarily as industrial abrasives. During 2003 and the six months ended 30 June 2004, sales of gem and near-gem diamonds, including polished diamonds, accounted for approximately 99.4 per cent. and 99.5 per cent. of our total diamond sales, respectively. We are one of Russia's largest industrial enterprises by revenue, with 2003 total revenues of RUB60.0 billion (US\$2.1 billion), and total revenues for the six months ended 30 June 2004 of RUB34.8 billion (US\$1.2 billion).

We operate open-pit, underground and alluvial mines, which are located near the cities of Aikhal, Anabar, Mirny, Nyurba and Udachny within Yakutia, and our eight primary ore treatment production plants have an aggregate design capacity to process approximately 30 million tonnes of ore annually. In 2003 we mined 30.1 million tonnes of ore in Yakutia, processing approximately 30.2 million tonnes of ore to produce rough diamonds valued at US\$1.6 billion, based on average market prices. For the first six months of 2004 we mined approximately 15.2 million tonnes of ore in Yakutia, processing 15.1 million tonnes of ore to produce rough diamonds valued at US\$1 billion, based on average market prices. As of 30 June 2004 we employed 47,260 people, including 15,207 people in connection with our primary Russian mining operations.

We had total sales of diamonds for 2003 and the six-month period ended 30 June 2004 of US\$1.8 billion and US\$1.1 billion, respectively. Exports accounted for 47.7 per cent. of our sales of rough diamonds for 2003 and for the six-month period ended 30 June 2004. In each case, a significant portion of our exports were through sales to De Beers. Our exports have been established pursuant to periodic export quotas imposed by Russia and expressed in carats. In 2003 we were granted a five-year quota for the export of diamonds, under which we may export annually up to US\$1.3 billion of diamonds (based on current market prices).

Historically, we have sold diamonds to De Beers pursuant to trade agreements. The most recent such agreement, the De Beers Trade Agreement provides for annual sales to De Beers of up to US\$800 million, based on current market prices, over a period of five years. However, the De Beers Trade Agreement remains subject to approval by the Directorate-General of the European Commission. Pending resolution of the Statement of Objections issued by the European Commission relating to the De Beers Trade Agreement, we have made monthly sales to De Beers under ad hoc written agreements for each shipment and made export sales to customers other than De Beers in 2003 and the first six months of 2004. We expect the European Commission to reach a decision on the De Beers Trade Agreement within the next several months.

52.3 per cent. of our total rough diamond sales in 2003 and for the six-month period ended 30 June 2004, were made to domestic purchasers, primarily Russian cutting and polishing companies that process the diamonds for use in jewellery. We also cut and polish some of our rough diamond production primarily through our Brillianty ALROSA division. Our sales of polished diamonds were US\$124 million and US\$65 million for the year ended 31 December 2003 and the six-month period ended 30 June 2004, respectively. Before 2003, our sales of industrial diamonds were conducted almost exclusively through Almaziuvelirexport, a Government of Russia-owned jewellery exporter. In 2003, we sold US\$10 million of industrial diamonds, and our sales of such diamonds in the first six months of 2004 were US\$5 million.

Because of the Secrecy Law and the regulations thereunder, we are prohibited from disclosing our diamond reserves. However, as certified by the Russian Federal Geological Fund of the Ministry of Natural Resources of Russia, our proven diamond reserves of categories B and C₁ (see "Industry Overview – Calculation of Diamond Reserves") are sufficient to permit mining of diamonds until 31 December 2029 in an annual average volume that is not less than the volume of diamonds produced during 2003. The Ministry of Finance of Russia has certified

that our proven reserves of natural diamonds (categories A, B and C₁) are sufficient to permit mining of diamonds until 31 December 2028 in an annual average volume that is not less than the volume of diamonds produced during 2003. The Russian Federal Geological Fund of the Ministry of Natural Resources of Russia also confirmed that the average quality of diamonds to be mined in each of the next 25 years will not be materially less than the average quality of the diamonds that we mined during the year ended 31 December 2003. See “– Diamond Reserves” and “Appendix A – Certification of Diamond Deposits”. To increase our reserves, we engage in a variety of exploratory activities. These include geological surveying, detailed prospecting and developmental analysis of current mines.

To reduce our costs and ensure operational support, we are engaged in a number of businesses that provide materials and services to our mining operations, including construction and freight transportation services, timber and logging production, agriculture and food supplies and passenger air transport. We have also developed oil and natural gas extraction and hydroelectric plants to supply a portion of our energy needs. In addition, we continue to maintain for the benefit of our Russian employees certain non-productive, “social” assets, which we inherited from our predecessor entities. We are continuing to transfer the obligation to maintain these assets to the Government of Yakutia.

We have established representative offices in London, England; Luanda, Angola; Ramat-Gan, Israel; and Antwerp, Belgium.

Our Formation and Development

The diamond industry in Russia dates back to the mid-1950s, following the discovery of significant diamond deposits in regions comprising the former Soviet Union, including the Mir and Zarnitsa diamond pipes. The former Soviet State-owned diamond mining company, Yakutalmaz, was established in January 1957 and sold its first lot of diamonds on the world markets in 1959.

We were established pursuant to Decree N158S and were registered as a closed joint stock company in Yakutia on 13 August 1992 under the name “Almazy Rossii-Sakha”, which was changed in 1998 to ALROSA Company Limited. We commenced operations as an independent entity on 1 January 1993. Pursuant to Decree N158S, we took direct control over the exploration, production, marketing and domestic and foreign sales of diamonds, with the objective of ensuring the efficient operation and development of Russia’s diamond industry and strengthening Russia’s position in the world diamond market. Under Decree N158S and a number of resolutions of the Government of Russia, various assets previously operated by the former State enterprise, Yakutalmaz, and the State-owned enterprise, Almaziuvirexport, were transferred to our newly established company, largely by means of a lease. In connection with our formation, we also entered into the Lease Agreement with Yakutia pursuant to which we operate certain key mining assets. See “– Regulatory and Environmental Matters – Lease Agreement”. We conduct almost all of our diamond production in Russia. Except for ALROSA Ltd. and our majority-owned subsidiaries, only three other companies have been granted mining rights in Russia under which they can undertake alluvial mining in the Ural region of Russia and in Siberia.

Our largest shareholders are the Government of Russia, which holds 37 per cent. of our shares through the Federal Agency for the Management of Federal Property, and the Government of Yakutia, which holds 32 per cent. of our shares through the Ministry of Property Relations of Yakutia. See “Principal Shareholders”. We maintain close ties with the Government of Russia and the Government of Yakutia, and in 2002 Mr. Alexey Leonidovich Koudrin, the Russian First Deputy Prime Minister and Minister of Finance at the time, was appointed as Chairman of our Supervisory Council. Mr. Koudrin is currently the Minister of Finance of Russia.

Strengths

We believe that we benefit from the following strengths:

- *We have a leading market position in a large and relatively stable market.* We are the second largest producer of rough diamonds in the world, accounting for approximately 19.0 per cent. of world production output in 2003, measured as a multiple of average market prices. As compared with other extractive industries, the market for rough diamonds is

characterised by relatively stable prices. We believe that this stability is primarily attributable to the role of the Diamond Trading Company in the market for rough diamonds. The Diamond Trading Company purchases and sells rough diamonds and tends to promote stability of diamond prices by aggregating supply and demand.

- *We have significant diamond reserves.* We have increased the reserves of our predecessor entities through a combination of successful exploration and investment. Based upon our internal analyses and certifications of the Russian Federal Geological Fund of the Ministry of Natural Resources of Russia, we believe that we have sufficient diamond reserves to continue our Russian mining operations at least through 31 December 2029.
- *Our mines have consistently produced high-quality, high-margin gems.* Other than our smaller alluvial operations, our mines have consistently produced gem and near-gem diamonds with per carat values ranging from US\$15 to US\$10,000. We believe that the quality of our diamonds is relatively high as compared to the quality of diamonds of other producers. Based on our geological surveys and production experience, we believe that the quality of diamonds generally remains consistent throughout our deposits. Accordingly, we expect to continue to benefit from the production of high quality diamonds in the future.
- *We have a limited number of competitors.* In general, the global diamond mining industry is characterised by a limited number of competitors, which we believe results primarily from a combination of the limited number of diamond deposits suitable for commercial mining and the large capital requirements for exploration and excavation. Within Russia we hold exclusive prospecting licences in numerous locations and, to date, no company other than ALROSA Ltd. and our majority-owned subsidiaries Severalmaz and ALROSA-Nyurba have been granted a licence to mine viable diamond pipes. Only three companies in Russia that are not members of our consolidated group have licences to mine diamonds from alluvial deposits, producing in the aggregate less than 2 per cent. of our diamond output in terms of both volume and value and selling them on the domestic market. In addition, Canada's ADC and Russia's LUKOIL and its subsidiary Arkhangelskgeologodobycha are currently engaged in a dispute over the rights to the licence to mine the Verhotinskoye diamond deposit in the Arkhangelsk region. Notwithstanding the liberalisation of the export controls relating to rough diamonds in early 2003 under the 2002 Decree, we believe that structural and legal barriers to entry will continue to exist in the Russian rough diamond market in the short term, which will assist us in maintaining our market position.
- *We continue to benefit from our export arrangements with De Beers.* Although we are developing alternative distribution channels, De Beers continues to purchase a substantial amount of rough diamonds from us each year, currently pursuant to ad hoc written agreements pending the European Commission's review of the De Beers Trade Agreement. We believe that the distribution of our diamonds through De Beers allows us to reduce our distribution costs and to obtain steady inflows of hard currency, as we receive all payments under the agreements with De Beers in US Dollars. See "Risk Factors – Risks Related to Our Business – The De Beers Trade Agreement has been challenged by the European Commission's Directorate-General for Competition and at least some limitation on our sales to De Beers is likely in the coming months. A final decision or settlement requiring an overly rapid or extensive reduction or a termination of our sales to De Beers could have an adverse impact on our sales, operating results and financial condition" and "Risk Factors – Risks Related to Our Business – The announcement of a European Commission decision or settlement requiring a significant reduction or termination of sales to De Beers may have an adverse impact on the market price of the Notes".
- *We have strong technical mining expertise.* Our predecessor entities have been engaged in diamond mining since 1957. In particular, we have developed unique mining expertise related to the permafrost environment of northeastern Russia, where winter temperatures can reach - 50°C. In addition, one of our divisions, the YakutNiproAlmaz, has 671 employees engaged in research and development, including development of new techniques of underground mining and ore processing. We believe that our experience helps us to increase efficiency and output and makes us an attractive partner for the joint development of mines outside of Russia.

Strategy

We generally formulate our long-term strategy pursuant to the adoption of five-year strategic plans and are currently in the process of developing a ten-year strategic plan. These plans

provide specific strategic objectives and actions to be strictly followed, although our Supervisory Council may revise the plans to react to significant changes in our industry. Under our current five-year plan we intend to:

- *Complete construction of new mines to enhance production.* We are currently constructing a number of new mines to replace mines which have recently closed and to enhance our long-term production capacity. We have put into operation at full capacity and are finalising the development of new Komsomolskaya and Nyurbinskaya open-pit mines and are developing the Botuobinskaya open-pit mine. In addition, we are constructing a new Mir underground mine to replace our recently closed Mir open-pit mine, as well as increasing the capacity of our Zarnitsa open-pit mine and our International and Aikhal underground mines. We are also planning the construction of the Udachny underground mine to continue the mining of diamonds at the Udachny pipe after the expected closure of the Udachny open-pit mine in 2010.
- *Lower costs and seek production efficiencies.* We are engaged in a number of cost reduction projects. In particular, we intend to continue to focus on reducing our energy costs through the construction of a hydroelectric power station on the Vilyui River in western Yakutia, our ongoing gas and oil refinery projects and the introduction of energy-saving equipment. We also intend to continue to modernise and automate our ore treatment plants and to implement more efficient technologies developed by our research institute. We anticipate that the use of new technologies, such as the dry enrichment technology which significantly reduces transportation expenses, would reduce our costs and permit us to engage in industrial mining of deposits whose development was considered non-economical in the past.
- *Divest social assets to improve focus on core business.* We are continuing to transfer to Yakutia and to local governments responsibility for the various social assets which we inherited from our predecessor entities, including residential houses, schools and hospitals. We believe that these transfers will enable us to reduce our maintenance and repair expenses over the long term. We also plan to increase our focus on core operations by divesting or reducing our participation in business ventures which are ancillary to our diamond production operations.
- *Capitalise on anticipated diamond market liberalisation in Russia.* We believe that the 2002 Decree, which became effective on 6 February 2003, and amendments to the Secrecy Law, which became effective on 20 February 2004, reflect the first step in a programme of liberalisation of the Russian diamond market. See "Industry Overview – Liberalisation of the Russian Diamond Market". We believe that this liberalisation trend will create certain opportunities for our business. Based on discussions with officials of the Government of Russia, we believe that the Government of Russia will implement further diamond market liberalisation reforms, and we intend to pursue additional opportunities resulting from such market reforms, if and when they occur.
- *Develop and implement our sales and marketing strategy.* While we believe that our relationship with De Beers will continue to be important to our business, we are currently developing a sales and marketing strategy. In preparation for the implementation of such strategy, we have begun to make alternative sales arrangements for the sale of rough diamonds both on the international and the domestic market and are considering additional strategies, including the establishment of a sales outlet outside Russia. We are working on establishing direct relationships with major diamond buyers and implementing arrangements for non-regular customers to buy diamonds from us on a tender or a non-tender basis. We have also started to increase our rough diamond inventory of high-quality rough diamonds in order to improve the range and consistency of diamonds that we can offer to domestic and international retail customers, meet such customers' future demands, increase sales efficiency and be less dependent on the quality of diamonds that we produce in a particular period.
- *Continue our relationship with De Beers.* We are currently working with De Beers to obtain European Commission approval of the De Beers Trade Agreement. Pending resolution of the Statement of Objections issued by the European Commission's Directorate-General with respect to the De Beers Trade Agreement, we intend to continue our monthly sales to De Beers under individual sale agreements. See "Risk Factors – Risks Related to Our Business – The De Beers Trade Agreement has been challenged by the European Commission's

Directorate-General for Competition and at least some limitation on our sales to De Beers is likely in the coming months. A final decision or settlement requiring an overly rapid or extensive reduction or a termination of our sales to De Beers could have an adverse impact on our sales, operating results and financial condition” and “Risk Factors – Risks Related to Our Business – The announcement of a European Commission decision or settlement requiring a significant reduction or termination of sales to De Beers may have an adverse impact on the market price of the Notes”.

- *Further diversify geographically.* In addition to exploring regions of Russia outside Yakutia, such as in the Arkhangelsk region where our subsidiary Severalmaz operates, we intend to seek geographic diversification by participating in additional joint ventures in key diamond mining regions in other countries. We are currently focused on Angola, where the Catoca mine is entering a second production phase which is expected to double its ore-processing capacity. We are also participating, with the Government of Angola, in the development of the Angolan Lour diamond deposit and other joint ventures and are in the process of constructing a hydroelectric power station to provide electricity to the Catoca mine. We are also considering participation in projects in Sierra Leone, the Democratic Republic of Congo and other countries in Africa.

- *Enhance financial planning and improve the efficiency of our corporate governance.* We have been working to improve our financial planning to strengthen our financial stability. As part of our strategy we intend to continue to restructure our debt portfolio toward long-term unsecured debt, which we believe will enable us to better manage our cash and enhance our liquidity. We have recently hired a First Vice President and a Vice President who are responsible for the implementation of this restructuring. In addition, we are seeking to improve the efficiency of our management information and financial reporting systems through implementation of a new integrated accounting software system.

In addition, while our primary focus continues to be on the production of rough diamonds, we have from time to time considered increasing our cutting and polishing operations, either through the expansion of our own facilities or the acquisition of other established polishing businesses. An increase in polishing activities may involve certain benefits, including the generation of higher margins for finished diamonds and an ability to obtain financing secured by finished diamonds. However, our five-year plan does not provide for growth in our polishing operations and our Supervisory Council is not currently reviewing any amendments to the plan in this regard.

We are also exploring opportunities to participate in the global diamond business in a broader range of roles. We consider and evaluate from time to time opportunities for acquisitions that may be attractive in the context of our core business and its expansion.

The implementation of our strategy is dependent on the availability of funds for capital expenditures. If we experience a significant reduction in revenues in the future, resulting from the occurrence of an event discussed under “Risk Factors” or otherwise, we believe that any such reduction would primarily affect our ability to make capital expenditures in the future.

Our Mining Operations

General Description of our Mining Business

The following map indicates the location of our principal operations within Yakutia, including our representative office in Yakutsk:



Our primary Russian diamond mining operations are located near the municipalities of Aikhal, Anabar, Mirny, Nyurba and Udachny in the northeastern region of Russia. Each of these regions is operated as a division of ALROSA Ltd. In addition, through our 32.8 per cent. ownership interest in Catoca Mining Ltd., a joint venture with Endiama and others, we participate in the mining of the Catoca diamond pipe in Angola. We also hold a 92.4 per cent. interest in Severalmaz, a subsidiary engaged in mining operations near Arkhangelsk in northwestern Russia. The following table sets forth information for each of these operations:

	Primary Russian Mining Operations ⁽¹⁾						Joint Ventures
	Udachny	Mirny	Aikhal	Nyurba ⁽²⁾	Anabar ⁽³⁾	Total	Catoca ⁽⁴⁾
Overburden stripped ('000 m³):							
Six months ended							
30 June 2004	600	1,079	11,919	3,105	370	17,073	3,024
2003	1,707	1,982	24,549	4,345	532	33,115	5,406
2002	6,085	1,665	16,308	4,185	691	28,934	4,499
2001	7,935	1,571	17,154	3,672	701	31,033	4,078
Ore hauled ('000 tonnes):							
Six months ended 30							
June 2004.....	5,669	2,459	6,006	864	460	15,458	2,367
2003	11,185	5,685	13,027	770	908	31,575	4,519
2002	11,525	3,293	20,666	597	930	37,011	3,652
2001	9,650	4,758	15,194	—	801	30,403	1,507
Ore processed ('000 tonnes)⁽⁵⁾:							
Six months ended 30							
June 2004.....	5,883	2,117	6,232	796	70	15,098	2,105
2003	11,129	5,984	12,707	800	988	31,608	3,796
2002	11,262	5,199	12,505	337	801	30,104	3,652
2001	9,421	6,126	12,361	—	801	28,709	2,643
Value of diamonds extracted (US\$ millions)⁽⁶⁾⁽⁷⁾:							
Six months ended 30							
June 2004.....	440	210	159	185	—	994	104
2003	737	394	322	174	22	1,649	188
2002	782	274	310	83	18	1,467	180
2001	708	578	355	—	25	1,666	110
Employees⁽⁸⁾:							
Six months ended 30							
June 2004.....	5,009	3,544	5,196	1,016	442	15,207	2,675
2003	4,548	3,568	5,277	770	414	14,577	2,599
2002	4,866	3,419	5,335	466	382	14,468	2,120
2001	5,016	3,453	5,469	389	349	14,676	1,911

Notes:

(1) The table does not include our subsidiary Severalmaz, which had no industrial production in these periods.

(2) The Nyurba division began producing diamonds in significant amounts in 2002 and has operated at full capacity since August 2003.

(3) Due to the Anabar division's northern location, ore processing takes place between June and October.

(4) We hold a 32.8 per cent. interest in Catoca Mining Ltd., a joint venture among ALROSA Ltd. and certain other parties. See "— The Catoca Mine in Angola".

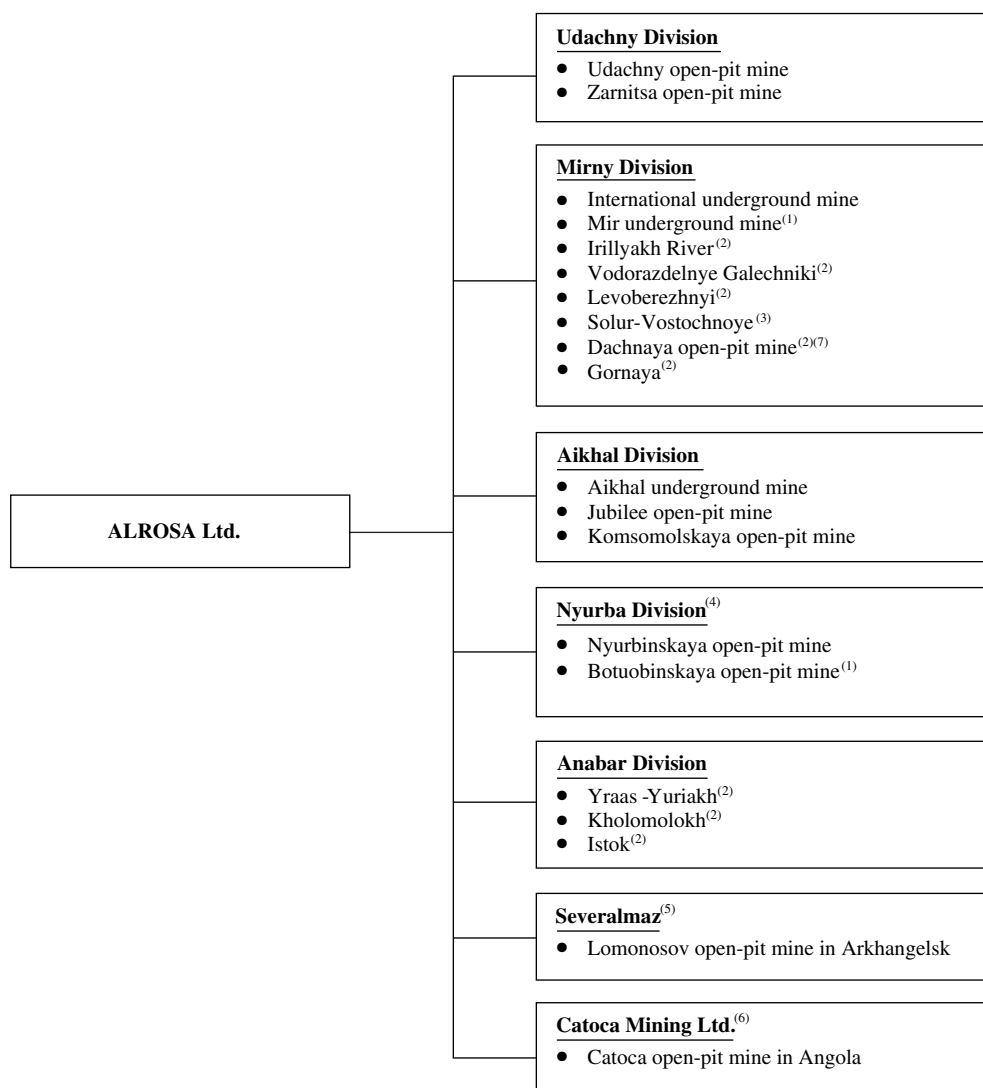
(5) The total tonnes processed may be greater than tonnes hauled due to the processing of existing stockpiles of ore.

(6) Value is determined based upon the average world market prices for rough diamonds.

(7) Under Russian law we are prohibited from disclosing our diamond production stated in carats, including ore-grade figures. See "Risk Factors – Risks Related to Our Business – We are prohibited from disclosing our Russian diamond reserves and other information which may be considered material by investors" and "— Diamond Reserves".

(8) Total number of employees engaged in primary mining operations at period-end.

The following table lists the primary mines operated by each of our divisions and through our Severalmaz subsidiary and our participation in the Catoca Mining Ltd. joint venture:



Notes:

(1) Under construction.

(2) Alluvial mines. Alluvial mining is seasonal and accounts for only a small portion of our total diamond production.

(3) Currently under development, production is not expected to commence in the near future.

(4) ALROSA-Nyurba holds the prospecting licence under which the Nyurba division operates its mines. ALROSA Ltd. controls 86.5 per cent. of ALROSA-Nyurba. All work at our Nyurba operations is performed by our Nyurba division pursuant to a services agreement with ALROSA-Nyurba.

(5) ALROSA Ltd. owns 92.4 per cent. of Severalmaz.

(6) ALROSA Ltd. owns 32.8 per cent. of Catoca Mining Ltd.

(7) We expect to complete mining at the Dachnaya open-pit mine in early 2005 and to close that mine thereafter.

Our mines vary as to mining conditions, yield and quality of diamonds produced. The International mine produces some of our highest quality diamonds with an average per-carat value of US\$130. By comparison, our Anabar alluvial mines produce smaller and lower-quality diamonds with per-carat values of up to US\$20. Diamond quality within a particular diamond pipe generally tends to be consistent throughout.

The following discussion describes the basic techniques used in diamond mining operations to extract and process ore. For a description of the geological conditions found in diamond fields, see "Industry Overview – Origin of Diamonds".

Accessing Ore

The primary difference between open-pit, underground and alluvial mining involves the means of accessing the diamond-bearing ore, as described below.

- *Open-pit mining:* In open-pit mining, access to the ore is achieved by stripping the overlying waste rock, or overburden, to expose the ore. Extraction of the ore body involves the same activity as in stripping the overburden. Rock is drilled and blasted and lines are established to demarcate the ore from the waste material. Extraction is generally accomplished using a circular mining system, with excavation starting from the centre of the pit and working outward in concentric circles so that the depth of the pit remains level as it gets deeper. Ore is removed by digging equipment and loaded into dump trucks for transportation to a processing facility. Our open-pit mines are designed to operate continually on a three-shift system.
- *Underground mining:* For our underground mines, we construct vertical shafts which run parallel to the diamond pipe, and the ore body is accessed at various levels via secondary horizontal shafts running from the primary vertical shaft to the diamond pipe. In underground mining, the ore is broken down, off-loaded and hauled to the surface via the vertical shaft. It is then hauled to a processing facility via dump truck. As with the open-pit mines, our underground operations are designed to operate continually on a three-shift system.
- *Alluvial mining:* In alluvial deposits, diamonds are contained within sedimentary gravel which generally lies in or on the banks of streams and rivers. The mining of alluvial gravel initially involves the mechanised removal of overburden (usually sand and rocks) to expose the layer of diamond-bearing gravel, which is then excavated for processing. There are several excavation techniques; however, our alluvial operations generally utilise dredges, which are floating barges that skim gravel from the bottom of the river or stream bed. Because all natural water resources within Yakutia freeze in the winter, our alluvial operations are seasonal. The diamond gravel is either transported to a processing facility or is processed directly on the dredge.

Diamond pipes generally may be mined using an open-pit method or an underground method. Open-pit mining is generally safer and less expensive than underground mining because there is no need for the installation of mechanical lifts or ventilation systems. In addition, open-pit mines typically generate higher volumes of ore than underground mines as underground production is limited by the mine's capacity to transport ore to the surface through its vertical shaft. However, open-pit mines generate much more overburden, as the mine walls must incline outward from the pit centre to avoid collapse. To maintain the incline, the surface diameter of the open pit must expand as the pit becomes deeper. Thus, an increasing amount of overburden must be removed from open pits, causing a decline in efficiency over the life of the mine. Accordingly, once an open pit attains a certain depth it becomes more efficient to mine the deeper levels of its diamond pipe via an underground mine, if feasible.

As some of our open-pit mines have matured and reached their target depths and some are close to maturity and reaching their target depths, we are in the process of shifting to underground mining in order to continue extracting diamonds from the deposits related to these open-pit mines. We now conduct underground mining at our International mine, have launched a pilot mining phase at our Aikhal underground mine and are constructing an underground mine to continue the extraction of ore at our Mir mine, where open-pit mining has ceased. In addition, we are currently completing feasibility studies relating to underground mining of our Udachny deposit.

Underground mines typically have lower ore production volumes than open-pit mines because the volume of ore that can be extracted is limited by the need to use access shafts to transport ore to the surface. In addition, underground mining is generally more capital-intensive than open-pit mining and will lead to increased operating expenses to maintain the more complex extraction infrastructure of underground mines. Due to the above factors, where we replace open-pit mining with underground mining, the historical operating and financial results of the replaced open-pit mines will not necessarily be indicative of the operating and financial results that may be achieved in the future with underground mining. However, we believe that capital expenditures and operating expenses will be offset, to an

extent, by our continued use of existing mining infrastructure and ore treatment plants, production declines relating to the transition from open-pit to underground mining can be compensated by production from new mines and we believe that the change in the extraction method from open-pit to underground mining will result in the average diamond content of ore being higher than that of ore that we currently extract from open-pit mines. See “Risk Factors – Risks Related to Our Business – As our open-pit mines mature, we must increasingly rely on underground mining, which is more capital-intensive and subjects us to additional risks”.

Ore Stocks

In general, we maintain production stockpiles of ore from our open-pit, underground and certain alluvial operations near their related ore treatment facilities. These production stockpiles are typically maintained in an amount equal to three to four months’ processing capacity to avoid any temporary shortages of ore for processing. In addition, the maintenance of production stockpiles allows the blending of different grades of ore, which helps increase overall diamond recovery.

Most of our alluvial operations process diamond-bearing gravel immediately and do not maintain production stockpiles. However, certain of our alluvial operations are located in areas where, for a portion of the year, seasonal weather conditions make ore processing impracticable, and consequently, during such periods, these operations accumulate production stockpiles.

Ore Processing

We use the same general processing techniques to process the ore derived from open-pit, underground and alluvial mining. Processing begins with milling – the process of breaking up ore to expose the diamonds contained therein. Russian diamond recovery practice differs in certain respects from that used elsewhere in the world, primarily due to the fact that Russian mining operations are located within a permafrost region. We use an autogeneous, or “self milling”, process whereby ore is broken down in a large tumbler, rather than by crushing. We believe that this process results in less damage to the diamonds contained in the ore. Use of these autogeneous mills also allows the permafrost ore to warm as it spins in the enclosed mill, which makes subsequent processing more efficient.

Once milled, the soft ore, which will not yield diamonds, is removed through a process known as screen sizing. Screen sizing sifts this soft ore to remove the finer dirt particles. The resulting condensed ore then goes through various additional processes to identify and separate the diamonds. Pieces of ore are first separated by size, with larger pieces processed through our proprietary x-ray sorting process. As part of this process, the pieces of ore are transported on a conveyor belt through a sorting machine that subjects the ore to x-rays. These sorters work on the principle that x-rays are absorbed by rock and dirt, but are deflected by diamonds. An optical sensor in the sorting machine identifies the diamonds by these deflected x-rays, which enables the sorter to mechanically separate the diamonds from the ore. Medium- and small-sized pieces of ore are processed using jigs. In this process, ore is placed in a water tank and a vertical agitation of the water, known as jigging, separates the ore into lighter minerals on the top of the tank and diamonds and other denser minerals (the concentrate) on the bottom. Discharge of the waste and collection of the diamond-bearing concentrate by a skimming apparatus is continuous. Our plants also utilise a gravitational separation process using spirals. As part of this process, ore is suspended in a water tank into which spiral shaped metal tubes are inserted. As these spirals rotate, the motion carries lighter particles up, through and outside of the spirals, while diamonds and other dense minerals accumulate on the inside of the spirals and can be continuously split off.

In addition, Ore Treatment Plant No. 12, which processes ore from the Udachny and Zarnitsa mines, uses a froth flotation process to recover particles as fine as 0.5 millimetres. This process involves the discharge of a water-borne stream of finely ground ore into a tank of water mixed with an oily reagent. Air is injected into the bottom of the tank to form bubbles which rise to the surface. The diamonds adhere to the bubbles and are collected from the froth discharged from the top of the tank. Waste material is drawn off from the bottom of the tank.

In the final stage of processing, the diamonds undergo an acid wash and other treatments, as necessary, to remove any residual waste materials adhered to the diamonds.

Udachny Division

Over the last 15 years, the Udachny division has been the leading producer of diamonds in Russia, processing 11.1 million tonnes of ore and producing diamonds valued at US\$737.1 million in 2003, and processing 5.9 million tonnes and producing diamonds valued at US\$440.3 million in the first six months of 2004, based on average market prices. In 2001 and 2002, this division produced diamonds valued at US\$708 million and US\$782 million, respectively, based on average market prices. The Udachny division produced approximately 44.7 per cent. of our total diamond production, based on average market prices, in 2003, and approximately 44.3 per cent. of our total diamond production for the first six months of 2004. It accounted for approximately 42.5 per cent. and 53.3 per cent. of our total diamond production in 2001 and 2002, respectively.

Udachny mines

The Udachny division operates the Udachny open-pit mine and the Zarnitsa open-pit mine. Information about each of these mines is set forth in the following table:

	Udachny Mine	Zarnitsa Mine
Year in which mining commenced	1968	1999
Explored depth of diamond pipe (metres).....	1,400	400
Mined depth (metres) ⁽¹⁾	505	40
Target depth (metres).....	610	200
Ore treatment plant processing mined ore.....	No. 12	No. 12

Note:

(1) As of 30 June 2004.

- *Udachny open-pit mine:* The Udachny division is principally engaged in mining the Udachny diamond pipe, which was discovered in 1955 following exploration in the basin of the Daldyn River. This deposit is located in the permafrost zone 12 kilometres south of the Arctic Circle. The Udachny deposit consists of two vertically dipping conjugate ore bodies of oval shape which diverge at a depth of 300 metres. We currently plan to keep the open-pit mine at Udachny operational until 2010, although it is expected that productivity will decrease until that year. Underground mining is scheduled to commence in Udachny in 2010 or 2011. Total production volume of the underground mine will be substantially lower than current levels of production by the open-pit method. We are currently completing feasibility studies relating to underground mining at this site and anticipate that construction of the underground mine will commence in 2005. Based on our internal assessments, we believe that the diamond reserves accessible at Udachny by underground mining should be sufficient for production to continue for not less than 45 years.

- *Zarnitsa open-pit mine:* Although construction of the Zarnitsa open-pit mine has not yet been completed, this mine began limited production in 1999. This mine relates to the Zarnitsa kimberlite field, which was the first kimberlite field discovered in Siberia. Although discovered first, development of this relatively small field would have been uneconomic if a treatment plant were built specifically for the Zarnitsa field. However, the new Zarnitsa mine is able to utilise the nearby Udachny ore-processing facilities. This deposit is located approximately 15 kilometres east of Udachny. In 2003 approximately 2.6 million tonnes of ore were extracted from this mine. Ore is mined constantly at the Zarnitsa mine, with occasional interruptions due to weather conditions, and is stored for periodic transportation to Ore Treatment Plant No. 12 for processing. Following completion of construction, the Zarnitsa open-pit mine will have a design capacity for the extraction of up to seven million tonnes of ore per year. However, our future production levels at this mine will continue to depend upon our processing capacity and overall production requirements.

The Udachny earthmoving fleet consists of 95 vehicles, including an H-285S hydraulic shovel with a 16 cubic metre bucket and EKG-8i, 10, 12.5 and 15 excavators, L1100 and Komatsu-PS-570S loading machines, 120 tonne HD-1200, 136 tonne Caterpillar and 42 tonne BelAZ dump trucks, which are used to clear and transport bedrock.

Udachny ore processing

Ore extracted from the Udachny and Zarnitsa open-pit mines is processed at Ore Treatment Plant No. 12, which is the largest of our ore treatment facilities, and one of the three largest such facilities in the world, in terms of capacity. This plant, which commenced operations in 1976, is equipped with seven autogeneous mills. In 2002 it began operating at its full design capacity of 11 million tonnes of ore per year. In addition to the separation processes employed by our ore treatment plants, Ore Treatment Plant No. 12 also employs a flotation process to recover the smaller diamonds (as small as 0.5 millimetres) which are commonly found in the Udachny ore. The plant underwent a comprehensive refurbishment between 1986 and 1990, and it currently meets all of our technical requirements. Based on the rate of depletion of the Udachny mine and the expected level of production at Zarnitsa, we project that there will be a sufficient amount of ore to allow this plant to operate at its design capacity for an additional 50 years.

Mirny Division

The Mirny division was established in 1957 to operate the Mir open-pit mine, our first mine, which was closed in 2001. It now operates the recently opened International underground mine, the Dachnaya open-pit mine and several alluvial mines and is constructing an underground mine at the Mir deposit. We expect to complete mining at the Dachnaya open-pit mine in early 2005 and to close it thereafter. In 2003, the Mirny division processed 6.0 million tonnes of ore and produced diamonds valued at approximately US\$393.7 million, based on average market prices. For the first six months of 2004, it processed 2.1 million tonnes of ore and produced diamonds valued at approximately US\$209.6 million, based on average market prices. In 2001 and 2002, this division produced diamonds valued at US\$578 million and US\$274 million, respectively, based on average market prices. The Mirny division produced approximately 23.9 per cent. of our total diamond production, by value, for 2003, and approximately 21.1 per cent. of our total diamond production for the six-month period ended 30 June 2004. It accounted for approximately 34.7 per cent. and 18.7 per cent. of our total diamond production in 2001 and 2002, respectively.

Mirny mines

Information about the International underground mine and certain alluvial mines is set forth in the following table. The table does not include the Mir underground mine, which is currently under construction, or the Dachnaya open-pit mine, which is scheduled to be closed in 2005.

	International Mine	Alluvial Mines
Year in which mining commenced	2002 ⁽¹⁾	1957
Explored depth of diamond pipe (metres).....	1,220	—
Mined depth (metres) ⁽²⁾	1,075 ⁽³⁾	—
Target depth (metres).....	1,220	—
Ore treatment plant processing mined ore	No. 3, No. 5	No. 5

Notes:

(1) Represents date of commencement of full capacity production. The International underground mine had limited commercial production starting in 1999. Open-pit mining of the International diamond pipe ended in 1981.

(2) As of 30 June 2004.

(3) This figure represents the depth of the underground mine's vertical shaft. Horizontal shafts are being built off the vertical shaft to access the ore body. The depth of the open pit was 284 metres as of 30 June 2004.

● ***International underground mine:*** The International mine was our first underground mine. It relates to the International diamond pipe, a subvertical oval ore body discovered in 1955. The International diamond pipe is located in an area of compact permafrost rock near the city of Mirny. The upper part of the International diamond pipe was excavated using the open-pit method to a depth of 284 metres. Below this level, the cross-section of the diamond pipe varies slightly and a water-bearing level prevents deeper open-pit mining. As a result, the open-pit operations were terminated in 1981.

Access to the underground deposit is gained by means of two vertical shafts. The cage shaft, which is 6.5 metres in diameter and 1,065 metres deep, is used to lower and raise personnel, cargo and equipment and to provide the mine with fresh air. The skip shaft, which is

5.5 metres in diameter and 1,025 metres deep, is used to haul rock, raise personnel in emergencies, deliver fill mixture and extract air from the mine.

In 2002, the second phase of the International underground mine became fully operational. It is expected that we will require RUB3.0 billion (US\$103.3 million) over the next five years for the completion of the second phase. The current mining plan, including the second phase, indicates a further 30 years of production for the International mine at current production levels.

- *Mir underground mine:* The Mir mine relates to the Mir diamond pipe, which is located on the left bank of the Irilyakh River near the town of Mirny. The Mir diamond pipe has confirmed diamond deposits to a depth of 1,265 metres. The Mir diamond pipe was mined as an open pit from 1958 to 2001. Construction of the underground mine commenced in 2002 and is expected to cost US\$780 million. Construction is scheduled for completion in 2008. We believe that the underground mine will produce approximately one million tonnes of ore per year, which is substantially less than the 4.5 million tonnes per year produced by the Mir open-pit mine. At this production level, the current mining plan suggests a production life for the Mir underground mine of 41 years. Continued mining of the Mir diamond pipe is expected to be difficult because of the presence of underground water and heavy mineralisation throughout the deposit. However, we expect that the additional expenses will be offset by high quality diamonds extracted from the Mir mine.

- *Alluvial mining:* In addition to underground mining, the Mirny division conducts alluvial mining on the Irilyakh River, and on the Vodorazdelnye Galetchniki and Levoberezhnyi alluvial deposits. These operations involve three floating dredges that collect diamond-bearing gravel from the surface of river beds. Two of these dredges have been refurbished within the last eight years, and currently meet our technical requirements. The third dredge began operations in August 2004. Because the rivers freeze during the winter season, the dredges operate on the rivers only from April through November. We are currently constructing an additional dredge to conduct alluvial mining of the Gornaya deposit.

The Mirny earthmoving fleet consists of 69 vehicles, including AM and AHM underground combines, Komatsu loading machines, dump trucks, EGK-5a and 6.3US and Caterpillar 5080 surface excavators and 48 tonne dump BelAZ trucks, which are used to clear and transport bedrock.

Mirny ore processing

Primary materials from the Mirny division are processed at Ore Treatment Plant No. 3 and Ore Treatment Plant No. 5.

- *Ore Treatment Plant No. 3:* This plant is the largest within the Mirny division, and has been operational since 1966. Plant No. 3 is located near the Mir diamond pipe deposit and was originally established for the Mir open-pit mine. Currently, the plant processes ore extracted from the International underground mine and from Mirny's alluvial operations. In addition, in 2002 it completed processing the stockpiled ore extracted from the Mir open-pit mine prior to the cessation of mining operations in 2001. Following an upgrade completed in 2003, Ore Treatment Plant No. 3 has a design capacity of up to 4.0 million tonnes of ore per year, and in 2003 it processed 1.0 million tonnes of ore. For the first six months of 2004, it processed 1.0 million tonnes of ore. In 2001 and 2002 it processed 2.2 million and 1.7 million tonnes of ore, respectively. Based on the expected productive lives of the mines it currently services and the expected addition of the Mir underground operation, we project that there will be a sufficient amount of ore to allow this plant to operate at its design capacity for an additional 50 years.

- *Ore Treatment Plant No. 5:* This plant processes diamond-bearing gravel from the Mirny alluvial dredges, and commenced operations in 1961. Similar to the operations of the alluvial dredges, its operations are seasonal, generally lasting from May to October. Ore Treatment Plant No. 5 has a design capacity of 450,000 cubic metres of diamond-bearing gravel per season, and in 2002 it began operating at full capacity. We estimate that there will be a sufficient amount of ore to allow this plant to operate at its design capacity for at least an additional five years.

Aikhal Division

The Aikhal division operates the Aikhal underground mine, which is currently in a pilot phase, the Jubilee open-pit mine and the Komsomolskaya open-pit mine, which began operations in 2002. In 2003, the Aikhal division processed 12.7 million tonnes of ore and produced diamonds valued at US\$322.4 million, based on average market prices. For the first six months of 2004, this division processed 6.2 million tonnes of ore and produced diamonds valued at US\$158.8 million, based on average market prices. In 2001 and 2002, the Aikhal division processed 12.4 million and 12.5 million tonnes of ore, respectively, and produced diamonds valued at US\$355 million and US\$310 million, respectively, based on average market prices, including diamonds produced by the Sytykan open-pit mine, which closed in 2001. The Aikhal division produced approximately 19.6 per cent. of our total diamond production, by value, for 2003, and approximately 16 per cent. of our total production, by value, for the six-month period ended 30 June 2004. It accounted for approximately 21.3 per cent. and 21.1 per cent. of our total diamond production in 2001 and 2002, respectively.

Aikhal mines

Information about the Aikhal, Jubilee and Komsomolskaya mines is set forth in the following table:

	Aikhal Mine	Jubilee Mine	Komsomolskaya Mine
Year in which mining commenced.....	1998 ⁽¹⁾	1989	2002
Explored depth of diamond pipe (metres).....	900	1,100	300 ⁽²⁾
Mined depth (metres) ⁽³⁾	377 ⁽⁴⁾	236	120
Target depth (metres)	700	500	260
Ore treatment plant processing mined ore....	No. 8	No. 14	No. 8, No. 14

Notes:

(1) The mine is currently operating in a pilot phase, with full production scheduled to commence in 2006. Upon completion, the mine is expected to produce approximately 0.5 million tonnes of ore per year. From 1961 to 1997, the Aikhal deposit was mined using the open-pit method.

(2) Exploration will be conducted in two stages, and the diamond pipe will be explored to a greater depth in the future.

(3) As of 30 June 2004.

(4) This figure indicates the depth of the open pit. The underground shaft target depth is approximately 700 metres.

- *Aikhal underground mine:* The Aikhal mine relates to the Aikhal diamond pipe, which was discovered in 1960. The Aikhal diamond pipe is located in the permafrost zone, 450 kilometres north of Mirny. Geologically, it is an explosion diamond pipe extending in a northeastern direction. In December 1997, the open pit reached its target depth of 350 metres, and the decision was made to begin underground mining. We began construction of the Aikhal underground mine in 1998. Currently, the first of three shafts has been completed, along with the lift machine, compressor and ventilation stations. We anticipate that the underground portion of the mine will reach a target depth of approximately 350 metres below the existing floor of the open pit. According to the development plan for this mine, the Aikhal underground mine will begin full production in 2006. We anticipate that the total cost to complete construction of the underground mine will be RUB2.1 billion (US\$72.3 million). Currently, the Aikhal underground mine is in a pilot phase, with approximately 85,200 tonnes of ore produced in 2003 and no ore processed in the first six months of 2004. The mine has projected output of 500,000 tonnes per year starting in 2006. This is the first mine in which production has begun prior to completion of construction. At the projected level of output, the current plan indicates a further 25 years of productive life for the Aikhal mine.

- *Jubilee open-pit mine:* The Jubilee open-pit mine relates to the large Jubilee diamondiferous ore deposit, discovered in 1975, approximately 15 kilometres northwest of the city of Aikhal. It is one of the largest diamond pipes in Russia. The Jubilee diamond pipe consists of three vertical ore bodies (western, central and eastern), composed of various types of ore. The diamond pipe is located in an area of compact permafrost rock. The current mining plan indicates more than 20 additional years of production for the Jubilee mine at current production levels. The Jubilee deposit is unusual in that the quality of diamonds has increased with the depth of the mine.

- *Komsomolskaya open-pit mine:* In 2002 we began mining operations at the Komsomolskaya diamondiferous ore deposit. The deposit is located approximately eight

kilometres northwest of the city of Aikhal. The target depth of the mine is 260 metres, although diamond reserves have been identified at depths of up to 300 metres at this site. The Komsomolskaya open-pit mine began production in 2002, producing 1.5 million tonnes of ore in 2003 and 0.8 million tonnes in the first six months of 2004. At the projected production level of 1.3 million tonnes of ore extracted per year we anticipate the Komsomolskaya mine will have a production life of at least 20 years.

The Aikhal earthmoving fleet consists of: 56 heavy-duty and 45 small dump trucks; 28 excavators and loading vehicles, including an H-285S hydraulic shovel with a 16 cubic metre bucket, EGK-5a, 8i, 10, 2.5 and 15 and L-1100 and Komatsu excavators and loading machines; ST-1000 and ST-710 scooptram long haul dump machines (LHDs); and 4 underground dump trucks, which are used to clear and transport bedrock.

Aikhal ore processing

The Aikhal division currently has a relatively large production stockpile of ore. The amount of ore stock awaiting processing is an amount equal to one year's combined processing capacity of the Aikhal treatment plants. Ore from the Aikhal division is processed at Ore Treatment Plant No. 8 and Ore Treatment Plant No. 14.

- *Ore Treatment Plant No. 8:* Ore Treatment Plant No. 8 was built in 1966, and it currently processes ore from the Aikhal underground mine. Since 2002, it has also processed ore from the Komsomolskaya open-pit mine. It has a design capacity of 1.6 million tonnes of ore per year, and it processed 1.7 million tonnes of ore in 2003 and 790,000 tonnes of ore during the first six months of 2004. We have adopted a reconstruction and modernisation programme for this plant, which we expect to complete in 2004. Based upon the anticipated depletion rates of the Aikhal and Komsomolskaya diamond pipes, we project that there will be a sufficient amount of ore to allow this plant to operate at its design capacity for an additional 24 years.

- *Ore Treatment Plant No. 14:* Built in 1996, Plant No. 14 has modern wet x-ray sorters which assist us in recovering large, high-quality gem stones. In 2000 Ore Treatment Plant No. 14 processed 9.7 million tonnes of ore. However, it has exceeded its design capacity of 10 million tonnes of ore per year since 2001, processing 10.8 million tonnes in 2001 and 11.0 million tonnes in each of 2002 and 2003. For the six-month period ended 30 June 2004, Ore Treatment Plant No. 14 processed 5.4 million tonnes of ore. This plant processes ore primarily from the Jubilee diamond pipe. We are currently engaged in a project to increase the automation in Ore Treatment Plant No. 14 and to increase its capacity to 11.4 million tonnes per year. This upgrade is expected to be completed in 2004 and to cost US\$400,000. Based on the expected rate of depletion of the Jubilee diamond pipe, we estimate that there will be a sufficient amount of ore to allow this plant to operate at its design capacity for at least an additional 25 years.

Nyurba Division

The Nyurba division operates the Nyurbinskaya open-pit mine and several alluvial mines. In addition it is constructing the Botuobinskaya open-pit mine. Diamondiferous formations exist adjacent to the Nyurbinskaya and Botuobinskaya diamond pipes. In 2003, the Nyurba division processed 0.8 million tonnes of ore and produced diamonds valued at US\$173.7 million, based on average market prices, accounting for approximately 10.5 per cent. of our total diamond production, by value. During the first six months of 2004, the Nyurba division processed 0.8 million tonnes of ore and produced diamonds valued at US\$185.3 million, based on average market prices, accounting for approximately 18.6 per cent. of our total diamond production, by value. The current mining plan provides for the development of the Nyurbinskaya diamond pipe followed by the Botuobinskaya diamond pipe. Under the mining plan, these two diamond pipes will produce diamonds at or in excess of current production levels for an additional 21 years.

The prospecting licence under which the Nyurba division operates is held by our majority-owned subsidiary, ALROSA-Nyurba. ALROSA Ltd. owns 86.4 per cent. and controls 86.5 per cent. of ALROSA-Nyurba, the local administration owns 10.0 per cent., 3.5 per cent. is held by ALROSA-Nyurba's management and employees and the remaining 0.1 per cent. are treasury shares. All work at the Nyurba mines is performed by our Nyurba division pursuant to a services agreement with ALROSA-Nyurba.

Nyurba mines

Information about the Nyurbinskaya and Nyurba alluvial mines is set forth in the following table. The table does not include the Botuobinskaya open-pit mine, which is currently under construction.

	Nyurbinskaya Mine	Alluvial Mines
Year in which mining commenced	2002 ⁽¹⁾	2002
Explored depth of diamond pipe (metres).....	870	—
Mined depth (metres) ⁽²⁾	90	—
Target depth (metres).....	360 ⁽³⁾	—
Ore treatment plants processing ore.....	No. 15, No. 16	No. 15, No. 16

Notes:

(1) Represents limited production during the construction of the mine.

(2) As of 30 June 2004.

(3) Represents target depth for open-pit mining.

- *Nyurbinskaya open-pit mine:* The Nyurbinskaya mine relates to the Nyurbinskaya diamond pipe located in the Sredne-Markhinsky kimberlite field. This deposit is located in the permafrost zone 175 kilometres south of the Arctic Circle. We plan to develop this deposit using, initially, open-pit mining, followed by underground mining once a depth of 300 to 360 metres is reached.

- *Botuobinskaya open-pit mine:* The Botuobinskaya mine will be put into operation to compensate for the depletion of the Nyurbinskaya deposits. It relates to the Botuobinskaya diamond pipe which was discovered in the Sredne-Markhinsky kimberlite field in 1994. We anticipate that open-pit mining will be used initially, followed by underground mining to develop this diamond pipe. We believe that parallel mining of the deeper levels of the Nyurbinskaya diamond pipe and of the reserves of the Botuobinskaya diamond pipe will make it possible to maintain the aggregate ore yield of the entire facility largely unchanged over time. We expect to complete construction of this mine in 2015, and, once completed, we expect that it will produce 1.2 million tonnes of ore per year. Based on geological surveys, we believe that the reserves and the diamond content of the Nyurbinskaya and Botuobinskaya diamond pipes will be comparable or superior to our other deposits and may have a production life of at least 30 years.

- *Alluvial mining:* In addition to open-pit mining, the Nyurba division conducts alluvial mining. In the first six months of 2004, these alluvial operations produced 231,000 tonnes of diamond-bearing gravel, all of which were processed. In 2002 and 2003, these alluvial operations produced 474,000 tonnes and 170,000 tonnes of diamond-bearing gravel, respectively.

The Nyurba earthmoving fleet consists of 25 vehicles, including three Caterpillar excavators, two Caterpillar loading machines, five 42 tonne BelAZ and fifteen 91 tonne Caterpillar dump trucks CAT-777D, which are used to clear and transport bedrock.

Nyurba ore processing

Ore from the Nyurba division is processed at Ore Treatment Plant No. 15 and Ore Treatment Plant No. 16. The capacity of both plants allows the processing of more ore than the existing mines currently produce, permitting the plants to increase processing in the event new mines are put into operation.

- *Ore Treatment Plant No. 15:* Ore Treatment Plant No. 15 commenced operations in July 1999. The plant initially processed ore extracted by our geologists in connection with the exploration of the Nyurbinskaya mine. Once the reserves were proven, the plant began processing production ore in 2001. The design capacity of Ore Treatment Plant No. 15 is 0.3 million tonnes per year, and in the first six months of 2004, Ore Treatment Plant No. 15 processed approximately 132,000 tonnes from the Nyurbinskaya mine, as well as the gravel produced by the alluvial operations. This is a seasonal plant because milling takes place outside the main building. Its season of operation runs from June to October. We believe that we could convert this plant into a continuous operating facility by constructing a building around the milling equipment, if additional capacity is required. Based upon the anticipated depletion of the Nyurbinskaya and Botuobinskaya diamond pipes, we estimate that there is a

sufficient amount of ore to allow this plant to operate at its design capacity for a further 25 years.

- *Ore Treatment Plant No. 16:* Ore Treatment Plant No. 16 became operational in August 2003, with production beginning later that year. Ore Treatment Plant No. 16 has the highest level of automation of any of our ore treatment facilities. The plant will process ore from the Nyurbinskaya and Botuobinskaya mines. It has a design capacity of 1.5 million tonnes of ore per year. Based upon the anticipated depletion rates of the Nyurbinskaya and Botuobinskaya diamond pipes, we estimate that there is a sufficient amount of ore to allow this plant to operate at its design capacity for at least an additional 25 years.

Anabar Division

The Anabar division was established in 1984. It operates in the far north of Yakutia, and carries out alluvial diamond mining within the Anabar district. Due to the Anabar division's northern location, ore processing takes place between June and October. In 2003, the Anabar division processed 1.0 million tonnes of diamond-bearing gravel and produced diamonds valued at US\$21.9 million, based on average market prices, through seasonal production. For the six-month period ended 30 June 2004 it processed 0.07 million tonnes of ore and produced diamonds valued at US\$0.4 million, based on average market prices. In 2001 and 2002, this division produced diamonds valued at US\$25 million and US\$18 million, respectively, based on average market prices. The Anabar division accounted for approximately 1.3 per cent. of our total diamond production, by value, for 2003, and produced approximately 0.0004 per cent. of our total diamond production, by value, for the first six months of 2004. The Anabar division accounted for approximately 1.5 per cent. of our total diamond production in 2001 and 1.2 per cent. in 2002.

Anabar alluvial mines

The Anabar division mines three alluvial deposits on the river Ebelyakh, and is preparing to mine alluvial deposits on the smaller rivers Kholomolokh and Istok. Operations on the Yrass-Yuriakh River were completed in 2004. Our subsidiary Almazy Anabara is preparing to mine alluvial deposits on the Morgogor River. These operations involve an ore-treatment plant and five flushing units, which are used for the preparation and/or processing of ferrous gravel. These units operate during a 100-day season, and have the capacity to process approximately 150,000 cubic metres of sand. The Anabar mines generally produce smaller diamonds, some of which are as small as 0.5 millimetres. As a result, the Anabar diamonds generally have per-carat values of only up to US\$20. However, the operating expenses of alluvial mines are relatively low compared with open-pit and underground mines.

The Anabar division earthmoving fleet consists of twenty 30 tonne BelAZ dump trucks and a Komatsu loading machine.

Anabar gravel processing

The gravel extracted from the Anabar alluvial mines is processed at Ore Treatment Plant No. 13. Construction of this plant began in 1997. During 2001, a preparing unit was built at this plant, which was designed to condense extracted gravel by removing the non-diamond-bearing gravel, thereby reducing the cost of transporting gravel from the placer deposit. The design capacity of Ore Treatment Plant No. 13 is approximately 800,000 tonnes per year. Seasonal mining of the Anabar alluvial deposits limits production at the plant to a 100-day period from June to September. Based upon the anticipated depletion of the Anabar alluvial deposits, we anticipate that there will be a sufficient amount of diamond-bearing gravel to allow this plant to operate at its design capacity for an additional 50 years.

Our Severalmaz Subsidiary

We control approximately 92.4 per cent. of Severalmaz, a diamond mining company which holds the licence to mine the Lomonosov diamond field in the Arkhangelsk region of northwestern Russia. Of the remaining 7.6 per cent., 5.0 per cent. is owned by the administration of the Arkhangelsk region and 2.6 per cent. by individuals and legal entities. We have transferred management of our stake in Severalmaz to Solecs Ltd., a wholly-owned subsidiary of OAO "Investment Group 'ALROSA'", in which we own 50 per cent. plus one share. The purpose of the transfer was to facilitate the offering of a minority stake in Severalmaz on the international capital markets to raise funds for development of Severalmaz

without recourse to borrowings. Our total equity investment in Severalmaz at 30 June 2004 was RUB2,677 million (US\$92.2 million).

The Severalmaz project is currently in its pilot stage. We began construction of an open-pit mine on the site in July 2002, and it is expected that construction of the pilot processing plant (capable of processing one million tonnes of ore per year) will be completed by the end of 2004. In this initial stage, commercial extraction of ore will be commenced at low levels, and ore will be processed at a temporary plant. Revenues from the sale of diamonds from this deposit will be used to fund the construction costs, and we do not have any obligations to contribute additional capital to Severalmaz. We intend to maintain the controlling stake in Severalmaz but plan to sell up to 42 per cent. of its shares to strategic or portfolio investors and to attract financing for development.

The Lomonosov diamond field consists of six kilometres of pipes. Difficult mining conditions exist in the area being developed by Severalmaz, including large volumes of groundwater. Technologies are currently being tested for use in the next stage of full production. These technologies primarily relate to the removal of groundwater from the mining area.

In the next stage of the project, a larger processing plant will be built in connection with the completion of the mine. This plant will have a design capacity sufficient to process approximately 5.6 million tonnes of ore per year. We expect this plant to become operational in 2008. The Severalmaz deposits have US\$8.4 billion of proven reserves, based on average market prices of diamonds comparable to those mined at the Lomonosov diamond field. To help its initial search for investors, Severalmaz has received a special exemption from the State secrecy restrictions to disclose its reserves.

The Catoca Mine in Angola

In 1989, our predecessor entered into a cooperation agreement with Endiama, an Angolan government-owned entity, Odebrest Mining Services Inc. of Brazil and Israel's Daumonti Financing Company B.V. In 1992, these parties agreed to establish Catoca Mining Ltd. as a joint venture to mine the Catoca diamond pipe in Angola. This diamond pipe is located in the Luande Norte Province in eastern Angola, approximately 1,000 kilometres north of the nation's capital. Catoca Mining Ltd. is the only company engaged in the development of a diamond pipe within Angola. We currently have a 32.8 per cent. interest in Catoca Mining Ltd. In addition, Endiama owns 32.8 per cent., Odebrest owns 16.4 per cent. and Daumonti Financing Company B.V. owns 18.0 per cent. In 2003 Odebrest announced its intention to divest its stake during 2004. We intend to participate in such divestment and are currently negotiating its terms with Odebrest and other shareholders of Catoca Mining Ltd. We anticipate that as a result of this transaction our stake in Catoca Mining Ltd. will increase to 39.2 per cent. See "Risk Factors – Risks Related to Our Business – Catoca Mining Ltd., our associated undertaking, and our other Angolan operations are subject to the risks of doing business in Angola".

Catoca Mining Ltd. is self-financing, and we are not required to make additional capital contributions. Our share of dividends from this joint venture for the year ended 31 December 2003 totalled RUB403 million (US\$13.9 million).

The Catoca diamond pipe is one of the largest diamond pipes in the world with a diamond pipe outcrop area covering approximately 657,000 square metres, and the deposit has been explored to a depth of 600 metres. Surveys conducted by our research division, YakutNiproAlmaz, as confirmed by the Angolan Ministry of Geology, have indicated that the Catoca diamond pipe contains 62 million cubic metres of ore volume at a depth of up to 100 metres, an average diamond content of 0.7 to 0.8 carats per cubic metre and reserves of approximately 60 million carats. We believe that, based on ore body size, mining conditions and the quantity and quality of diamonds, the Catoca diamond pipe is comparable to other diamond mines such as the Orapa in Botswana, the Premier in the Republic of South Africa and our Udachny mine. The venture is operating on a concession basis, and is not required to purchase mineral rights to the Catoca deposit.

The Catoca mine commenced production in August 1997. In the first six years of production, the Catoca mine produced 10.4 million carats of diamonds worth approximately US\$706 million. In 2003, the Catoca mine processed 2,105 million tonnes of ore (3,796 million tonnes in the first six months of 2004) and produced 3.1 million carats of diamonds (1.8 million carats

in the first six months of 2004). The cost per tonne of ore processed at Catoca for 2003 was US\$13. Because resource depletion has been minimal, the current mining plan indicates a further 30 years of production for the Catoca mine at the production levels projected for the second stage of mining. Catoca Mining Ltd. sells its diamonds through ASCORP, an export agency of the Government of Angola. As of 30 June 2004, the Catoca operations employed 2,675 persons, including 170 of our employees seconded to Catoca Mining Ltd.

In 2002, Catoca Mining Ltd. commenced a second phase of development of the Catoca diamond field, which is expected to increase production and processing capacity to seven million tonnes per year through the expansion of its processing plant. The total cost to complete the second phase is expected to be approximately US\$50.8 million, which will be completely self-financed through the revenues of Catoca Mining Ltd. YakutNiproAlmaz is providing all design services in connection with the second phase, and the work is being supervised by our representative.

In addition to the second stage development of the Catoca mine, we started construction of a hydroelectric station to supply electricity to Catoca. The construction is conducted by Hydroshikapa Ltd., a joint venture entity with the Government of Angola in which we hold 55 per cent. This project is expected to cost approximately US\$45 million and the financing has been guaranteed by us.

Catoca Mining Ltd. maintains a policy of social responsibility designed to assist the local communities and improve local living standards. This programme entails vocational training, fair wages and free medical care for workers. In addition, Catoca Mining Ltd. provides relief aid to refugees and displaced persons, restores bridges, builds local water supplies and has begun to build a hospital in Saurimo, the capital of Luande Norte Province.

We have also agreed to construct a new mine in Angola to extract diamonds from the two Lour diamond pipes, which have ore of similar quality to the Catoca diamond pipe. Total capital expenditures for this project are expected to be approximately US\$100 million. The Lour diamond pipes are to be mined by Kamachia-Kamagiku Ltd., a joint venture between the entities controlled by the Government of Angola (55 per cent.) and Escom Alrosa (45 per cent.), a joint venture between us and Escom Mining in which we hold a 44 per cent. interest. We have reached a preliminary agreement with Escom Mining which contemplates that Escom Mining will finance all US\$100 million of the expected capital expenditures for this project through an 8.5-year loan to Kamachia-Kamagiku Ltd. bearing interest at the rate of LIBOR plus 2 per cent., and we will pledge our 44 per cent. interest in Escom Alrosa as security for this loan. The loan will have no recourse to us and our exposure in connection with this project is limited to our contribution into the charter capital of Escom Alrosa of US\$4 million.

Diamond Sorting and Valuation

After rough diamonds have been recovered through the ore treatment processes, the diamonds are sorted in accordance with their value. The valuation of diamonds is conducted by our division, the United Selling Organisation, which maintains sorting facilities in Mirny and in Moscow. As of 30 June 2004, the United Selling Organisation had 770 employees, including 109 experts and sorters in Yakutsk and 323 experts and sorters in Moscow.

The Mirny sorting facility receives rough diamonds directly from our Yakutian mining operations and performs the initial valuation of these stones. The diamonds are weighed and the largest stones, those weighing 10.8 carats or more, are forwarded to our valuation experts in Moscow to assign values to these diamonds based on the special methodology adopted by the Ministry of Finance of Russia. All diamonds are individually sorted, except that diamonds weighing three grainers or less are sorted on the basis of representative samples. In this initial sorting, the valuation is made on the basis of 16 categories, including, amongst other things, the quality, size and special characteristics of the diamonds. This valuation is conducted under the supervision of representatives of Gokhran, the diamond depository of Russia, who set the valuation methodology, and the initial values assigned to each stone are based on the Price List which is maintained and updated from time to time by the Ministry of Finance of Russia. We believe that this oversight by Gokhran helps us to ensure that we maintain and consistently comply with the appropriate sorting standards. Our sorting and valuation processes are certified by the Russian Committee for Standards, and they meet the

requirements of ISO 9000, an internationally recognised set of instructions for the operation of a quality management system.

Following the first sorting, we send our diamonds by air to Moscow where they are sorted again in our licenced sorting facility. In this second sorting, the diamonds are sorted on the basis of 32 categories and, if necessary, further chemical treatment of the diamonds is performed. As in Mirny, the sorting is monitored by Gokhran representatives. This second sorting verifies and adjusts the initial value assigned to each diamond. Because diamond valuation is based on certain judgements involving the 30,000 to 40,000 characteristics which determine value and because the second sorting involves finer distinctions among stones, there is often a small variation between the first and second valuations, which is generally between 1 per cent. and 3 per cent. of the initial valuation. We use the initial values for internal business planning purposes and for the purpose of insuring the transportation of these diamonds.

We are the only company in Russia which sorts diamonds, and we have received a licence from the Government of Russia to conduct these activities. We are in a unique position to operate sorting facilities because of our extensive inventory of rough diamond samples, representing each sorting classification and sub-classification. These samples are referred to by the sorters in order to confirm their classifications. These diamond samples have been taken from our own production, as well as from De Beers' inventory. In addition, we have developed extensive internal know-how with respect to diamond classifications and we maintain an internal programme for training our diamond sorters.

Our 32 category classification system is largely based on the De Beers "sample" system, which was established in 1989 and is generally accepted as the international standard. Because De Beers is continually refining its classification system, we make adjustments from time to time to our system to eliminate discrepancies. However, differences sometimes exist between the De Beers classification system and our own as we implement the necessary adjustments to our system.

Following the second sorting, our gem and near-gem diamonds are grouped into "boxes" of diamonds, and the boxes are collected into lots for sale. Each box contains an assortment of different types of diamonds, having an aggregate weight equal to a standard number of carats. The standard number of carats contained in a box varies depending on the quality of diamonds offered in the box. Within a box, the individual diamonds may vary widely by weight and other characteristics. All of our gem and near-gem diamonds are individually tracked by computer, and the placement of diamonds into boxes, and the collection of boxes into lots, is determined by this computerised tracking system. Each box is assigned a price based on the aggregate valuation of the diamonds within the box. See "– Sales of Rough and Polished Diamonds – Domestic Sales of Rough Diamonds". As part of this process we reserve up to US\$500 million of our gem and near-gem diamonds for inclusion in lots to be sold to De Beers. See "– Sales of Rough and Polished Diamonds – Export of Rough Diamonds". In addition, larger diamonds that we are required to sell either by domestic tender or to the Government of Russia are segregated. See "– Regulatory and Environmental Matters – Subsoil Licences".

The lots not assigned to De Beers are offered to domestic purchasers, and preferred customers are typically permitted to review these lots first. Representatives of prospective buyers inspect the boxes on offer, and each buyer generally has the right to reject up to 20 per cent. of the boxes within a lot for any reason. The price of the rejected boxes is then deducted from the total sales price of the lot. As more fully described in "– Sales of Rough and Polished Diamonds", boxes that are not sold on the domestic market are offered to De Beers and other export customers.

In addition to sorting, the United Selling Organisation performs additional services. These include arranging the transport of diamonds to purchasers and complying with customs requirements in connection with exported diamonds. The United Selling Organisation also maintains secure facilities in which representatives of De Beers and other diamond buyers can inspect the lots of diamonds being offered.

Historically, we have not maintained an inventory of diamonds other than technical rolling stock. However, due to the changing structure of our export sales and continued liberalisation of the domestic diamond market, we have begun to increase our inventory of high-quality

rough diamonds. We plan to increase this inventory by approximately US\$200 million over the next two to five years, which will permit us to improve the range and consistency of diamonds we can offer to domestic and international retail clients and to be less dependent on the quality of diamonds that we produce in a particular period. See “– Strategy”. Moreover, because several months can elapse between extraction of a diamond and its ultimate sale, we maintain a rolling stock of diamonds which are in the process of being sorted, valued and distributed.

The diamonds extracted from the Catoca mine are sorted by Catoca Mining Ltd. in Angola.

Sales of Rough and Polished Diamonds

The sales figures provided in this section “Sales of Rough and Polished Diamonds” are presented on an historical rather than on an inflation-adjusted basis.

Sales of Rough Diamonds

Our rough diamonds (including gem, near-gem and industrial diamonds) are primarily sold in one of the following ways:

- *Exports through De Beers:* In 2003 and during the six-month period ended 30 June 2004, exports through De Beers accounted for 34.4 per cent. and 25.0 per cent., respectively, of our total diamond sales. See “– Export of Rough Diamonds” below.
- *Open market export sales:* Starting from April 2003 we have engaged in export sales of rough diamonds on the open market. The total value of such sales was US\$110 million, or 6.4 per cent. of total rough diamond sales, in 2003 and US\$165 million, or 15.7 per cent. of total rough diamond sales, during the first six months of 2004. These figures do not include sales within the CIS. We expect that the volume of our export sales outside DeBeers will continue to increase as we develop and implement our sales and marketing strategy. See “– Strategy – Develop and implement our sales and marketing strategy”.
- *Exports through Almaziuvelirexport:* We are required by law to withhold from our lot sales to De Beers “representative control parcels” equivalent to 5 per cent. of such sales, by value. These control parcels of rough diamonds are sold outside of Russia by Almaziuvelirexport as our agent, less a 1.5 per cent. commission. Sales of these control parcels enable the Government of Russia to verify whether the prices paid to us by De Beers for rough diamonds are representative of market prices. The De Beers Trade Agreement allows us to withhold these representative control parcels, which are not counted as part of the export quota and do not affect the total annual volume of trade between us and De Beers.
- *Sales within Russia and to CIS:* 50.3 per cent. of total diamond sales in 2003, amounting to US\$927 million, and 50 per cent. of total diamond sales for the six-month period ended 30 June 2004, amounting to US\$559 million, were made to domestic purchasers, primarily Russian cutting and polishing companies that process the diamonds for use in jewellery, as well as to customers within the CIS. In addition, we are required to sell diamonds having a weight of 10.8 carats or more only through auctions held within Russia in accordance with rules and procedures established by the Government of Russia, except for those stones sold by Gokhran and polished by Brillianty ALROSA. See “– Domestic Sales of Rough Diamonds” below. The Government of Russia and the Government of Yakutia have the right to acquire diamonds from us, including all rare diamonds having “special gemological qualities” as determined by the Ministry of Finance of Russia, at agreed market prices pursuant to the Lease Agreement and the licences under which we operate. See “– Regulatory and Environmental Matters – Lease Agreement”.

We had no sales of rough diamonds to Yakutia or Russia in 2001 and 2002. In the fourth quarter of 2003 the Government of Russia resumed purchases of rough diamonds from us. The division of our rough diamond production between the domestic and export sales channels is driven to a large extent by domestic demand. In practice, as part of our sorting process we set aside for our sales to De Beers up to US\$500 million of our total production of gem and near-gem diamonds, excluding diamonds having a weight equal to or more than 10.8 carats, which must be sold through an auction process within Russia. The remaining diamonds are offered to domestic purchasers and, to the extent that these diamonds remain unsold on the Russian market, they are sold to other export customers and, to the extent they remain unsold, to De Beers. As described below in “– Domestic Sales of Rough Diamonds”, we

attempt to manage domestic demand to achieve prices for our diamonds that are not less than the prices established according to the De Beers Trade Agreement.

- *Sales of Industrial Diamonds:* We have historically conducted our export sales of industrial diamonds almost exclusively through Almaziuvelirexport, a jewellery exporter owned by the Government of Russia. We sold industrial diamonds with an aggregate value of US\$10 million and US\$5 million in 2003 and during the six-month period ended 30 June 2004, respectively. See “– Sales of Industrial Diamonds” below. Under the 2002 Decree, we are now authorised to directly sell our industrial diamonds to purchasers outside Russia and are no longer required to conduct such sales through Almaziuvelirexport, and we are considering plans to directly market these stones. However, we are gradually reducing production of industrial diamonds due to the inefficiency of extracting such diamonds during ore processing and the relatively low margins associated with their sale (industrial diamonds contribute about 1 per cent. of our revenues). As a result, our sales of industrial diamonds may decline in the future.

Sales of Polished Diamonds through Brillianty ALROSA

We also cut and polish some of our rough diamond production through our Brillianty ALROSA division, and to a lesser extent through subsidiaries, and sell these stones as finished diamonds. Our sales of polished diamonds were US\$124 million in 2003, and US\$65 million for the six-month period ended 30 June 2004. See “– Sales of Polished Diamonds” below.

We have established representative offices in London, England; Luanda, Angola; Ramat-Gan, Israel; and Antwerp, Belgium. We established these offices to maintain a presence in the important jurisdictions involved in the diamond trade, particularly Belgium, where the world’s largest diamond exchange is located. These offices conduct diamond market research, maintain business contacts with local diamond authorities and organisations and conduct marketing and advertising activities for our benefit. In addition, the representative offices cooperate with local media on matters relating to our operations. In anticipation of the liberalisation of the Russian diamond market, our office in Antwerp, Belgium has made experimental purchases and sales of diamonds.

Export of Rough Diamonds

In the past, we were the only company authorised to export rough diamonds, other than the Government of Russia-owned Almaziuvelirexport. However, the 2002 Decree, which became effective on 6 February 2003, authorised all diamond mining enterprises to export their production, subject to restrictions on sales of large and rare diamonds. See “– Regulatory and Environmental Matters – Subsoil Licences” and “Industry Overview – Liberalisation of the Russian Diamond Market”. Currently, the only other diamond mining companies with the right to mine diamond pipes within Russia are our majority-owned subsidiaries Severalmaz and ALROSA-Nyurba. Only three companies that are not members of our consolidated group, Ural-Almaz, Verkhnelenskaya Company and Nizhnelenskaya Company, mine diamonds in Russia from alluvial deposits, producing in the aggregate less than 2 per cent. of our diamond output in terms of both volume and value. In addition, Canada’s ADC and Russia’s LUKOIL and its subsidiary Arkhangelskgeologodobycha are currently engaged in a dispute over the rights to the licence to mine the Verhotinskoye diamond deposit in the Archangelsk region. In addition, the 2002 Decree authorises diamond-cutting entities to export up to 15 per cent., by value, of the rough diamonds they purchase in any year from Russian diamond mining companies or from the Government of Russia’s diamond stocks, provided that (i) the diamonds had been offered for sale on the domestic market and were not sold within 10 business days and (ii) the export sale price is at least as high as the price at which the diamonds were offered on the domestic market.

The maximum amount of diamonds that we can export each year, by carat volume, is determined pursuant to a periodic export quota set by the Government of Russia. By law, the quota for each period is issued one month prior to the end of the prior period, although, in practice, there may be delays. Historically, we have been granted annual quotas. However, the 2002 Decree authorised the Government of Russia to grant multi-year quotas of up to five years, and in February 2003 we were granted a five-year quota for the export of diamonds, under which we may export annually up to US\$1.3 billion of diamonds (based on current market prices). See “Industry Overview – Liberalisation of the Russian Diamond Market”. However, we may not export diamonds produced by our subsidiaries under our export quota and each of our subsidiaries is required to receive its own export quota and licence. See “Risk

Factors – Risks Related to Our Business – Failure or delay in obtaining separate export quotas and export licences by our subsidiaries could negatively affect domestic prices, force us to revise our financial forecasts and negatively affect our results of operations”. The quota amounts, as expressed in carats, are protected as state secrets, and are therefore not disclosed. See “Risk Factors – Risks Related to Our Business – We are prohibited from disclosing our Russian diamond reserves and other information which may be considered material by investors”. Exports of rough diamonds are subject to a customs duty of 6.5 per cent., calculated on value as stated in the relevant export contract.

Pursuant to the 2002 Decree, we must obtain a certificate from the Government of Russia confirming the origin of the rough diamonds we export. This regulation represents the implementation in Russia of the Kimberley Process, a self-regulatory system devised by the World Diamond Council and the United Nations which relies on certificates of origin in an attempt to eliminate trading in “conflict diamonds”, the name ascribed to diamonds which are extracted in war-torn regions and sold by rebel forces to fund insurrection.

Historically, we have relied on De Beers for the export of our rough gem and near-gem diamonds. In the past our export licence agreements required us to make our export sales through De Beers; however, as described below, pursuant to the 2002 Decree, which became effective in February 2003, export restrictions requiring sales through De Beers have been abolished, which allowed us to test the market by making export sales to other customers in 2003. Our sales to De Beers were US\$635 million in 2003 and US\$279 million for the six-month period ended 30 June 2004. Export sales to customers other than De Beers (not including sales within the CIS) were US\$110 million in 2003 and US\$165 million for the six-month period ended 30 June 2004. In 2001 and 2002 sales to De Beers were US\$868 million and US\$677 million, respectively. De Beers resells the diamonds that it purchases from us on the world market through the Diamond Trading Company.

On 17 December 2001, we entered into the new five-year De Beers Trade Agreement. Under the De Beers Trade Agreement, we have agreed to sell, and De Beers has agreed to buy, each year, a maximum of US\$800 million in value of our current production of natural rough diamonds. The prices paid by De Beers for our rough diamonds under the agreement are based on a schedule of prices agreed by the parties, which they may agree to amend from time to time. Payment for diamonds is made at the time of shipment, and the cost of transportation of diamonds from our Moscow facilities, including the cost of insurance, is the responsibility of De Beers. Sorting of diamonds under the De Beers Trade Agreement is performed by representatives of both parties based on agreed samples taken from the shipments. Either party can terminate the agreement if they are unable to resolve a disagreement as to sorting relating to more than 5 per cent. of the total value of a shipment or if there is a material breach of the terms of the agreement.

We are required by law to withhold from our lot sales to De Beers “representative control parcels” equivalent to 5 per cent. of such sales, by value. These control parcels of rough diamonds are sold outside of Russia by Almaziuvelirexport as our agent, less a 1.5 per cent. commission. Sales of these control parcels enable the Government of Russia to verify whether the prices paid to us by De Beers for rough diamonds are representative of market prices. The De Beers Trade Agreement allows us to withhold these representative control parcels, which are not counted as part of the export quota and do not affect the total annual volume of trade between us and De Beers.

In anticipation of the 2002 Decree, the De Beers Trade Agreement also contains a provision allowing us to export up to 15 per cent. of our production, in addition to the 5 per cent. control parcels, through channels other than De Beers in the event that we are allowed to do so pursuant to the adoption of a decree on market liberalisation. Although the 2002 Decree, which was adopted after the execution of the De Beers Trade Agreement, eliminated the requirement that we export our rough gem and near-gem diamonds solely through De Beers, we intend to continue to sell a portion of our exports of rough diamonds through De Beers. We also plan to export greater volumes of our diamonds than the percentage of our production specified in the De Beers Trade Agreement and we are decreasing the portion of our diamonds that we export through De Beers. See “Industry Overview – Liberalisation of the Russian Diamond Market”.

Although we entered into the De Beers Trade Agreement on 17 December 2001, that agreement will only become effective if and when we receive confirmation from the Directorate-General that the agreement is consistent with the provisions of the Treaty of the European Communities. The Directorate-General is continuing its investigation into the impact of the De Beers Trade Agreement, and in January 2003 it issued a Statement of Objections which sets forth its initial objections to the implementation of the De Beers Trade Agreement. In view of the Statement of Objections, we can offer no assurance that the De Beers Trade Agreement will be approved on terms acceptable to us, or that it will be approved by the European Commission in any form. Pending the outcome of the investigation, we have been selling diamonds to De Beers on the basis of ad hoc written agreements, negotiated with respect to each separate shipment. However, we cannot guarantee that an adverse decision by the Directorate-General will permit us to continue to engage in such ad hoc agreements with De Beers. See "Risk Factors – Risks Related to Our Business – We are dependent on De Beers for the distribution of our diamonds outside of the Commonwealth of Independent States", "Risk Factors – Risks Related to Our Business – The De Beers Trade Agreement has been challenged by the European Commission's Directorate-General for Competition and at least some limitation on our sales to De Beers is likely in the coming months. A final decision or settlement requiring an overly rapid or extensive reduction or a termination of our sales to De Beers could have an adverse impact on our sales, operating results and financial condition" and "Risk Factors – Risks Related to Our Business – The announcement of a European Commission decision or settlement requiring a significant reduction or termination of sales to De Beers may have an adverse impact on the market price of the Notes". We expect the European Commission to make a decision regarding the De Beers Trade Agreement within the next several months. See "– Strategy".

Domestic Sales of Rough Diamonds

In 2003 and for the six-month period ended 30 June 2004, we sold US\$927 million and US\$559 million, respectively, of our rough diamonds (including gem, near-gem and industrial diamonds) to domestic purchasers, which includes all purchasers within the CIS. In 2001 and 2002, such sales were US\$687 million and US\$831 million, respectively.

Our domestic sales are primarily made to Russian cutting and polishing companies. We believe that we supply the vast majority of diamonds purchased by these companies. We believe this is partly due to the fact that VAT would apply to the purchase of rough diamonds from sources outside of Russia, which would significantly reduce the margins that these companies could achieve by polishing imported diamonds. Other factors include price disparities between the domestic market and the international market.

Domestic polishing companies specialise in the production of "Russian cut" diamonds. This is a relatively high-quality cut, which requires diamonds of a sufficient size and of sufficiently high quality. However, as an emerging market, Russia consumes mainly lower-value diamonds, including substantial imports from India which dominates the market for polishing smaller, lower-quality diamonds. As a result, the Russian cutting and polishing industry mainly produces polished diamonds for export. We believe that, except for a small number of companies, Russian cutting and polishing operations have minimal working capital, and generally perform work based on advances provided by large diamond companies outside of Russia.

Although there are approximately 130 cutting and polishing facilities registered with the Ministry of Finance of the Russian Federation, the domestic industry is dominated by, and our largest customers are:

- *Smolensk Kristall*: This is one of the largest polishing operations in the world with approximately 900 polishers. Smolensk Kristall is controlled by the Government of Russia but may be privatised in the future. See "Risk Factors – Risks Related to Our Business – One of our largest domestic customers may be privatised".
- *Tuymaada Group in Yakutsk*: This group is estimated to have over 500 polishers. We own approximately 12.7 per cent. of the Tuymaada Group.
- *Ruiz Diamond in Moscow*: This facility is controlled by Lev Liviev of Israel.
- *Brillianty ALROSA in Moscow*: Brillianty ALROSA is our branch. It operates a facility with approximately 250 polishers, and it has a long-term contract with Kristall, a polishing

company in Barnaul ("Barnaul Kristall") with an additional 188 polishers as of 30 June 2004, who polish diamonds for our account.

We maintain an approved list of cutters and polishers to whom we sell diamonds. Diamond polishers may be added to this list, upon request, following our review of their standing in the industry. In general, our larger, established customers have priority in selecting diamond lots for purchase.

We offer our full range of gem and near-gem rough diamond production to the domestic market, with the exception of up to US\$500 million of our production which is initially set aside for sale to De Beers and rare diamonds which may only be sold to Russia. The prices at which we sell diamonds on the domestic market are established by us with reference to the Price List maintained by the Ministry of Finance of Russia. However, we make adjustments to the prices specified in the Price List by establishing correction factors by which the Price List figures are multiplied. Based upon changes in market conditions, our marketing department periodically suggests new correction factors, which may be made effective by order of our president. The correction factor system helps us to react promptly to changes in the domestic rough diamond market, as it often takes one to three months for these changes to be reflected in an updated Price List.

In setting these correction factors, our objective is to manage the allocation between the domestic and export markets so that the prices we receive domestically are not less than the prices we could receive from sales to De Beers and on the export market. Our correction factors include a premium for diamonds which are in demand among Russian polishers. By participating in the Russian polishing industry through Brillianty ALROSA, we are better able to assess this demand and to seek higher overall domestic prices. We estimate that the capacity of Russian diamond polishers is greater than the amount of diamonds that we supply to the domestic market.

We believe that, even where our domestic prices contain a premium over the prices at which we sell diamonds to De Beers, our domestic prices generally are lower than the prices of other potential suppliers to Russian polishers, including the Diamond Trading Company's and international prices. Diamonds which remain unsold on the domestic market and on the export market are offered to De Beers, which then seeks to resell these diamonds at a higher price through the Diamond Trading Company.

We are required by law to conduct auctions within Russia for the sale of diamonds weighing 10.8 carats or more, except for stones of special gemological interest which can only be sold to Gokhran and those stones sold by Gokhran and polished by Brillianty ALROSA. See "– Regulatory and Environmental Matters – Subsoil Licences". Diamonds weighing at least 10.8 carats account for approximately 3 per cent. of our total production, by value, and less than 1 per cent. in carats. As an initial matter, we must obtain administrative approval to commence each auction process relating to diamonds weighing at least 10.8 carats. This approval is granted routinely, and its purpose is to confirm that the diamonds being auctioned are not gems of special gemological interest. See "– Sales of Rough Diamonds to Russia and Yakutia". At these auctions, diamonds are sold to the highest bidder. The main participants in these auctions have been the large Russian polishing companies, including Smolensk Kristall, which polish these rough diamonds on behalf of foreign companies. However, as a result of the 2002 Decree, non-Russian persons and entities are now authorised to participate in our auctions of rough diamonds weighing 10.8 carats or more and to export such diamonds, so long as the purchase price is above the minimum price set by us and by the Ministry of Finance of Russia in its Price List. See "Industry Overview – Liberalisation of the Russian Diamond Market".

Also as a result of the 2002 Decree, Russian diamond-cutting entities may export up to 15 per cent., by value, of the rough diamonds they purchase in any year from Russian diamond-mining companies or from the Government of Russia's stocks, subject to certain conditions. See "Industry Overview – Liberalisation of the Russian Diamond Market". The customer base of Russian diamond cutting entities consists primarily of foreign customers.

Sales of Rough Diamonds to Russia and Yakutia

As described in "– Regulatory and Environmental Matters – Subsoil Licences", Russia has the right to purchase diamonds from us. Pursuant to the Federal Law of the Russian Federation No. 41-FZ "On Precious Metals and Precious Stones" dated 26 March 1998, as amended ("Law

on Precious Stones”), Russia has the right at any time to acquire any of our output of Russian diamonds. In addition, diamonds of special gemological interest can be sold only to Russia. These are diamonds that have characteristics which make them particularly rare, and they include all diamonds weighing more than 50 carats. Both of these rights require Russia to pay us the full market value of the diamonds to be purchased. This market price is agreed between us and Russia. It is expected that this price would generally reflect the prices set forth in the Price List. However, the Price List contains prices for diamonds only up to 10.79 carats.

Mathematical formulae approved by the Ministry of Finance of Russia are used to calculate a representative price for larger diamonds based on the size and other characteristics of these diamonds.

We had no sales of rough diamonds to Yakutia or Russia in 2001 and 2002. In the fourth quarter of 2003 the Government of Russia resumed purchases of rough diamonds from us, purchasing diamonds valued at US\$11.4 million in 2003 and US\$39.7 million in the six months ended 30 June 2004.

Sales of Polished Diamonds

We cut and polish some of our diamonds mainly through our branch, Brillianty ALROSA, and also through our subsidiary Orel-ALROSA. In 2003 and for the six-month period ended 30 June 2004, we sold US\$124 million and US\$65 million, respectively, of polished diamonds. This represented approximately 6.7 per cent. of our diamond sales for 2003 and 5.7 per cent. of our diamond sales for the six-month period ended 30 June 2004. In 2001 and 2002 our sales of polished diamonds were US\$134 million and US\$113 million, respectively. This represented approximately 8 per cent. and 7 per cent. of our total sales for 2001 and 2002, respectively. For 2002 and 2003 our total expenses relating to polishing diamonds through Brillianty ALROSA were RUB282 million (US\$9.7 million) and RUB259 million (US\$8.9 million), respectively, not including the cost of the rough diamonds which were polished. For the six-month period ended 30 June 2004, these expenses were RUB134 million (US\$4.6 million). We primarily sell our polished diamonds to jewellery companies and diamond-trading firms located outside Russia.

Our cutting and polishing operations are ancillary to our main business of producing rough diamonds. However, we believe that maintaining these polishing operations provides several significant benefits. By polishing a portion of our production, we limit the supply of rough diamonds available to the domestic market, which we believe has a positive effect on domestic rough diamond prices. Brillianty ALROSA also helps us to understand the domestic polishing industry and to better assess domestic demand.

Brillianty ALROSA cuts and polishes diamonds at our Moscow polishing facility, which is located in premises leased from Almazny Mir Company. As of 30 June 2004, Brillianty ALROSA employed approximately 238 polishers. In addition, we have a long-term contract with Barnaul Kristall, a company that had 188 polishers as of 30 June 2004, which polishes diamonds for our account.

We have recently upgraded our Moscow polishing facility. In the future we may consider increasing our cutting and polishing capacity further, either through additional expansion or the acquisition of other established polishing operations.

We are also considering the spin-off of Brillianty ALROSA into a separate subsidiary. We believe that this separation would allow Brillianty ALROSA to compete more effectively. In particular, if Brillianty ALROSA were a separate subsidiary, it would be able to tender for diamonds weighing 10.8 carats or more that we sell by tender within Russia in accordance with Russian law. See “– Regulatory and Environmental Matters – Subsoil Licences”. We believe that being able to cut and polish these larger stones would enhance the reputation of Brillianty ALROSA and assist it in building a brand identity. See “Risk Factors – Risks Related to Our Business – Our activities with respect to diamond cutting and polishing subject us to additional risks which may increase in the future”.

Brillianty ALROSA maintains a small inventory of cut diamonds awaiting sale, which was valued at approximately US\$6 million as of 30 June 2004.

Sales of Industrial Diamonds

For the years 2001, 2002 and 2003, direct sales of industrial diamonds, including sales through Almaziuvelirexport without the application of inflationary accounting, amounted to US\$8 million, US\$7 million and US\$10 million, respectively. Such sales for the six-month period ended 30 June 2004 were US\$5 million. In addition, we are engaged, to a limited extent, in the production and sale of industrial diamond-related products. These include diamond tools for medical use produced by our subsidiary EPL Diamond.

Diamond Reserves

Historically, we have estimated our diamond reserves by the use of mapping, drilling, sampling and evaluation methods consistent with standard Russian methodology, which differs from international practice in certain respects. For a description of these differences, see "Industry Overview – Calculation of Diamond Reserves". Accordingly, our proven and probable reserve figures may not be comparable to similarly titled measures of other mining companies.

We are prohibited under Russian law from disclosing information concerning diamond reserves located in Russia, including the grade of deposits and production volume in carats. See "Risk Factors – Risks Related to Our Business – We are prohibited from disclosing our Russian diamond reserves and other information which may be considered material by investors". However, as certified by the Russian Federal Geological Fund of the Ministry of Natural Resources of Russia, the proven diamond reserves of categories B and C₁ (see "Industry Overview – Calculation of Diamond Reserves") are sufficient to permit mining of diamonds until 31 December 2029 in an annual average volume that is not less than the volume of diamonds produced during 2003. The Ministry of Finance of Russia has certified that our proven reserves of natural diamonds (categories A, B and C₁) are sufficient to permit mining of diamonds until 31 December 2028 in an annual average volume that is not less than the volume of diamonds produced during 2003. The Russian Federal Geological Fund of the Ministry of Natural Resources of Russia also confirmed that the average quality of diamonds to be mined in each of the next 25 years will not be materially less than the average quality of the diamonds that we mined during the year ended 31 December 2003. See "Appendix A – Certification of Diamond Deposits".

Information and statements set forth in the preceding paragraph are included herein as public official statements made on the authority of the Ministries. The Notes have not been guaranteed by Russia, the Ministries or any other agency or political subdivision of Russia, and do not represent obligations of any such body.

In addition to physical reserves, calculated as the aggregate amount of carats underground, we track each mine's reserves by the realisable value of its deposits. This calculation is based on the physical reserves figure in carats, determined in accordance with Russian geological practice as described in "Industry Overview – Calculation of Diamond Reserves", and the projected average per carat value of the diamonds within the deposit. The average per carat value is determined by the Ministry of Finance of Russia, the technical committee of the Ministry of Natural Resources of Russia and Gokhran, based on their analysis of a representative sample of diamonds extracted from the deposit and by reference to the prices set forth in the Price List.

The calculation of the realisable value of reserves is necessary in order to obtain a certification of reserves from the Ministry of Natural Resources of Russia. To obtain a licence for the extraction of these reserves, we first prepare a report for submission to the Ministry of Natural Resources of Russia, which includes an analysis of the deposit's physical reserves, taking into account the geological, mining and technological conditions of the relevant site and a feasibility study. The report must be prepared in accordance with special instructions adopted by the Ministry of Natural Resources of Russia, and it includes a business case analysis for the deposit utilising the realisable value of the deposit's proven reserves (categories A, B and C₁, as described in "Industry Overview – Calculation of Diamond Reserves"). The business case analysis indicates projected future revenues and expenses, based on the measurement of the reserves, and utilises a six-year amortisation of assets and other parameters. The report is submitted to the Ministry of Natural Resources of Russia, which reviews it for accuracy and retains independent experts to physically verify the determination of proven reserves. If necessary, the Ministry of Natural Resources of Russia will prepare and submit to us a list of objections and request additional information relating to the report. Following the issuance

of a statement of objections, a working group is assembled to discuss issues relating to the report. The working group includes our representatives and representatives from the Ministry of Natural Resources of Russia, and may include the independent experts who reviewed our report and members of a relevant scientific institute. The working group's proposals for the resolution of the issues identified in the statement of objections is then submitted to a general meeting of the Ministry of Natural Resources of Russia. The general meeting can approve or amend the resolutions of the working group, and certify the reserve figures by majority vote of the officers of the Ministry of Natural Resources of Russia. To be certified, it must be demonstrated that reserves are sufficient to support production for at least 25 years. The decision of the Ministry of Natural Resources of Russia with respect to the certification of reserves is final. However, we can request that the Ministry of Natural Resources of Russia reconsider a determination in the event there is a change in circumstances relating to the reserves, such as a change in market prices or projected mining costs. A change may also result from our reclassification of some of the deposit's probable reserves as proven reserves due to changes in our ability to extract the reserves.

Our mining licences are typically granted for a period of 13 to 25 years. However, some of these licences require periodic review and confirmation of reserves within the relevant diamond pipes, as a condition to continued mining under the licences. We are currently confirming the reserves of the Jubilee mine, and the shape of the Jubilee diamond pipe, to the Ministry of Natural Resources of Russia under the relevant licence. Our mining licences generally may be revoked if we are deemed to have materially breached environmental laws or failed to exploit the relevant diamond deposit by mining in a technically inefficient manner. None of our mining licences has been revoked.

Our Moscow-based analytical department monitors world rough diamond prices, and periodically recalculates the realisable value of our reserves based on new price levels. We are required to submit a report of our reserves to the Ministry of Natural Resources of Russia each year. In connection with an application for renewal of any of our licences, it may be determined that the relevant diamond deposit is no longer economically viable, in which case the Government of Russia could refuse to renew our licences with respect to such deposit. At no time have any of our mines been found, as a consequence of a recalculation of the realisable value of their reserves (including the recalculation relating to the severe decline in world market prices for rough diamonds following the events of 11 September 2001 in the United States, when such prices fell by more than 14 per cent.), to be unable to support further production. However, we cannot provide any assurance as to the effect of any severe decline in world market prices of rough diamonds in the future. See "Risk Factors – Risks Related to Our Business – Our business is particularly susceptible to fluctuations in diamond prices".

Exploration and Development

Exploration Activities

In Russia, as in most other diamond-producing regions of the world, the majority of diamond reserves are found in primary deposits. We estimate that there are nearly 700 diamond pipes in Yakutia. A significant number of deposits are also located in the Arkhangelsk region, and a very small number of deposits are located within the Perm region. However, only a small portion of these deposits could be mined profitably. We believe that the vast majority of the major commercially attractive deposits in Russia are located within Yakutia.

We constantly seek to increase our Russian reserves through the utilisation of underground mining at mature diamond pipes that have been excavated to a depth at which open-pit mining is no longer economically feasible, such as the International and Aikhal mines; exploitation of primary diamond deposits and diamond-bearing placer deposits; and growth of reserves through the addition of newly discovered diamond deposits. We conduct exploration on the basis of state licences issued by the Ministry of Natural Resources of Russia on an auction basis. See "– Regulatory and Environmental Matters – Subsoil Licences". Our exploration activities are currently concentrated primarily in the Nyurba region, as well as and around the Mirny, Aikhal, and Udachny regions. We also conduct exploration activities in the Arkhangelsk region.

We employ a number of techniques to locate new deposits. These include surveys of the tectonic characteristics of regions to identify conditions suitable for the formation of

diamonds, as well as the identification of minerals which are usually found near diamond pipes. We maintain three exploratory expeditions, located in Mirny (approximately 1,500 employees), Udachny/Aikhal (approximately 1,100 employees) and Arkhangelsk (approximately 400 employees). Our geological service consists of a research facility that carries out research work using its own resources and cooperates with other Russian geological surveys centres. We incurred expenses of RUB843 million (US\$29.0 million) in the six months ended 30 June 2004 with respect to our geological prospecting activities. In 2002 and 2003, our expenditures on exploration were RUB1.1 billion (US\$37.9 million) and RUB1.3 billion (US\$44.8 million), respectively.

Diamond exploration is a capital-intensive undertaking that involves many risks and we can give no assurances that any of our new or ongoing exploration programmes will result in additional diamond-producing operations.

Research and Development

Our research and development division, YakutNiproAlmaz, has principal responsibility for research as well as for designing and implementing research and development projects and creating long-term plans for production processes. Our research and development focuses primarily on mining, ore treatment, automation of production processes, reserves forecasts and environmental control. These projects focus on efficiency improvements, decreasing costs and improving diamond yield. The Institute has considerable expertise in operations involving permafrost ground. Its recent activities include:

- the improvement of techniques to develop open pits with steeply pitched walls, which reduce expenses by requiring the removal of less overburden;
- work on techniques to reduce damage to the natural qualities of diamonds resulting from extraction and ore dressing;
- the development of techniques of water-free (dry) dressing of ore containing a very low diamond content, which may be efficient in developing certain deposits;
- work on techniques relying on new physical methods to regulate and stabilise the physical and chemical properties of flush water in ore dressing processes; and
- improvement of methods and techniques to extract diamonds using radiometric separation.

Including its work in Angola, over the last 40 years the Institute has prepared 18 mines and processing plants, as well as all the towns and settlements surrounding our operations.

The Institute is located in Mirny, with a branch in St. Petersburg, and another branch is being established in Novosibirsk. As of 30 June 2004, the Institute had 671 employees, 14 of whom held doctoral degrees in technical sciences. From time to time the Institute also subcontracts work to up to 50 subcontractors a year, including the various institutes of the Russian Academy of Sciences. In 2003, we incurred expenses of RUB157.8 million (US\$5.4 million) relating to scientific research and RUB456 million (US\$15.7 million) on project works and permafrost surveys. For the six-month period ended 30 June 2004, we incurred expenses of RUB48.7 million (US\$1.7 million) relating to scientific research and RUB173.6 million (US\$6.0 million) on project works and permafrost surveys.

Recently the Institute entered into a five-year cooperation agreement with De Beers to share technologies and to jointly research issues of interest to both parties. The Institute holds a number of patents, including seven foreign patents.

Supporting Operations

Transportation of Supplies and Resources

Materials and supplies used in our mining operation are shipped by rail to the river port at Osetrovo, then transported by the River Lena to our port at Lensk and delivered to the mines by truck. During the river navigation season, which lasts from May through September, the volume of cargo (600,000 to 800,000 tonnes) is shipped by river. Mirny, Aikhal and Udachny can be reached from Lensk by means of a year-round gravel road and a network of winter motor roads running in frozen river beds. Urgent cargoes are delivered by air transport, with airports located in Mirny, Vitim, Lensk, Aikhal, Polyarny and Saskylakh. Equipment from Asia generally comes via sea to Vladivostok, then by air. We transport approximately half of our

supplies by river on our own vessels, and we generally use our own aircraft for the transportation of goods by air.

Supply of Energy and Water

The provision of fuel and energy is essential to our mining operations. Fuel and energy costs represented 15.5 per cent. of our total cost of sales in 2003 and approximately 17.0 per cent. for the six-month period ended 30 June 2004, in each case excluding payments made under our Lease Agreement. Our operations use electricity, oil and natural gas. In addition, our mining operations use a substantial amount of water. In order to reduce our fuel and energy costs and to reduce our dependence on outside suppliers, we have engaged in a number of projects related to the supply of fuel, energy and water, which are described below.

- *Electricity:* In 2003, we used approximately 2.3 billion kilowatt hours of electricity, and approximately 1.3 billion kilowatt hours during the six-month period ended 30 June 2004. Over 55.7 million kilowatt hours used in 2003 were generated by our two diesel electric power plants, and we produced 41.0 million kilowatt hours in the six-month period ended 30 June 2004. Our remaining energy needs were supplied by Yakutskenergo, the regional power-generation and distribution company. Electricity is supplied to our operations over dedicated 110 kV and 220 kV power lines, with three 220 kV lines assigned to Aikhal and Udachny, two 220 kV lines to Mirny and two 110 kV lines to Lensk. We believe that the total supply of electricity within our power distribution area substantially exceeds our foreseeable needs.

We are currently completing a third hydroelectric station on the Vilyui River, which is expected to supply up to 27 million kilowatt hours of electricity in 2004, and up to 1.2 billion kilowatt hours of electricity by 2012, within the western power distribution province of Yakutia. This will supplement the existing hydroelectric plants owned by Yakutskenergo, the Yakutian energy utility, located in Chernyshevsky. In 2000 we purchased a 66 per cent. stake in Vilyuiskaya from Yakutskenergo for an aggregate consideration of RUB980 million (US\$33.8 million). In July 2003 we increased our stake in Vilyuiskaya to 71.5 per cent. at a cost of RUB730 million (US\$25.1 million) by purchasing newly issued shares of the company. In December 2003, we further increased our shareholding to 72.2 per cent. through an additional cash contribution of RUB114 million (US\$3.9 million). The first electricity generating unit at the hydroelectric power station began operating on 8 September 2004. We estimate the cost to complete the construction of the hydroelectric power station to be approximately RUB2,781 million (US\$95.8 million). We expect to complete the hydroelectric power station by 2010. We are currently working together with Yakutskenergo to create a joint venture to operate a power-generating facility for the western Yakutia power distribution province consisting of three hydroelectric power stations, the Mirny power plant and the existing power distribution companies. We have negotiated a non-binding letter of intent for this project, although the economic terms have not yet been agreed. We believe that the creation of this venture will increase the reliability of electricity supplies within western Yakutia, and reduce our usage charges and overall electricity costs.

- *Natural gas:* Our Mirny division makes extensive use of natural gas for the generation of heat and for its technological needs. Mirny has four operating natural gas heat-generation plants, supplying virtually all of its heating requirements. As part of our effort to ensure the reliability of power supplies to Aikhal and Udachny and to reduce heating costs in these areas, we began constructing a 500 kilometre natural gas pipeline in 1999 to link Mirny and Udachny. The gas pipeline is currently under construction, as are gas boiler houses in the towns of Aikhal and Udachny. We anticipate that our Aikhal division will begin using natural gas for its heating needs in 2004 and Udachny will begin using natural gas in 2006, upon completion of the pipeline to that city. We expect that the total cost of completion of the pipeline and the heat-generation plants in Aikhal and Udachny will be RUB1.2 billion (US\$41.3 million).

The natural gas we use is currently supplied to Mirny, and will be subsequently supplied to Aikhal and Udachny, from the Srednebotuobinsky Oil and Gas Condensate Field, located 140 kilometres from Mirny. This field has proven natural gas reserves of more than 80 billion cubic metres. Our majority-owned subsidiary, ALROSA-Gas, holds a licence to extract gas within a section of the field that has reserves of more than 17 billion cubic metres. We hold a 53 per cent. interest in ALROSA-Gas and Yakutia owns a 47 per cent. interest. In December 2002, we signed a non-binding memorandum of intention to sell our stake in ALROSA-Gas to

Gazprom. Although the basic economic terms are subject to agreement of the parties, the memorandum provides that we would be entitled to stable gas prices for the next 50 years, with inflation adjustments only. The sale of ALROSA-Gas would include the transfer of all of its gas pipelines connecting to the natural gas field. We intend to use the proceeds from the anticipated sale to finance capital expenditures. We have not yet begun negotiations with respect to the final terms of this sale, and, accordingly, we can give no assurance as to when this sale will be completed, if at all.

- *Oil:* Oil is used as fuel for gas boiler houses and furnaces in Aikhal and Lensk. The oil is supplied from the Irillyakh and Srednebotuobinsky Oil and Gas Condensate Fields. The Irillyakh Field, which has estimated reserves of more than 14 million tonnes, is operated by our wholly owned subsidiary, Irillyakhneft. In order to meet our needs for diesel fuel and petrol, the company acquired equipment for a refinery plant to be constructed near Mirny, with a design capacity to process 250,000 tonnes of crude oil per year. The crude oil to be used by the refinery will be supplied by the Irillyakh Field. The residual fuel (mazut) by-product of the refining process will be used in our boiler houses in Lensk and Aikhal. On 18 November 2003, we signed a non-binding protocol with Tasuryakhneftedobycha, an oil company operating in Yakutia, the Government of Yakutia, and Irillyakhneft, for the sale of equipment for the refinery plant to Tasuryakhneftedobycha. We intend to use the proceeds from the anticipated sale to finance capital expenditures. It is expected that under the final agreement we would be entitled to receive supplies of oil and oil products from the Srednebotuobinskoye and Irillyakh Fields at domestic Russian prices for the year 2003, fixed in US Dollars, for heating of the towns of Aikhal and Lensk. We have not yet completed the negotiations of the final terms of this sale, and, accordingly, we can give no assurance as to when this sale will be completed, if at all.

- *Water:* Drinking water used in our facilities and by the local communities surrounding our operations, as well as the water we use for our industrial and technological needs, is supplied from natural reservoirs. Aikhal has two fresh water reservoirs and each of Mirny and Udachny has one. Our ore-processing facilities recycle water, using fresh water only when necessary. In 2003 and the six-month period ended 30 June 2004, water intake from the reservoirs was approximately 37.6 million cubic metres and approximately 20.2 million cubic metres, respectively.

We continue to work to reduce our energy and water consumption. An example is our increasing use of frequency-regulated drives designed to conserve energy during start-up of heavy ore-processing equipment. At Ore Processing Plant No. 12, a drive has been installed on the primary conveyors and sediment machines and other mechanisms. Moreover, all of our newly-designed facilities are fitted with this type of drive. Some of our industrial facilities also have heating systems which use infrared electric irradiators and we are considering a gas-based system to heat the air supplied to underground mines. These devices are more energy efficient and we believe that they will reduce our energy costs.

Equipment Purchases

We purchase our vehicles and other mining equipment from a number of suppliers. These include Komatsu, Caterpillar and BelAZ for ore transport vehicles, and KrAZ, Maz of Belorussia, Volvo and Manesman for lorries and dump trucks. We purchase drilling equipment from Tamrock, Bumer, Voronezh and Karpin, and purchase milling equipment from Rockail of Japan, Svedala of Sweden, and the Syzran engineering plant of Russia. Purchases are made pursuant to individually negotiated agreements, and in 2003 we incurred expenses of RUB2.1 billion (US\$72.3 million) relating to purchases of plants, mining equipment and transport vehicles. During the six-month period ended 30 June 2004, we purchased plants, mining equipment and transport vehicles in the amount of approximately RUB1.2 billion (US\$41.3 million). Our US equipment purchases have been financed through credits received from the Export-Import Bank of the United States. See "Description of Existing Material Agreements – Material Financing Agreements".

We make our equipment purchases through a department responsible for purchases of materials and equipment, which attempts to obtain bulk purchase discounts where possible. We do not generally order custom-made equipment; however, the equipment we purchase is typically modified by the manufacturer to work in cold climates. All of our principal mining equipment must operate in temperatures as low as -50°C.

Maintenance of Equipment

All of our mining, transportation, technological and earthmoving equipment is maintained regularly according to a set schedule. All repair work is performed at facilities which service our Udachny, Aikhal and Mirny operations. As at 30 June 2004, these repair and maintenance facilities employed 1,327 persons. In order to carry out specialist repair operations, we retain independent repair contractors (pursuant to applicable safety requirements imposed by law). Repair and maintenance quality is supervised by the State Technical Supervisory Committee (Gostekhnadzor) and the State Technical Mining Supervisory Committee (Gosgortekhnadzor).

Regulatory and Environmental Matters

Subsoil Licences

The Government of Russia grants several types of subsoil use licences: licences for geological survey, licences for exploration and production and combined licences (for geological survey, exploration and production). The licensing regime for the use of subsoil for geological surveys, exploration and production of mineral resources is established primarily by the Subsoil Law and the regulations thereunder. Until January 2000, when important amendments to the Subsoil Law were introduced, geological survey licences were typically granted for up to five years, while production licences were granted for up to 20 years and licences for combined activities were granted for up to 25 years. Under the Subsoil Law, as currently in effect, the maximum term of a geological survey licence remains five years, while production licences may be issued for the useful life of the mineral reserves field, calculated on the basis of a feasibility study for exploration and production that ensures rational use and protection of the subsoil. Subsoil use licences may in certain circumstances be extended. The terms of subsoil use licences include conditions to the subsoil activities, subsoil plot borders, a defined licence term, deadlines for commencement of work/stages, terms and conditions of payment for use, agreed production levels and provisions regarding title to extracted production, title to geological data, environmental, subsoil protection and safety requirements, preparation of an abandonment plan and recultivation of land. Licencees also have to make payments for subsoil operations, one time and regular licence payments, payments for geological data, tender or auction participation fees and licence issuance fees, as well as a tax on production of mineral resources. A tax on production of mineral resources is levied with regard to diamonds and other precious stones in an amount equal to 8 per cent. of the value of production. A licence recipient is also usually granted rights to use the land surrounding the licence area.

Important amendments to the Subsoil Law, passed in August 2004 (the "2004 Amendments"), significantly changed the procedure for awarding exploration and production licences, in particular abolishing the joint grant of licences by federal and regional authorities. Under the 2004 Amendments, production licences and combined exploration and production licences are awarded by tender or auction conducted by the Ministry of Natural Resources of Russia. While the auction or tender commission may include a representative of the relevant region, the separate approval of regional authorities is no longer required in order to issue subsoil licences. The winning bidder is expected to submit the most technically competent, financially attractive and environmentally sound proposal that meets published tender terms and conditions. Licences for exploration and production may also be issued without the holding of an auction or tender to holders of geological survey licences that discover mineral resource deposits through exploration work conducted at their own expense. Regional authorities may issue production licences in respect of "subsoil areas of local significance" and for "common" mineral resources, such as clay, sand or limestone.

Licensing agreements for subsoil use identify the terms and conditions for the use of the subsoil, the rights and obligations of the licensee and the manager of the subsoil plot and the level of payments. Prior to the 2004 Amendments, the relevant regional authority, the Ministry of Natural Resources of Russia and the licensee were each party to a licence agreement. Under the 2004 Amendments, it is expected that only the Ministry of Natural Resources of Russia and the licensee will be party to future licence agreements. Although most of the conditions set out in a licence are based on mandatory rules, a number of provisions in a licensing agreement are negotiated between the parties.

Licences may be transferred only under certain limited circumstances that are identified in the Subsoil Law, including the reorganisation or merger of the licence holder or in the event that

an initial licence holder transfers its licence to a legal entity in which it has at least a 50 per cent. ownership interest, provided that the transferee possesses the equipment and authorisations necessary to conduct the exploration or production activity that is covered by the transferred licence.

A licence holder has the right to develop and sell resources extracted from the licence area. Russia, however, retains ownership of all subsoil resources at all times.

The licences generally require the licence holder to make various commitments, including:

- extracting annually an agreed target amount of reserves;
- conducting agreed mining and other exploratory and development activities;
- protecting the ecology in the licence areas from damage;
- providing geological information and data to the relevant authorities;
- submitting on a regular basis formal progress reports to regional authorities; and
- making all obligatory payments when due.

Our mining licences are typically granted for a period of 13 to 25 years. However, some of these licences require periodic review and confirmation of reserves within the relevant diamond pipes as a condition to continued mining under the licences. We are currently confirming the reserves of the Jubilee mine, and the shape of the Jubilee diamond pipe, to the Ministry of Natural Resources under the relevant licence.

Article 10 of the Subsoil Law provides that a licence to use a licenced area may be extended at the initiative of the licence holder where the licence holder complies with the terms of the licence and where the development of the field requires completion or liquidation operations. We intend to extend our licences for each of our licence territories that are expected to continue to produce subsequent to the end of their current periods. However, in the event that the Government of Russia determines that we have not complied with the terms of one of our licences, it may not extend the licence upon the expiration of its current period.

Governmental authorities may undertake periodic reviews for ensuring compliance by subsoil licence users with the terms of their licences and applicable legislation. A licensee can be fined for failing to comply with the subsoil production licence and the subsoil production licence can be revoked, suspended or limited in certain circumstances, including:

- a breach or violation by the licensee of material terms and conditions of the licence;
- the repeated violation by the licensee of the subsoil regulations;
- the failure by the licensee to commence operations within a required period of time or to produce required volumes, both as specified in the licence;
- the occurrence of an emergency situation;
- upon the emergence of a direct threat to the life or health of people working or residing in the area affected by the operations under the licence;
- the liquidation of the licensee; and
- the non-submission of reporting data in accordance with the legislation.

None of our mining licences has ever been revoked or suspended.

Regulation of Diamond Sales

We have historically been required to obtain annually a new export licence which sets forth our export quota. However, the 2002 Decree authorised the grant of multi-year quotas of up to five years. In February 2003 ALROSA Ltd. received a five-year export quota for the export of diamonds, under which we may export annually up to US\$1.3 billion of diamonds (based on current market prices). We believe that this new five-year export quota will assist us in securing long-term financing. See “– Sales of Rough and Polished Diamonds – Export of Rough Diamonds” and “Risk Factors – Risks Related to Our Business – We are dependent on licences and quotas issued by the Government of Russia and the Government of Yakutia to conduct our business”. We will still be required to obtain annual export licences under this new five-year export quota. Our subsidiary ALROSA-Nyurba received a one year export quota and export licence in September of this year, which allows us to increase our export capacity. ALROSA-Nyurba will not fulfill the entire 2004 export quota and must procure a new export

quota and export licence for 2005 and the following periods. See “Risk Factors – Risks Related to Our Business – Failure or delay in obtaining separate export quotas and export licences by our subsidiaries could negatively affect domestic prices, force us to revise our financial forecasts and negatively affect our results of operations”.

Pursuant to the Law on Precious Stones, Russia is entitled at any time to acquire any part of our domestic output of diamonds at market prices as agreed between us and the Government of Russia. In addition, diamonds of special gemological interest can be sold only to Russia. These are diamonds that have characteristics which make them particularly rare, such as their colour, and they include all diamonds weighing more than 50 carats. See “– Sales of Rough and Polished Diamonds – Sales of Rough Diamonds to Russia and Yakutia”.

Resolution No. 233 also provides that diamonds of 10.8 carats or more must be sold on an auction basis within Russia, except for stones of special gemological interest which can only be sold to Gokhran and those stones purchased from Gokhran and polished by Brillianty ALROSA. See “– Sales of Rough and Polished Diamonds – Domestic Sales of Rough Diamonds”. In addition, it provides that Almaziuvelirexport is responsible for selling the representative control parcels of diamonds extracted from deliveries to De Beers for our account, less a commission of 1.5 per cent. Almaziuvelirexport is wholly owned by the Government of Russia. See “– Sales of Rough and Polished Diamonds – Export of Rough Diamonds”.

Lease Agreement

On 19 January 1993, we entered into the Lease Agreement, pursuant to which we lease production and non-production assets used by our predecessor entities in connection with their exploration and mining activities. Under the Lease Agreement we:

- lease the assets of Yakutalmaz, and companies comprising it, as well as other assets identified by the parties; and
- obtain the use of land, diamond deposits and minerals and other natural resources, including timber, which we require for our business.

Under the Lease Agreement, we are subject to annual royalty payments and other payments in connection with our use of mineral and water resources, the use of land and logging areas and the disposal and burial of waste. The current terms of the Lease Agreement, as amended in 2003, provide that we must make lease payments, including royalty and ecology fund payments but excluding extraction tax, to Yakutia in 2004 of RUB10,500 million (US\$361.7 million), inclusive of VAT. This figure includes RUB983 million (US\$33.9 million), which is to be contributed to the ecology fund for the mitigation of any environmental damage resulting from our operations and to promote the social and economic development of the nine regions of the “diamond-bearing province”. In addition, under applicable legislation, we pay taxes to Russia and Yakutia at the rates established by the Government of Russia and the Government of Yakutia, respectively, including:

- an extraction tax of 8 per cent. of the estimated value of diamonds extracted;
- a land use tax; and
- a tax in connection with the use of logging areas, conventional mineral deposits, associated minerals and water taken from natural reservoirs for industrial needs.

The laws of Russia provide for an exemption from mineral resources payments during an initial period of development of mineral deposits. We have been entitled to receive subsidies from Yakutia for our exploration activities in an amount equal to 1.5 per cent. of the amount we pay towards the recovery of mineral resources in Yakutia, which subsidies would be offset against our royalty payments to Yakutia. However, these subsidies were abolished in 2002.

The following table sets forth the expense incurred by us under the Lease Agreement, expressed in millions of Roubles including the non-recoverable component of VAT for the six months ended 30 June 2004 and for the years ended 31 December 2003, 2002 and 2001:

	For the six months ended 30 June 2004	For the year ended 31 December		
	2004	2003	2002	2001
	<i>(amounts in RUB millions)</i>			
Royalty payments	4,346	9,096	8,166	10,504
Ecology fund	460	856	734	983
Total	4,806	9,952	8,900	11,487

The principal economic terms of the Lease Agreement are subject to renegotiation every five years, with the next renegotiation scheduled to occur in 2006. However, the terms may be amended at any time by the parties. The terms have been amended seven times in the 10 years since the Lease Agreement became effective.

We are required to return the leased production assets and certain owned assets to Yakutia at the end of the lease term, unless we exercise a purchase option relating to these assets prior to the expiration of the term of the Lease Agreement. The mechanism for determining the value of the leased assets to be returned to Yakutia is currently being negotiated between us and Yakutia. As of 30 June 2004, the carrying value of the assets subject to the Lease Agreement was RUB15,594 million (US\$537.2 million), including owned assets valued at RUB5,600 million (US\$192.9 million).

Environmental Matters

As part of our mining operations, we use various chemicals and produce overburden and wastewater which could have a negative impact on wildlife and vegetation in adjacent areas if improperly discharged. In addition, we use hazardous materials, such as solvents, to clean, refurbish and maintain our equipment. Through Irilyakhneft, we are engaged in oil extraction and refining, and we dispense petroleum products from underground storage tanks on our sites. These and other activities are subject to various laws and regulations concerning environmental protection.

The mitigation of the ecological effects of mining on the environment in the Udachny and Mirny areas presents a particular challenge for us. Because the wastewater from these operations has a high salt content it cannot be discharged into the river system or onto the adjacent land. To address this problem, the Udachny and Mirny mines operate a system of underground storage of brines in the geological fractures of permafrost rock. We consider this method to be the most effective way to dispose of the mineralised water. In 1995 we engaged independent environmental consultants from the United States to conduct an environmental audit of the Udachny mine. On the basis of the consultants' analysis, we believe that our mining operations at Udachny satisfied all applicable environmental requirements.

We have adopted a long-term programme, guided by international standards, to address environmental concerns and follow a policy aimed at protecting water and air quality in order to minimise the impact of our activities on the local environment and to improve our employees' working conditions. Although we believe there are no existing material liabilities relating to non-compliance with environmental laws and regulations, there can be no assurance that there are no undiscovered potential liabilities or that future uses or conditions will not result in the imposition of environmental liability upon us or expose us to third-party actions. Furthermore, we can provide no assurance that changes in environmental regulations in the future will not require us to make significant capital expenditures to change our methods of disposal of hazardous materials or otherwise alter aspects of our operations. See "Risk Factors – Risks Related to Our Business – We may be subject to environmental liabilities".

Health and Safety

Mining is an inherently dangerous activity. As with any construction or excavation work, there is the general risk of accidents involving the heavy equipment, machines and structures used in the mining industry. In particular, each year we use approximately 20,000 tonnes of explosives which create additional dangers. Employees working above the site floor are subject to accidents involving falls and those below, to cave-ins. In addition, as the depth of our mine pits increases, a number of problems often arise, the principal one being the resulting reduction in natural ventilation and deterioration of air quality in the working zones of the pit. The air quality is affected by the exhaust gases from the large trucks used in the pit and the gaseous by-products of blasting. In addition, in open-pit mines sudden air temperature changes can lead to deep inversions of the atmosphere in the pit with the difference between the surface temperature and the lower-level temperature being as great as 10°C to 20°C, resulting in ventilation problems. See "Risk Factors – Risks Related to Our Business – We are subject to general mining risks".

Various Russian laws govern workplace safety. With respect to mining activities, the approval of the Russian Mining Supervisory Committee is required to commence any mining project. The Committee has the power to inspect facilities and wide powers to take remedial measures. These powers include ordering site closure and terminating the employment of violators. In the past five years, we have not had any serious accidents and the Mining Supervisory Committee has not taken any material action with respect to our operations.

We have instituted a general programme to improve worksite safety. As part of this programme, every mining employee certifies each calendar quarter his knowledge of our safety procedures.

Non-Mining Activities

Commercial and Ancillary Services

We operate a number of commercial businesses ancillary to, and for the benefit of, our mining operations and the surrounding communities. The primary purpose of these operations is to help us to reduce our operating costs. Although these businesses occasionally provide services to third parties, including local governments, the third party revenues are not material. These commercial businesses are described below.

- *Construction services:* As of 30 June 2004, we had 5,093 employees performing construction services. We maintain a construction division which is engaged in the construction and expansion of our mines. However, this division also performs ancillary work, such as constructing temporary housing for workers exploring or developing a mining deposit in a new region and maintaining the non-mining properties owned by us and our affiliates. The construction division was instrumental in rebuilding our port municipality of Lensk, which was severely damaged by flooding in 2001. As part of this effort, the division constructed a dam surrounding Lensk, which was designed to prevent future flooding. In addition, our construction subsidiary OAO Viluygesstroi provides construction services to us and to external customers. For the first six months of 2004, this subsidiary had total sales of RUB529.6 million (US\$18.2 million), including intercompany sales of RUB306 million (US\$10.5 million). In 2003, expenses related to work performed for us by our construction division amounted to RUB13.5 billion (US\$465.0 million). Expenditures for the six-month period ended 30 June 2004, were RUB5.8 billion (US\$199.8 million).
- *Transportation services:* We maintain a fleet of cargo ships and lorries, as well as aircraft designed to carry freight, in order to transport supplies and materials for our mining and other activities, including our construction division. The activities of the transportation division are coordinated by our Material Supply and Logistics Department. In 2003, we transported approximately 135 thousand tonnes of freight at a cost of RUB1 billion (US\$34.4 million), and in the six-month period ended 30 June 2004 we transported approximately 69 thousand tonnes at a cost of RUB0.4 billion (US\$13.8 million).
- *Agriculture and food supplies:* Through wholly owned subsidiaries, we operate retail food stores for the benefit of our employees in the cities in which we operate in Yakutia. We estimate that our stores supply approximately one-half of the food sold in those cities. In addition, we engage in agricultural operations which grow fresh produce in greenhouses to meet the needs of our employees within Yakutia.

- *Logging and timber production:* ALROSA-Lesprom, our subsidiary in which we hold an 82.5 per cent. interest, is engaged in the processing of timber within Yakutia. The timber products of ALROSA-Lesprom are intended primarily for use by our construction division, particularly for the construction of wooden temporary housing for workers engaged in the development of mines within newly settled areas of Yakutia. However, a small portion of the timber produced by ALROSA-Lesprom is sold to non-affiliated third parties.
- *Passenger air transport:* To support our transportation requirements, we have established our own airline as a division under the ALROSA name. This airline currently has 40 aircraft and operates regularly scheduled flights involving eight routes from Mirny and two routes from Polyarny. To support air travel in Yakutia we maintain small airports in Vitim, Lensk, Aikhal and Saskylakh. The airline division receives fees from third parties who use these airport facilities. In 2003 and in the six-month period ended 30 June 2004, the ALROSA airline transported 173,669 and 84,262 passengers, respectively.

Social Services

To support habitation and encourage employees to relocate to these mining areas, our predecessor entities created a complete local infrastructure in Mirny, Udachny, Aikhal and Lensk. Upon our formation, we assumed responsibility for these assets, which included hostels, residential houses, schools, hospitals, hotels, cultural centres and retail shops. In 2003 and for the six-month period ended 30 June 2004, we incurred expenses of RUB2,695 million (US\$92.8 million) and RUB1,118 million (US\$38.5 million), respectively, to support and maintain these assets, net of reimbursed expenses. We also incurred significant expense for charitable contributions.

By the end of 1996, we had transferred most of these social assets to the local authorities of Yakutia, and the transfer was effected by decree of the Government of Yakutia. Included in the transfer were all housing units built prior to 1993; these are considered to be State property as they were constructed during Soviet times. In addition, we transferred our interest in retail shops to majority-owned subsidiaries.

In 1999, we began negotiating with Yakutia for the transfer to Yakutia, in stages, all of our remaining social assets, which are primarily residential housing units, and also include sports complexes and cultural facilities, such as cinemas and theatres. This transfer has been substantially completed. However, we remain responsible for the maintenance of certain of these assets. In addition, to minimise its expected costs, Yakutia has required, as a condition to transfer, that we renovate and modernise the properties to be transferred.

As of 30 June 2004, we owned approximately 179,558 square metres of housing space. The houses and flats owned by us have been allocated to the employees of our structural divisions. Housing space is allocated to employees pursuant to a joint decision by us and our local trade union. Employees living in this housing do not pay rent, but are responsible for their utilities costs and maintenance payments. Utilities rates are established by Yakutia.

With respect to the properties which we lease to employees, we are obligated to pay the majority of the utilities costs. Work has proceeded to reduce our subsidy payments, but wage and salary levels in Yakutia are a stumbling block to any such measure.

In addition to housing, we also typically fund some maintenance of roads. Local municipalities and Yakutia generally finance the upkeep of roads. However, where there is a shortfall in budgeted funds, we have contributed in the past, and expect to continue to contribute to, maintenance expenses. We estimate that we finance approximately one-half of the maintenance costs of the roads within and connecting the cities of our operations in Yakutia.

Competition

The world diamond mining industry is highly concentrated, and the number of mining companies is limited by, among other things, the high capital costs required, the limited number of economically feasible mining sites and limited access to distribution channels. We believe that only four companies produce the majority of the world's diamond production: De Beers, ALROSA, Rio Tinto/Argyle and BHP Billiton. See "Industry Overview – Major Producers of Rough Diamonds". We expect that the number of diamond mining companies will continue to be limited due to high barriers to entry, including the high capital

costs involved and the limited access to licences or concessions to develop commercially feasible diamond deposits.

We are the second largest diamond mining company in the world, based on value of production. In 2003 we produced approximately 19.0 per cent. of the world's rough diamond output, measured as a multiple of average market prices. We believe that only the diamonds produced in Botswana are of a higher quality, on average, than the rough diamonds that we produce. Accordingly, we believe that the quality of our diamonds represents an important competitive advantage for our business.

Unlike commodity markets, competition in the world diamond market involves the system of common marketing. See "Industry Overview – Marketing and Role of the Diamond Trading Company". Through the Diamond Trading Company, the supply of diamonds is monitored and aggregated supply is matched to aggregated demand. In the past, by aggregating supply and demand, the Diamond Trading Company was able to create market efficiencies, with reduced price volatility and higher levels of output, which tended to promote relatively stable pricing. Our market analysis indicates that the Diamond Trading Company's price regulation was in line with global economic trends.

Demand for polished diamonds and, consequently, demand for rough diamonds, is positively affected by the Diamond Trading Company's access to global diamond production and its sorting policies, as a result of which it is able to offer a better range of diamonds to polishers internationally. Under normal circumstances, the Diamond Trading Company supplies approximately 60 per cent. to 65 per cent. of the world's rough gem diamonds. A significant portion of our diamonds not sold within the CIS are currently sold to De Beers and distributed through the Diamond Trading Company, although we are increasing the volume of our sales outside De Beers. See "– Strategy – Develop and implement our sales and marketing strategy" and "– Sales of Rough and Polished Diamonds – Sales of Rough Diamonds – Open market export sales".

Within Russia, we hold exclusive prospecting licences in numerous locations and, to date, no company other than ALROSA Ltd. and our majority-owned subsidiaries Severalmaz, and ALROSA-Nyurba, has been granted a licence to mine diamond pipes. Except for us, only three other companies in Russia, Ural-Almaz, Nizhnelenskaya Company and Verkhnelenskaya Company, have licences to mine diamonds from alluvial deposits, together producing less than 2 per cent. of our diamond output in terms of both volume and value.

Insurance

We use a specialist transport company, a division of the Russian Ministry of Communications, to transfer our diamonds by air from Mirny to Moscow. For domestic sales of gem and near-gem diamonds, the customer is generally required to assume the risk of transport of diamonds from our Moscow facilities. Similarly, our agreements with De Beers provide that De Beers is responsible for the risk of loss from the transport of diamonds from our Moscow premises.

We insure our diamond products, including all rough diamonds, against all types of risks during transportation from our mining operations in Yakutia to the customs warehouse in Moscow. Our total transportation insurance expense was RUB50 million (US\$1.7 million) in 2003 and RUB26.7 million (US\$0.9 million) for the six-month period ended 30 June 2004.

We also maintain general liability insurance in an amount that we believe is sufficient with respect to our mining operations. However, few of our operating assets are insured, and, in the case of assets which are insured, the insurance is generally insufficient to cover replacement costs. Accordingly, we can offer no assurance that we will not incur losses beyond the limits of, or outside the coverage of, our insurance policies. See "Risk Factors – Risks Related to Our Business – We could be subject to liabilities which are not covered by insurance".

We maintain carrier liability insurance with respect to our airline, and we insure our airplanes.

Financial Reporting and Information Management

ALROSA is comprised of 37 structural divisions, each responsible for our quarterly financial reporting. Divisions which account for nearly 99 per cent. of our revenues have been included in our integrated financial system, which allows real-time access to accounting information.

The remaining divisions report their quarterly figures to our central accounting department in Mirny via paper forms or electronic media, such as diskette. We expect to include these remaining divisions in the integrated system over the next year.

Properties

We currently have eight operational ore treatment plants, each located near one of our principal mining operations. The following table provides capacity and other information for each of these plants. Several of our older ore treatment plants have been closed or are used for experimental processing. The following table sets out information for the ore treatment plants currently utilised in production:

Processing ('000 tonnes, except where indicated otherwise)

Ore Treatment Plant	Year Built	Primary Mines Served	For the six months ended 30 June	For the year ended 31 December		
			2004	2003	2002	2001
No. 3.....	1966	International and alluvial gravel from Mirny.....	960	1,609	1,742	2,241
No. 5.....	1961	Alluvial gravel from Mirny ('000 m ³).....	123	450	451	402
No. 8.....	1966	Aikhal and Komsomolskaya ..	790	1,662	1,504	1,565
No. 12.....	1976	Udachny and Zarnitsa.....	5,883	11,129	11,262	9,421
No. 13.....	1997	Alluvial gravel from Anabar..	35	988	801	801
No. 14.....	1996	Jubilee	5,442	11,045	11,001	10,766
No. 15.....	1999	Nyurbinskaya.....	132	474	337	—
No. 16.....	2003	Nyurbinskaya and alluvial gravel from Nyurba	664	326	—	—

We lease Ore Treatment Plants Nos. 3, 5, 8, 12 and 14 pursuant to the Lease Agreement, and we own Ore Treatment Plants Nos. 13, 15 and 16. Ore Treatment Plant No. 3 was upgraded in 2003, increasing its design capacity to 1.7 million tonnes of ore annually and implementing technologies to reduce electricity consumption and the amount of equipment required for processing. We have also adopted a reconstruction and modernisation programme for Ore Treatment Plant No. 8, which is expected to be completed in 2004. The design capacity of Ore Treatment Plant No. 13 was upgraded to approximately one million tonnes of ore per year in 2003. We are currently engaged in a project to increase the automation in Ore Treatment Plant No. 14 and to increase its capacity to 12 million tonnes of ore per year, which is expected to be completed in 2004. In addition, Ore Treatment Plant No. 16 became operational in August 2003, with production beginning later that year. It has a design capacity of 1.5 million tonnes of ore per year. We believe that, with these improvements, our ore treatment facilities will have sufficient capacity to meet our needs for the foreseeable future.

Our diamond polishing division, Brillianty ALROSA, leases a building of approximately 5,285 square metres in Moscow for its diamond-cutting and polishing operations from Almazny Mir Company. We incur rent expenses in the amount of RUB37 million (US\$1.3 million) per year for the use of these premises, and this lease is renewed on an annual basis.

In addition, we maintain corporate offices in Moscow, Mirny and Yakutsk, and lease representative offices in London, England; Luanda, Angola; Ramat-Gan, Israel; and Antwerp, Belgium.

Applicable Russian federal law has required that rights to real property be registered since January 1998. However, much of our real property is located in Yakutia, where this registration system has only been in place since 2000. As with many Russian companies extensively using real property, we have only recently been able to register our real property rights. Although we have established an internal department to effect these registrations, a considerable part of our real estate rights are not yet registered and, therefore, the validity of our title has not yet been confirmed. As a result, we can give no assurance that the validity of these unregistered real property rights are not subject to challenge prior to such registration.

Legal Matters

Litigation

In addition to litigation arising in the ordinary course of business, we are involved in a civil claim relating to the technologies used at our Nyurba operations. In January 2003, we received notice that Bateman instituted arbitration proceedings against us for an alleged breach of contract. Bateman was the outside construction firm involved in the development of our Nyurba ore treatment plant. The claim sought damages of approximately US\$46.1 million and requested that the arbitration panel issue an order to prevent us from performing further work on the construction of the Nyurba diamond processing plant. We made a counterclaim in the amount of approximately US\$700,000 reflecting our damages in connection with the termination of the contract with Bateman.

The claim was heard by an arbitration panel of the Stockholm Chamber of Commerce in March 2004. The arbitration panel issued its decision on 28 May 2004. Pursuant to the decision, we were ordered to pay Bateman US\$8 million (net of approximately US\$300,000 awarded to us on our counterclaim). We are appealing the decision of the arbitration tribunal and believe that our grounds for appeal are strong. However, there can be no assurance that we will not be required to pay the sum awarded by the arbitration tribunal to Bateman. We have fully provided for this liability. See "Risk Factors – Risks Related to Our Business – We are currently appealing a damages award in an arbitration claim relating to certain ore treatment technologies used at our Nyurba operations".

In addition, we are currently cooperating with the European Commission with respect to its investigation of the De Beers Trade Agreement. See "– Sales of Rough and Polished Diamonds", "Risk Factors – Risks Related to Our Business – The De Beers Trade Agreement has been challenged by the European Commission's Directorate-General for Competition and at least some limitation on our sales to De Beers is likely in the coming months. A final decision or settlement requiring an overly rapid or extensive reduction or a termination of our sales to De Beers could have an adverse impact on our sales, operating results and financial condition" and "Risk Factors – Risks Related to Our Business – The announcement of a European Commission decision or settlement requiring a significant reduction or termination of sales to De Beers may have an adverse impact on the market price of the Notes".

Tax Claims

In March through October 2002, ALROSA Ltd. was subject to a comprehensive tax audit by the Department of the Ministry of Taxes and Duties of Russia for the Republic of Sakha (the "Ministry of Taxes in Yakutia") covering taxable years 1999 to 2001. As a result of this audit the Ministry of Taxes in Yakutia initially assessed us in the amount of approximately US\$977.3 million at then-current exchange rates. After we formally protested these assessments, in January 2003, the Ministry of Taxes in Yakutia reduced its demands to RUB1.9 billion (US\$65.4 million).

Pursuant to our application in January 2003, the Ministry of Taxes in Yakutia agreed to offset RUB1.2 billion (US\$41.3 million) of its claims against the Government's obligations to us. In addition, ALROSA Ltd. paid local taxes pursuant to the demand notices in the amount of RUB30.7 million (US\$1.1 million).

At the end of January 2003 we filed a higher-level administrative appeal against the assessments with the Ministry of Taxes and Duties of Russia. Following the denial of this appeal, we contested the full amount of the assessment in court. In March 2004 the court ruled in our favour with respect to RUB1.6 billion (US\$55.1 million), denied our claim with respect to RUB70 million (US\$2.4 million) and postponed a decision with respect to the remaining RUB216 million (US\$7.4 million) of our claim, later the court ruled in our favour in respect of this remaining amount. However, the Ministry of Taxes in Yakutia disputed the court's decision in a higher court. In early November 2004, the higher court ruled in our favour with respect to RUB1.6 billion (US\$55.1 million). Nevertheless, the Ministry of Taxes in Yakutia still has the right to dispute this decision in a higher court, and currently it is not possible to predict the likelihood as to whether we will ultimately prevail in this claim. It is also not possible to predict whether the Ministry of Taxes in Yakutia will raise any of the same issues in any future tax audits relating to taxable years after 2001.

The Audit Chamber

The Audit Chamber is an independent authority in Russia, which is authorised to investigate Russian agencies and other entities associated with the Government of Russia. The Audit Chamber may report its findings and make recommendations to such entities; however, these recommendations do not carry the force of law and are, therefore, not mandatory.

On 15 December 2002, the Audit Chamber issued the Audit Chamber Report to the Government of Russia and to us. Among other things, the Audit Chamber Report recommended that we generally promote more rational expenditures, reduce overhead, minimise non-production costs, rationalise our corporate structure and replenish our internal working capital. The Audit Chamber Report also recommended that we apply stringent financial controls relating to our sales to the Tuymaada diamond polishing group of Yakutia, as their trade debt had increased in recent years, and consider a reduction in sales to Yakutian diamond-cutting operations which have experienced credit difficulties in the past. In addition, the Audit Chamber Report concluded that the initial placement of shares by ALROSA Ltd. violated certain technical requirements of Russian law. Accordingly, the Audit Chamber Report further recommended that we strictly observe legal procedures in any purchase of shares from our officers or employees to the extent that the suggestions to the Government of Russia concerning share transfers (discussed below) are implemented.

The Audit Chamber Report also made recommendations to the Government of Russia, including the following:

- *Transfer assets underlying the Lease Agreement:* The Audit Chamber Report reviewed the Lease Agreement under which we currently lease underground resources, assets and facilities from Yakutia. The report noted that, pursuant to an agreement with the Government of Russia prior to our founding, Yakutia received all of the assets of Yakutalmaz, one of our predecessor entities, and these constitute a significant part of the assets subject to the Lease Agreement. The Audit Chamber Report concluded that this contribution to Yakutia was unconstitutional because Russia received none of the assets, which contradicts the Russian Constitutional principle which states that underground resources are the joint property of Russia and the relevant local subdivision. In addition, the Audit Chamber Report concluded that Russian law does not provide for the lease of underground resources, and states that the only legal way to use underground resources is pursuant to an applicable licence. The Audit Chamber also found that the payments we make under the Lease Agreement do not correspond with the system of payments for use of underground resources under Russian law. Based on these findings, the Audit Chamber recommended that the Yakutalmaz assets be transferred from Yakutia to Russia.
- *Amend the Lease Agreement:* In connection with the transfer of assets described above, the Audit Chamber Report recommended that the Lease Agreement be amended to entitle the Government of Russia to any future lease payments made with respect to our lease of the Yakutalmaz assets.
- *Invalidate initial purchases of our shares:* The Audit Chamber Report states that the distribution of our shares to non-governmental entities and individuals contravenes the Russian Supreme Council Resolution No. 3020-1 dated 27 December 1991, which prohibits the privatisation of mining enterprises. The Audit Chamber Report also concluded that the controlling share in ALROSA Ltd. should have been issued to the Government of Russia. As a remedy, the Audit Chamber Report recommended that the Government of Russia seek to invalidate the purchase of our shares by the local districts within Yakutia and transfer such shares to federal ownership in order to increase the Government of Russia's ownership in us to 51 per cent.
- *Change representatives on our Supervisory Council:* The Audit Chamber Report concluded that the membership of our Supervisory Council is not in accordance with Presidential Decree No. 1481 dated 26 November 1992, which established the Supervisory Council. Accordingly, the Audit Chamber recommended that Russia change its representatives on our Supervisory Council to ensure the protection of its interests.
- *Confirm status of ALROSA Ltd. as a closed joint stock company:* The Audit Chamber Report referred to Russian laws requiring certain joint stock companies to be in the form of open joint stock companies. These include joint stock companies with more than 50 shareholders, those owned by the Government of Russia and companies formed from formerly State-owned

enterprises. According to the Audit Chamber Report, it is not entirely free from doubt that the available exemptions from these laws apply to us. Accordingly, the Audit Chamber Report recommended that the Government of Russia submit to the Federal Assembly of Russia legislative amendments to confirm that our status as a closed joint stock company is in compliance with Russian law.

The Audit Chamber also expressed its opinion that we need to increase the volume of our diamond exports, and that De Beers purchases rough diamonds from us at prices which are below market value.

In November 2002, the Government of Russia assumed ownership of our shares previously owned by the Russian Servicemen's Fund. In addition, based on discussions with representatives of the Ministry of Finance of Russia, we believe that the Government of Russia has considered the conversion of ALROSA Ltd. from a closed joint stock company into an open joint stock company, although it has no immediate plans to do so. We believe that it is unlikely that the Government of Russia will seek to implement any other recommendation of the Audit Chamber. However, we can give no assurance in this regard. See "Risk Factors – Risks Related to Our Business – The Audit Chamber has issued a series of recommendations which, if implemented by the Government of Russia, would change our relationship with Yakutia, the ownership of our shares, the membership of our Supervisory Council and our ability to export diamonds".

In addition to the issue of the Audit Chamber Report in December 2002, the Audit Chamber has examined the 1993 contract under which we were required to sell approximately US\$1.2 billion of diamonds on behalf of Almaziuvelirexport. In connection with the Audit Chamber's review we were not able to supply records confirming all of these sales because, under our record retention policy, we do not maintain records dating back to the time of these sales. Based on the absence of records, the Audit Chamber issued a report which concluded that we may have breached certain contractual obligations in connection with our sale of diamonds on behalf of Almaziuvelirexport. Although the Audit Chamber has submitted this claim to the General Prosecutor's Office, we do not expect that the General Prosecutor's Office will institute any claim against our management with respect to these sales.

To date, no action has been taken by the Russian Government or the General Prosecutor's Office to implement the recommendations of the Audit Chamber.

In September 2004, the Audit Chamber collegium approved a programme to review the accuracy and timeliness of revenue payments from the sales of rough diamonds on the export market. As part of this program, the Audit Chamber has begun a review of prices set for rough diamonds exported by Alrosa. We expect that this review will be concluded by 2005.

Management and Employees

Supervisory Council

Under our charter, the Supervisory Council consists of 15 members elected by cumulative voting from candidates nominated by the shareholders. Each member has one vote. The Supervisory Council is headed by the Chairman who is entitled to cast a tie-breaking vote. Its members are elected for a period ending upon the occurrence of the next annual shareholders' meeting and may be re-elected without limitation thereafter. The Supervisory Council exercises general guidance over our activities in accordance with the authority provided under Russian federal legislation, and controls our executive bodies. The Supervisory Council does not, however, supervise the day-to-day running of our business. The present term of the Supervisory Council members will expire on the date of the next annual general shareholders' meeting, which we expect will take place in June 2005.

The Supervisory Council is managed by the Chairman (Aleksey Leonidovich Koudrin) and Deputy Chairman (Vladimir Tikhonovich Kalitin).

The present members of the Supervisory Council are:

Name	Member Since	Principal Occupation
Aleksey Leonidovich Koudrin ⁽¹⁾	June 2002	Minister of Finance; Chairman of the Supervisory Council
Vladimir Tikhonovich Kalitin ⁽³⁾	June 2002	President of ALROSA Ltd., Deputy Chairman of the Supervisory Council
Gennadyi Fedorovich Alekseev ⁽²⁾	June 2002	First Deputy Chairman of the Government of Yakutia
Ernst Borisovich Beriozkin ⁽²⁾	June 2002	Minister of Finance of Yakutia
Egor Afanasyevich Borisov ⁽²⁾	June 2002	Chairman of the Government of Yakutia
Ivan Kirillovich Demianov ⁽³⁾	June 2004	Vice President of ALROSA Ltd.
Galina Maratovna Makarova ⁽²⁾	June 2003	Minister of Property Relations of Yakutia
Ivan Sergeyevech Materov ⁽¹⁾	June 1997	Deputy Minister of Industry and Energy of Russia
Yuri Mitrofanovich Medvedev ⁽¹⁾	June 1999	Deputy Head of the Federal Agency for the Management of Federal Property of Russia
Vladimir Dmitrievich Milovidov ⁽¹⁾	June 2004	Assistant of the Chairman of the Government of Russia
Aleksander Pavlovich Morozkin ⁽³⁾	June 2002	First Vice President, Executive Director of ALROSA Ltd.
Anatoly Tarasovich Popov ⁽⁴⁾	June 2002	Head of Administration of Mirninsky Ulus
Vyacheslav Anatolyevich Shtyrov ⁽²⁾	July 1992	President of Yakutia
Aleksander Vasilievich Tikhonov ⁽¹⁾	June 2001	Director of Department for Structural Reorganisation of the Ministry of Transport of Russia
Leonid Fedorovich Tolpezhnikov ⁽¹⁾	June 2002	Head of the Administrative Department of the Ministry of Finance of Russia

Notes:

(1) Nominee of Russia.

(2) Nominee of Yakutia.

(3) Nominee of the shareholder employees.

(4) Nominee of the administrations of the local districts of Yakutia.

The members of the Supervisory Council can be contacted at the Moscow Representative Office address of ALROSA Ltd., 10/12 1st Kazachy per., Moscow 109017, Russia.

Aleksey Leonidovich Koudrin, Chairman of the Supervisory Council. Mr. Koudrin became a member of the Supervisory Council in June 2002. He is also the Minister of Finance. He does not currently hold any managerial positions with any other companies.

Vladimir Tikhonovich Kalitin, President of ALROSA Ltd. and Deputy Chairman of the Supervisory Council. Mr. Kalitin has been a member of the Supervisory Council since June 2002. As President, Mr. Kalitin is responsible for the day-to-day management of ALROSA Ltd.

He served as Chief Engineer from 1999 to 2002. In addition, he is Chairman of the Board of Directors of Viluigesstroj, a company engaged in construction of diamond industry-related facilities. He has been Chairman of the Board of Directors of the Joint Mongolian-Russian company, "M and Diamond", since 2002 and is also a member of the Supervisory Board of Severalmaz.

Gennadyi Fedorovich Alekseev, First Deputy Chairman of the Government of Yakutia. Mr. Alekseev became a member of the Supervisory Council in June 2002. He currently serves as a member of the Board of Directors of Vilyuiskaya and is a member of the Board of Directors of the Open Joint Stock Company Respublikanskaya Investizionnaya Kompaniya SakhaKapital ("SakhaKapital"), an investment company.

Ernst Borisovich Beriozkin, Minister of Finance of Yakutia. He became a member of the Supervisory Council in June 2002 and also serves as a member of the Board of Directors of SakhaKapital.

Egor Afanasyevich Borisov, Chairman of the Government of Yakutia. He became a member of the Supervisory Council in June 2002. He does not currently hold any managerial positions with any other companies.

Ivan Kirillovich Demianov, Vice President of ALROSA Ltd. He became a member of the Supervisory Council in June 2004. He does not currently hold any managerial positions with any other companies.

Galina Maratovna Makarova, Minister of Property Relations of Yakutia. She became a member of the Management Board in 2003. She does not currently hold any managerial positions with any other companies.

Ivan Sergeyevich Materov, Deputy Minister of Industry and Energy of Russia. Mr. Materov became a member of the Supervisory Council in June 1997. He served as the Co-Chairman of the Supervisory Board from 1998 to 2000. He does not currently hold any managerial positions with any other companies.

Yuri Mitrofanovich Medvedev, Deputy Head of the Federal Agency for the Management of Federal Property. He became a member of the Supervisory Council in June 1999. He does not currently hold any managerial positions with any other companies.

Vladimir Dmitrievich Milovidov, Assistant of the Chairman of the Government of Russia. He became a member of the Management Board in 2004. Mr. Milovidov is also a member of the boards of directors of OAO International Airport Sheremetyevo, OAO Rossgosstrakh and the Federal Agency for Mortgage and Housing Lending.

Aleksander Pavlovich Morozkin, First Vice President, Executive Director. As our First Vice President, Mr. Morozkin is responsible for all of our operations in Yakutia. He became a member of the Supervisory Council in June 2002 and served as Vice President from 1998 to 2002. He currently serves as the Chairman of the Board of Directors of Upravlenie Rabotchego Snabzheniya, a company engaged in the supply of goods and materials required for our activities, as Chairman of the Board of Directors of Lenskaya Optovo-Torgovaya Kontora, a company engaged in the wholesale of goods, and Chairman of the Board of Directors of Irilyakhneft, a company engaged in oil refining. He is also President of the Board of Directors of Vilyuiskaya, a company which, after completion of its construction of a hydroelectric power station, will supply electricity for our activities. In addition, he is a member of the Board of Directors of ALROSA-Nyurba, and he serves as a member of the Board of Directors of ALROSA-Gas, a company engaged in gas extraction. Mr. Morozkin has also been a member of the Board of Directors of the Mirninsky Commercial Bank MAK-Bank ("MAK-Bank") since 2002.

Anatoly Tarasovich Popov, Head of Administration of Mirninsky Ulus since 2002. Mr. Popov became a member of the Management Board in 2003. He does not currently hold any managerial positions with any other companies.

Vyacheslav Anatolyevich Shtyrov, President of Yakutia. Mr. Shtyrov has been a member of the Supervisory Council since July 1992. He served as President of ALROSA Ltd. from 1995 to 2002. He is also a member of the Supervisory Board of our subsidiary, ALROSA-Nyurba.

Aleksander Vasilievich Tikhonov, Director of Department for Structural Reorganisation of the Ministry of Transport of Russia. Mr. Tikhonov became a member of the Supervisory Council in June 2001. He does not currently hold any managerial positions with any other companies.

Leonid Fedorovich Tolpezhnikov, Head of the Administrative Department of the Ministry of Finance of Russia. He became a member of the Supervisory Council in June 2002. He served as Director of the Centre of Marketing Research and Director of the Analytic Centre of ALROSA Ltd. from 1996 to 2000. He does not currently hold any managerial positions with any other companies.

Most of the companies in which members of our Supervisory Council hold management positions are subsidiaries of ALROSA Ltd. See "Subsidiaries".

Management Board

Our Management Board is responsible for our general management, except for those matters that, as a matter of law, are reserved to the shareholders or the Supervisory Council. Thus, the Management Board is responsible for our day-to-day operations. Our charter states that the Supervisory Council determines the total number of members of the Management Board. The members of the Management Board are appointed by the Supervisory Council, and the term of their service shall be determined in the relevant contract with each member. Each member of the Management Board has one vote and decisions are taken by simple majority. The Management Board is headed by the President, who is entitled to cast a tie-breaking vote. Meetings of the Management Board are required to be held at least quarterly. Currently, the Management Board has 23 members.

The present members of the Management Board are:

Name	Year of Birth	Responsibility
Vladimir Tikhonovich Kalitin	1947	President
Aleksander Pavlovich Morozkin	1948	First Vice President, Executive Director
Aleksander Olegovich Nichiporuk	1957	First Vice President
Gennady Anatolyevich Melnik	1942	Chief Engineer
Yuri Anatolievich Ionov	1950	Vice President
Vasily Mikhailovich Vlasov	1945	Vice President
Ivan Kirillovich Demyanov	1942	Vice President
Yuri Aleksandrovich Dudenkov	1943	Vice President
Valentina Anatolievna Potrubeyko	1961	Vice President
Olga Alekseevna Liashenko	1948	Chief Accountant
Dmitry Konstantinovich Novikov	1969	Vice President
Sergei Aramovich Ulin	1950	Vice President
Gustav Afanasievich Iakovlev	1938	Vice President
Pyotr Andreevich Galaev	1947	Vice President
Sergei Grigorievich Aliabiev	1953	Director of Nyurba Division
Pyotr Mikhailovich Glagolev	1955	Director of Almazdortrans Department
Yuri Andreevich Doynikov	1955	Director Mirny Division
Aleksander Vladimirovich Kozupeev ..	1962	Director of Anabar Division
Yuri Anatolyevich Petrov	1959	Director of Udachny Division
Semen Fedotovitch Ponomarev	1949	Director of Aikhal Division
Aleksander Sergeevich Chaadaev	1960	Chief Engineer of Capital Construction Department
Anatoly Tarasovich Popov	1947	Head of Administration of Mirninsky Ulus
Pavel Antonovich Tretyakov	1954	Head of the trade union "ProfAlmaz"

The members of the Management Board can be contacted at the Moscow Representative Office address of ALROSA Ltd., 10/12 1st Kazachy per., Moscow 109017, Russia.

Vladimir Tikhonovich Kalitin, President. Mr. Kalitin is responsible for the general management of ALROSA Ltd. He became a member of the Management Board in 1996. He served as Chief Engineer from 1996-2002. He does not currently hold any managerial positions with any other companies.

Alexander Pavlovich Morozkin, First Vice President, Executive Director. Mr. Morozkin is responsible for the operation of ALROSA Ltd.'s divisions in the Yakutia. He became a member

of the Management Board in 1998. He was Vice President of ALROSA Ltd. from 1998-2002. Since 2002, he has been the Chairman of the Board of Directors of Upravlenie Rabochego Snabzheniya, which is engaged in the supply of goods and materials required for our activities. In addition, he is Chairman of the Board of Directors of Lenskaya Optovo-Torgovaya Kontora, a subsidiary of ALROSA Ltd. engaged in the wholesale of goods. He is Chairman of the Board of Directors of Irilyakhneft, a company engaged in oil refining. Mr. Morozkin is a Member of the Board of Directors of ALROSA-Nyurba, and a member of the Board of Directors of MAK-Bank. He is also Chairman of the Board of Directors of Vilyuiskaya and a member of the Board of Directors of ALROSA-Gas.

Aleksander Olegovich Nichiporuk, First Vice President. Mr. Nichiporuk is responsible for financial and economic activity. He became a member of the Management Board in 2004. From 1994 he served as a head of the management board of the Bank for Development of Entrepreneurship. Mr. Nichiporuk has a PhD in economics.

Gennady Anatolyevich Melnik, Chief Engineer. Mr. Melnik is responsible for the production activities and technical development of ALROSA Ltd. in Yakutia. He became a member of the Management Board in 1995. Since 2002, he has also been a member of the Board of Directors of Vilyuiskaya and Chairman of the Board of Directors of the research-and-production activities of Burevestnik, a company which is engaged in the production of electronic equipment.

Yuri Anatolievich Ionov, Vice President. Mr. Ionov is responsible for economic security and legal issues. He became a member of the Management Board in 2003.

Vasiliy Mikhailovich Vlasov, Vice President. Mr. Vlasov is responsible for our relationships with the local districts of Yakutia. He became a member of the Management Board in 2002. Mr. Vlasov also served as Co-Chairman of the Supervisory Council from 1998 to 2002. He has been a member of the Board of Directors of the insurance company SAPI-Polis since 2002. In addition, he has been Chairman of the Board of Directors of SakhaKapital since 2002. Mr. Vlasov also became a member of the Board of Directors of Tuymaada Diamond in 2002.

Ivan Kirillovich Demyanov, Vice President. Mr. Demyanov is responsible for social issues. He became a member of the Management Board in 2002. Since 2002, Mr. Demyanov has also been Chairman of the Board of Directors of Pension Fund Almaznaya Osen and a member of the Board of Directors of MAK-Bank. Since 2002, Mr. Demyanov has also been a member of the Board of Directors of Sanatoriy Leninogorskiy, a leisure resort. In addition, he has been a member of the Board of Directors of SAPI-Polis, an insurance company, since 2002.

Yuri Aleksandrovich Dudenkov, Vice President. Mr. Dudenkov is responsible for sales and marketing. He became a member of the Management Board in 1998. Since 2002, Mr. Dudenkov has also been a member of the Board of Directors of Orel-ALROSA, a company engaged in diamond polishing. In addition, since 2002, he has been a member of the Board of Directors of the Closed Joint Stock Company Promyshlennaya-investitsionnaya kompaniya Orel-Almaz, and a member of the Board of Directors of Almaznyi Mir Company, companies whose activities are linked to diamond polishing.

Valentina Anatolievna Potrubeyko, Vice President. Mrs. Potrubeyko is responsible for economy and planning for ALROSA Ltd. She became a member of the Management Board in 2003. She does not currently hold any managerial positions with any other companies.

Olga Alekseevna Liashenko, Chief Accountant. Mrs. Liashenko is responsible for our accounting department. She became a member of the Management Board in 1993. She does not currently hold any managerial positions with any other companies.

Dmitry Konstantinovich Novikov, Vice President. Mr. Novikov is responsible for our investment projects and leasing. He became a member of the Management Board in 2002. Prior to 2002 he was Chairman of the Board of Directors of the investment company "IK Vostok-Capital".

Sergei Aramovich Ulin, Vice President. Mr. Ulin is responsible for our external relations, including relations with De Beers. He became a member of the Management Board in 1993. Mr. Ulin was a President of the Russian Diamond Chamber, a Russian diamond exchange.

Gustav Afanasievich Iakovlev, Vice President, Head of the Yakutsk Representative Office. Mr. Iakovlev is responsible for our relationship with the authorities of Yakutia. He became a member of the Management Board in 1993. He is a member of the Board of Directors of Tuymaada Diamond, a company engaged in the polishing and sale of diamonds.

Pyotr Andreevich Galaev, Vice President. Mr. Galaev is responsible for resources supply, transport and trade. He became a member of the Management Board in 2002. He has also been a member of the Board of Directors of Aikhalskiy Otdel Rabochego Snabjeniya, a company, which is engaged in diamond trading and polishing, since 2002. In 2002, he became a member of the Board of Directors of Udachninskiy Kombinat Pischevyh Predpriyatiy, which is engaged in diamond trading and polishing, and a member of the Board of Directors of Udachninskiy Otdel Rabochego Snabjeniya, which is engaged in the wholesale supply of goods. He has been Chairman of the Board of Directors of Mirninsky Otdel Rabochego Snabjeniya, which is engaged in the wholesale supply of goods, since 2002 and is a member of the Board of Directors of Sudokhodnaya kompaniya ALROSA-Lena, a company which is engaged in shipping.

Sergei Grigorievich Aliabiev, Director of Nyurba Division. Mr. Aliabiev is responsible for the management and production activities of Nyurba Division. He became a member of the Management Board in 2002 and served as the Deputy General Director from 1996 to 2001. He became Director of Nyurba Division in 2001 and has been a member of the Board of Directors of Almazy Anabara since 2002. Mr. Aliabiev became Chairman of the Board of Directors of Konezavod im. Stepana Vasilyeva, a company engaged in horse breeding, in 2002.

Pyotr Mikhailovich Glagolev, Deputy General Director of ALROSA Ltd., Director of Almazdortrans Department. Mr. Glagolev is responsible for shipping operations and transportation of goods and resources by car in Western Yakutia. He became a member of the Management Board in 1996. In 2002, Mr. Glagolev became a Member of the Board of Directors of Lenskaya Optovo-Torgovaya Kontora, a company engaged in wholesale trade, and Chairman of the Board of Directors of ALROSA-Lesprom. He also became a member of the Board of Directors of Sudokhodnaya kompaniya ALROSA-Lena in 2002.

Yuri Andreevich Doynikov, Director of Mirny Division. Mr. Doynikov became a member of the Management Board in 2003. From 2000 until 2002 he has served as a Director of Aikhal Division.

Aleksander Vladimirovich Kozupeev, Director of Anabar Division. Mr. Kozupeev is responsible for the management and production activities of Anabar Division. He became a member of the Management Board in 2003.

Yuri Anatolyevich Petrov, Director of Udachny Division. Mr. Petrov is responsible for the management and production activities of Udachny Division. He became a member of the Management Board in 2002. In addition, he served as the Head of the industry-technical department of Mirny Division from 1997 to 2001. Mr. Petrov also became Chairman of the Board of Directors of Udachninskiy Kombinat Pischevyh Predpriyatiy, a company engaged in diamond trading and polishing and Chairman of the Board of Directors of Udachninskiy Otdel Rabochego Snabjeniya, a company engaged in the diamond trade, in 2002.

Semen Fedotovitch Ponomarev, Director of Aikhal Division. Mr. Ponomarev is responsible for the management and production activities of Aikhal Division. He became a member of the Management Board in 2003.

Aleksander Sergeevich Chaadaev, Chief engineer of Capital Construction Department. Mr. Chaadaev became a member of the Management Board in 2003. He does not currently hold any managerial positions with any other companies.

Anatoly Tarasovich Popov, Head of Administration of Mirninsky Ulus. He became a member of the Management Board in 2003. He does not currently hold any managerial positions with any other companies.

Pavel Antonovich Tretyakov, Head of the trade union ProfAlmaz. He became a member of the Management Board in 2003. He does not currently hold any managerial positions with any other companies.

Most of the companies in which members of our Management Board hold management positions are subsidiaries of ALROSA Ltd. See "Subsidiaries".

Compensation of the Members of the Supervisory Council and Management Board

Total aggregate compensation, including salary and bonuses and other deferred compensation, paid to members of our Supervisory Council and Management Board during the six-month period ended 30 June 2004 was RUB92 million (US\$3.2 million). There are no

outstanding loans made by us to any of such members, and we have given no guarantees in respect of obligations of any of such members to third parties. Members of the Management Board are eligible to participate in our pension plan.

Board Practices

We do not enter into service contracts with the members of our Supervisory Board. Our Management Board members enter into employment contracts which set forth their compensation and annual performance goals. However, these contracts do not obligate these members to work for us for any specified length of time.

Audit Committee

Our Audit Committee was elected by the general shareholders' meeting in accordance with our charter in order to exercise control over our financial and economic activities. Under our charter, the Audit Committee consists of five members elected at a shareholders' meeting for a term ending on the date of the next annual general shareholders' meeting. The current term of the Audit Committee will expire in June 2005.

The Audit Committee is a statutory audit committee required under the Russian legislation governing joint stock companies and the functions and the scope of the Committee's authority are significantly more limited than those of an audit committee of the board of directors required for certain companies in the United States under the Sarbanes-Oxley Act of 2002 and audit committees established by companies organised in some European countries.

The present members of the Audit Committee are:

Name	Responsibility
Lyudmila Afanasyevna Nikolaeva	Deputy Head of the Administration of the President and the Government of Yakutia
Valery Vladimirovich Eliseev	Deputy Head of the Administrative Department of the Ministry of Finance of Russia
Alexei Petrovich Efimov	Head of the Department of the Ministry of Industry of Yakutia
Ludmila Valentinovna Ganchenko	Deputy Chief Accountant of ALROSA Ltd.
Yulia Anatolievna Filippova	Head of Division of the Ministry of Property Relations of Yakutia

Employees

The following table sets forth our employees as at 30 June 2004 and as at 31 December 2001, 2002 and 2003:

	As of 30 June	As of 31 December		
	2004	2003	2002	2001
Mining Activities				
Udachny	5,009	4,548	4,866	5,016
Mirny	3,544	3,544	3,419	3,453
Aikhal	5,196	5,277	5,335	5,469
Nyurba	1,016	770	466	389
Anabar	442	414	382	349
United Selling Organisation	983	989	997	1,018
Maintenance	1,327	2,009	2,072	4,174
Construction	5,093	5,769	6,246	7,465
Transport	4,954	5,206	5,535	6,937
Geology	2,667	2,615	3,047	2,969
Management in Moscow and Mirny	475	498	507	501
Supply	918	931	981	1,023
Other activities ⁽¹⁾	5,923	6,332	6,396	3,147
Total ALROSA Ltd.	37,547	38,902	40,249	41,910
Subsidiary employees	9,713	8,096	8,508	5,770
Total ALROSA Ltd. and subsidiaries	47,260	46,998	48,757	47,680

Note:

(1) Includes employees of our diamond sorting facilities in Mirny, Brillianty ALROSA, our YakutNiproAlmaz Institute and our representative offices in Russia and abroad.

We intend to significantly reduce our number of employees over the next 10 years through divestiture of non-core business ventures, such as ALROSA-Gas, as well as expected productivity gains. We anticipate that, other than with respect to divestitures, this reduction will be accomplished primarily through normal employee turnover rather than redundancies.

Our non-executive management employees are represented by ProfAlmaz, the Russian diamond workers' labour union. However, these employees are not required to join the union. Relations with employees are governed by the terms of a rate agreement, which provides the framework for relations between the employees and our management personnel, including wages and salaries, benefits, pensions, training and safety matters. In 2001, we signed a five-year development plan with ProfAlmaz, setting forth the terms of employment for union members. We have not experienced any disruption in operations as a result of any labour dispute, strike or employee legal action, and we believe relations with employees are good.

We maintain a comprehensive training programme, which includes sponsorship of promising students, as well as worker training.

The average monthly wage for our employees was RUB24,900 (US\$858) as of 1 August 2004. We significantly increased the salary and bonus levels of our employees since 30 June 2003, commensurate with an increase in the cost of living and to reward our employees for the achievement of production and financial targets. This increase in wages and salaries caused a corresponding increase in pension expenses. Russian legislation also requires us to pay for the cost of one trip by employees and their families once every two years or, in lieu thereof, to pay employees a pre-determined travel allowance. The destination may be any place within Russia. In addition, for workers with health problems, we will pay 70 per cent. of the cost for the employee and one non-working family member to visit a sanatorium within Russia, selected from an approved list, that specialises in the relevant medical condition.

Each employee with more than 15 years of service is entitled to continued benefits after retirement based on their final salary and location. Because of work in the harsh conditions in northern Yakutia, female employees who have worked for at least 15 years in this region are entitled by law to retire at the age of 50, which is five years earlier than the normal Russian retirement age. The retirement age for male employees who have worked for at least 15 years in this region is 55, which is five years earlier than the normal Russian retirement age. Employees within this northern region also qualify for relocation expenses, should they decide to relocate to another region upon retirement.

Since 1999 we have operated a defined benefit plan through our consolidated subsidiary Pension Fund Almaznaya Osen. We have no formal legal obligation to support the plan but we recorded a provision in our IFRS consolidated financial statements because we intend to pay retirement benefits to our employees in the future.

Principal Shareholders

We are a closed joint stock company and, therefore, our shares may be transferred only in compliance with our shareholders' right of first refusal and in accordance with our charter. Our shareholders are currently considering the conversion to an open joint stock company structure which would allow the transfer of our shares, free of the existing shareholders' right of first refusal; however, no decision has been made in this regard. The following table sets forth the ownership of our ordinary share capital as of 30 June 2004:

	Number of Shares	Per cent.
Federal Agency for the Management of Federal Property of Russia ⁽¹⁾	74,000	37.0
The Ministry of Property Relations of Yakutia	64,000	32.0
Administrations of eight local districts ("ulusy") of Yakutia	16,000	8.0
Other shareholders ⁽²⁾	46,000	23.0
Total	200,000	100.0

Notes:

(1) Formed in March 2004 as a successor of the State Property Ministry of Russia.

(2) Consist primarily of former and current employees of ALROSA Ltd. and its predecessor entities.

On 15 December 2002 the Audit Chamber issued the Audit Chamber Report to the Government of Russia, recommending certain changes in our shareholding structure. See "Our Business – Legal Matters – The Audit Chamber".

Shares held by Supervisory Council and Management Board Members

As of 30 June 2004, the members of the Supervisory Council beneficially owned in the aggregate 603 shares of ALROSA Ltd. and the members of the Management Board beneficially owned in the aggregate 1,495 shares of ALROSA Ltd.

Shareholders' Meetings

Shareholders' meetings may be convened by the Supervisory Council upon its own initiative, upon the request of shareholders holding more than 10 per cent. of the voting shares of ALROSA Ltd., upon the request of our internal auditing committee or upon the request of an external auditor. The general shareholders' meeting takes place each year not earlier than two months, and no later than six months, after the end of the financial year. Each ordinary share of ALROSA Ltd. carries the right to cast one vote at the general meeting.

Certain Transactions with Related Parties

Our shareholders include Russia and Yakutia, and our mining business requires us to obtain concessions from both of these entities. As a result, we have engaged in several transactions with these related parties. For a description of the licences and lease involving Russia and Yakutia under which we operate, please see “Our Business – Regulatory and Environmental Matters – Subsoil Licences” and “Our Business – Regulatory and Environmental Matters – Lease Agreement”. For a description of our sales to these entities, please see “Our Business – Sales of Rough and Polished Diamonds – Sales of Rough Diamonds to Russia and Yakutia”.

We have entered into a number of credit agreements with Sobinbank, our unconsolidated affiliate. At 31 December 2003, our indebtedness to Sobinbank amounted to RUB675 million (US\$23.3 million), compared to RUB1,977 million (US\$68.1 million) at 31 December 2002. At 30 June 2004 our outstanding indebtedness to Sobinbank amounted to RUB670 million (US\$23.1 million).

Beginning in 2000, our diamond-polishing division, Brillianty ALROSA, leased approximately 5,285 square metres in Moscow for its diamond-cutting and polishing operations from Almazny Mir Company, 52.37 shares in which are owned by the Government of Russia and 47.37 shares by us. Payments under the lease were RUB18 million (US\$0.6 million) for the first six months of 2004, RUB37 million (US\$1.3 million), RUB38 million (US\$1.3 million) and RUB33 million (US\$1.1 million) for the years 2003, 2002 and 2001, respectively.

We sell rough diamonds on credit to Smolensk Kristall, a diamond-polishing company wholly owned by the Government of Russia. Total sales were RUB2,778 million (US\$95.7 million) for the first six months of 2004, RUB4,988 million (US\$171.8 million) in 2003, RUB4,668 million (US\$160.7 million) in 2002 and RUB5,477 million (US\$188.7 million) in 2001. Accounts receivable for Smolensk Kristall totalled RUB435 million (US\$15.0 million) as at 30 June 2004, RUB444 million (US\$15.3 million), RUB549 million (US\$19.0 million) and RUB410 million (US\$14.1 million) as at 31 December 2003, 2002 and 2001, respectively.

We sell rough diamonds on credit to the Tuymaada Group in Yakutsk, a group of diamond polishers controlled by Yakutia and in which we have a 12.7 per cent. interest. Total sales to the Tuymaada Group were RUB310 million (US\$10.7 million), for the first six months of 2004, RUB554 million (US\$19.1 million) in 2003, RUB523 million (US\$18.0 million) in 2002 and RUB1,617 million (US\$55.7 million) in 2001. Accounts receivable for Tuymaada Group totalled RUB157 million (US\$5.4 million) as at 30 June 2004. As of 31 December 2003, accounts receivable totalled RUB174 million (US\$6.0 million), as of 31 December 2002, RUB295 million (US\$10.2 million) and as of 31 December 2001, RUB762 million (US\$26.2 million). During the last three years, the financial position of Tuymaada Group has been unstable and there is substantial doubt as to whether it will be able to settle its outstanding accounts receivable with us. Accordingly, we have created a full provision against these receivables in our IFRS consolidated financial statements for the six months ended 30 June 2004 and years ended 31 December 2003 and 2002.

We also sell rough diamonds on credit to ZAO PIC Orel-Almaz, our affiliate. Total sales were RUB257 million (US\$8.9 million) for the first six months of 2004, RUB362 million (US\$12.5 million) in 2003, RUB68 million (US\$2.3 million) in 2002 and RUB85 million (US\$2.9 million) in 2001. Accounts receivable for ZAO PIC Orel-Almaz totalled RUB165 million (US\$5.7 million) as at 30 June 2004, RUB168 million (US\$5.8 million) as of 31 December 2003, RUB147 million (US\$5.1 million) as of 31 December 2002 and RUB211 million (US\$7.3 million) as of 31 December 2001. During the last several years, the financial position of ZAO “PIK Orel Almaz” has been unstable. Despite the fact that it pays its current accounts receivable on time, it has significant outstanding receivables with us which have been outstanding for several years. We are unable to determine whether these receivables will be collected in the future. Accordingly, we have created a provision against them totalling RUB77 million in our IFRS consolidated financial statements for the six months ended 30 June 2004 and the year ended 31 December 2003 and totalling RUB54 million in our IFRS consolidated financial statements for the year ended 31 December 2002.

We are required by Russian law and our charter to obtain the approval of independent disinterested directors or shareholders for transactions “with interested parties”. In general terms, “interested” parties include any of our shareholders, together with their affiliates, that

own at least 20 per cent. of our voting shares, as well as members of our Supervisory Council and Management Board, our President and any entities in which these entities or individuals own a specified interest or occupy specified positions. Due to the technical requirements of Russian law, these same parties may also be deemed to be “interested parties” with respect to certain transactions between entities within our group. See “Risk Factors – Risks Related to the Legal and Regulatory Environment in Russia – Some transactions between us and interested parties or affiliated companies require the approval of disinterested directors or disinterested shareholders and our failure to obtain such approvals may lead to invalidation of transactions that are important for our business”.

Description of Existing Material Agreements

Material Agreements Relating to Operational Matters

For a description of the Lease Agreement under which we lease production assets from Yakutia, see "Our Business – Regulatory and Environmental Matters – Lease Agreement". For a description of the De Beers Trade Agreement for the export of diamonds, see "Our Business – Sales of Rough and Polished Diamonds – Export of Rough Diamonds".

Construction Services

- *DSK*. On 19 June 2001, we entered into an agreement with the Joint Stock Company DSK, a construction company, for the construction by DSK of housing in Lensk for an aggregate consideration of RUB564 million (US\$19.4 million).
- *Rostovshakhtostroi*. On 6 August 2001, we entered into an agreement relating to the Mir underground mine with the Joint Stock Company Rostovshakhtostroi, a construction company. This contract required Rostovshakhtostroi to construct a reinforced shaft using special construction techniques, in exchange for an aggregate consideration of RUB963.3 million (US\$33.2 million).

Other Material Agreements

Yakutskenergo. On 11 May 2000, we entered into an agreement for the sale and purchase of shares in Vilyuiskaya. The aggregate consideration for these shares was RUB980 million (US\$33.8 million).

Material Financing Agreements

As of 30 June 2004, we had a total indebtedness of RUB52.1 billion (US\$1.79 billion).

2008 Notes

On 6 May 2003, the Issuer issued the 2008 Notes at an issue price of 98.996 per cent., guaranteed by ALROSA Ltd. These notes are listed on the Luxembourg Stock Exchange.

Severalmaz Loan

On 9 March and 9 April 2004, ING Bank N.V. issued an aggregate principal amount of US\$150 million 8.875 per cent. Credit Linked Notes due 2006 (the "Credit Linked Notes") the proceeds of which were used to extend a loan to our subsidiary Severalmaz (the "Loan") in the amount of US\$150 million. The Loan bears interest at 8.875 per cent. per annum. In the event Severalmaz is unable to repay its indebtedness under the Loan, the holders of the Credit Linked Notes can require ALROSA Ltd. to purchase the Credit Linked Notes.

US Dollar-Denominated Borrowings

- *Sberbank*. On 2 June 2004, we entered into a credit facility agreement with Sberbank in the amount of US\$70 million. The interest rate for this loan is 8.2 per cent. This loan matures on 1 June 2005. The credit facility is secured by a pledge of commercial paper issued by ALROSA Ltd. As of 1 October 2004, US\$70 million was outstanding under this credit facility agreement.
 - *Vneshtorgbank*. On 21 June 2002, we entered into a secured term loan agreement with a syndicate of banks led by Vneshtorgbank in the amount of US\$60 million. The interest rate on this loan is LIBOR plus 8.61 per cent. It is secured by a pledge of rough diamonds and of receivables related to contracts for the sale of diamonds. Under the terms of this loan agreement, we have undertaken not to change our legal form without prior written consent of the syndicate of banks. This loan matures 720 days after the first disbursement, which occurred on 28 June 2002, and is repayable in 18 equal instalments starting from February 2003. As of 1 October 2004, there were no amounts outstanding under this loan agreement.
- On 6 March 2002, we entered into a credit agreement with Vneshtorgbank pursuant to which Vneshtorgbank agreed to provide us with financing in the amount of US\$6.1 million, available from 1 February 2005 until 28 February 2005. Any amounts drawn down under this credit agreement will carry an interest rate of 13 per cent. and are to be repaid within 30 days of the drawdown. As of 1 October 2004, no amounts were outstanding under this credit agreement.

On 24 June 2004, we entered into a number of credit agreements with Vneshtorgbank pursuant to which Vneshtorgbank agreed to provide us with financing in the total amount of US\$75 million. Any amounts drawn down under the individual credit agreements will carry an interest rate of 8.75 per cent. and must be repaid within 180 days of each respective drawdown. As of 1 October 2004, a total of US\$75 million was outstanding under these credit agreements.

- *Export-Import Bank of the United States/The Chase Manhattan Bank.* On 28 February 2001, we entered into a US\$65 million medium term credit facility agreement to finance exports from the United States to Russia. Pursuant to this agreement we have borrowed: (i) US\$7.2 million and US\$7.7 million, each of which is to be repaid in ten equal semi-annual instalments, beginning on 25 July 2001; (ii) US\$8.2 million; (iii) US\$5.42 million; (iv) US\$5.40 million; and (v) US\$10.1 million, which are to be repaid in ten equal semi-annual instalments, beginning 15 July 2003. Additionally, we borrowed the sum of US\$7.3 million, which is to be repaid in nine equal semi-annual instalments, beginning 15 July 2004. As of 1 October 2004, US\$32.1 million was outstanding under this credit facility agreement.

- *Black Sea Trade and Development Bank.* On 9 December 2002, we entered into a US\$18.5 million credit facility agreement with Black Sea Trade and Development Bank. Drawdowns under this facility must be repaid in 9 equal semi-annual instalments. The current interest rate under this facility is LIBOR plus 6 per cent., but we have negotiated a reduction of the interest rate to LIBOR plus 3.75 per cent. starting in November 2004. As of 1 October 2004, US\$7.5 million was outstanding under this credit facility agreement.

- *EDC.* On 3 December 2003, we entered into a US\$15 million credit facility agreement with Export Development Canada ("EDC"), the Canadian export credit agency. Under this facility we are entitled to borrow from EDC up to US\$15 million in one or more tranches to finance exports from Canada. Drawdowns under the facility must be repaid in 10 equal semi-annual instalments. The interest rate under this facility is LIBOR plus 3.75 per cent. As of 1 October 2004, US\$1.5 million was outstanding under this credit facility agreement.

- *Commerzbank.* We have entered into the following loan agreements with Commerzbank: On 15 July 2003, we entered into a loan agreement in the amount of US\$20 million in order to finance our working capital requirements. The interest rate on this loan is LIBOR plus 4 per cent. As of 1 October 2004, a total of US\$20 million was outstanding under this credit agreement.

On 28 October 2003, we entered into a loan agreement in the amount of US\$20 million. The purpose of this loan was to finance our working capital requirements. The interest rate on this loan is LIBOR plus 4 per cent. As of 1 October 2004, no amounts were outstanding under this loan agreement.

- *Alfa Bank.* We have entered into the following credit agreements with Alfa Bank:

On 28 November 2003, we entered into a credit facility agreement in the amount of US\$42 million. The credit facility expires on 28 May 2005. As of 1 October 2004, no amounts were outstanding under this credit facility agreement.

On 26 January 2004, we entered into a credit facility agreement in the amount of US\$42 million. This credit facility expires on 26 July 2005. The interest rate for this agreement is determined on a case-by-case basis for each borrowing. As of 1 October 2004, no amounts were outstanding under this credit facility agreement.

On 26 May 2004, we entered into a credit facility agreement in the amount of US\$30 million. This credit facility expires on 26 November 2005. As of 1 October 2004, no amounts were outstanding under this credit agreement.

- *Rosbank.* We have entered into the following loan agreements with Rosbank:

On 10 December 2002, we entered into a three-year US\$25 million loan agreement. This loan bears interest at 10 per cent. As of 1 October 2004, US\$25 million was outstanding under this agreement.

On 14 March 2003, we entered into a two-year US\$20 million loan agreement. This loan bears interest at 11 per cent. As of 1 October 2004, US\$20 million was outstanding under this agreement.

- *Mosnarbank*. On 21 October 2003, we entered into a short-term credit agreement with Mosnarbank for the amount of US\$20 million. The interest rate on this loan is LIBOR plus 6 per cent. Upon the merger between Mosnarbank and Bank Evrofinance in January 2004, this loan was transferred to Bank Evrofinance. As of 1 October 2004, US\$20 million was outstanding under this credit agreement.
- *Ost-West Handelsbank AG*. On 31 March 2004, we entered into a short-term US\$10 million (increased to US\$15 million in May 2004) credit facility agreement with Ost-West Handelsbank AG. Under this credit facility we can borrow funds in tranches of US\$1 million or more for a period of between 30 and 60 days at an interest rate of LIBOR plus 3.5 per cent. This credit facility expires on 29 December 2004. As of 1 October 2004, US\$15 million was outstanding under this credit facility agreement.
- *Moscow Narodny Bank Limited*. On 23 June 2004, we entered into a credit agreement with Moscow Narodny Bank Limited in the amount of US\$50 million (the amount was increased to US\$90 million on 21 July 2004). The interest rate on this loan is LIBOR plus 4.5 per cent. The amounts borrowed under this agreement must be repaid within 24 months of drawdown. As of 1 October 2004, US\$90 million was outstanding under this credit agreement.
- *JPMorgan Chase Bank*. In September 2004, we entered into a credit facility agreement with JPMorgan Chase Bank in the amount of US\$100 million. The interest rate applicable to borrowing under this credit facility agreement is LIBOR plus 2 per cent. plus a percentage determined on the basis of certain costs. This credit facility matures 6 months after the date of its execution. As of 1 October 2004, US\$100 million was outstanding under this credit facility agreement.
- *Syndicated Loan*. On 2 September 2004, we entered into a loan agreement with a syndicate of banks. The loan was arranged by Société Generale and Citibank N.A. A total amount of US\$300 million is available under this agreement to be issued in two tranches. The interest rate on this loan is LIBOR plus 3.25 per cent. plus a percentage determined on the basis of certain costs, and the agreement provides for security arrangements in case of a default. This loan matures 3 years after the date of its execution. As of 1 October 2004, US\$100 million was outstanding under this loan agreement.

Rouble-Denominated Borrowings

- *Sberbank*. On 15 August 2002, we entered into a non-revolving credit facility agreement with Sberbank in the amount of RUB2.5 billion (US\$86.1 million). From 1 October 2002, this credit facility carries a variable rate of interest based on the average quarterly turnover of ALROSA Ltd.'s bank account and a fee of 0.1 per cent. of the unused portion of the facility. This credit facility is secured by our pledges of: (i) commercial paper issued by ALROSA Ltd. and rough diamonds; (ii) three of our airplanes; and (iii) two buildings located in Moscow. Sberbank may cancel our credit facility and demand repayment of outstanding amounts in the event that our quarterly income is less than US\$47 million, or in the event of a decrease in our charter capital. This credit facility expires on 15 December 2004. As of 1 October 2004, there were no amounts outstanding under this facility.
- *Promstroybank*. On 24 July 2003, we entered into a loan agreement with Promstroybank in the amount of RUB1 billion. The loan carries an interest rate of 12.95 per cent and matures on 24 January 2005. As of 1 October 2004, RUB1 billion (US\$34.4 million) was outstanding under this loan agreement.
- *Alfa-Bank*. We have entered into the following financing agreements with Alfa Bank:
On 15 July 2003, we entered into a loan agreement in the amount of RUB1 billion. The loan carries an interest of 12.5 per cent. and matures on 15 January 2005. As of 1 October 2004, RUB1 billion (US\$34.4 million) was outstanding under this loan agreement.
On 28 November 2003, we entered into a credit facility agreement in the amount of RUB1,260 billion. The interest rate for this loan is to be set by a supplementary agreement between us and Alfa-Bank. As of 1 October 2004, there were no amounts outstanding under this facility.
- *ZAO Citibank*. On 6 June 2003, we entered into a credit facility agreement with ZAO Citibank under which we are permitted to borrow funds from ZAO Citibank in Roubles in an aggregate amount equivalent to up to US\$20 million. All funds borrowed under this agreement will be calculated at the relevant exchange rate as of the time of the borrowing,

subject to agreement on the terms of borrowing. The purpose of this credit facility is to finance our working capital requirements. As of 1 October 2004, RUB580 million (US\$20.0 million) was outstanding under this credit facility agreement, bearing interest at a rate of 8 per cent.

Multi-Currency Borrowings

- *AKB Derzhava*. On 26 June 2003, we entered into a loan agreement with AKB Derzhava. This loan agreement has a US Dollar tranche of US\$150 million and a Rouble tranche of RUB3 billion. The interest rate for this facility is 21 per cent. for Rouble-denominated borrowings and 12 per cent. for US Dollar-denominated borrowings. This agreement expires 20 June 2005. As of 1 October 2004, no amounts were outstanding under this agreement.

- *JP Morgan Bank International*. On 8 August 2003, we entered into a framework credit facility agreement with JP Morgan Bank International, under which we are permitted to borrow funds in Roubles or US Dollars upon request, subject to agreement on the terms of the borrowing. The interest rate for this agreement is set at the time of each borrowing. As of 1 October 2004, no amounts were outstanding under this credit facility agreement.

- *International Moscow Bank*. We have entered into the following credit agreements with International Moscow Bank:

On 26 November 2003, we entered into a US\$20 million credit facility agreement. The interest rate for this facility is LIBOR plus 4 per cent and the facility expires on 31 October 2004. As of 1 October 2004, US\$20 million was outstanding under this credit agreement.

On 26 November 2003, we entered into a loan agreement in the amount of RUB590 million. The interest rate for this agreement is determined on a case-by-case basis for each borrowing. The loan matures on 31 October 2004. As of 1 October 2004, no amounts were outstanding under this agreement.

On 15 July 2004, we entered into a loan agreement in the amount of US\$40 million with a floating interest rate, which is dependent on the duration of the loan. As of 1 October 2004, the interest rate for this agreement was 6.4 per cent. The maximum possible rate for the loan is LIBOR plus 4.75 per cent. This agreement expires on 15 July 2007. As of 1 October 2004, US\$581,000 was outstanding under this credit agreement.

On 15 July 2004, we entered into a loan agreement for RUB1.1 billion. The interest rate for this agreement is determined on a case-by-case basis for each borrowing. This loan matures on 15 July 2007. As of 1 October 2004, no amounts were outstanding under this agreement.

The total amount of indebtedness under the above-described credit agreements may not exceed US\$40 million or the Rouble equivalent of that sum.

- *OAo Impexbank*. On 28 April 2004, we entered into a credit facility agreement with OAo Impexbank under which we may borrow funds in Roubles and US Dollars on the terms agreed between the parties through the Reuters Dealing System or through negotiations. The total amount to be drawn under this agreement is US\$20 million or the Rouble equivalent of this sum, with the interest rate to be determined on a case-by case basis for each borrowing. Each of the amounts drawn down under this agreement must be repaid within 30 days of drawdown. The agreement expires on 28 April 2005. As of 1 October 2004, no amounts were outstanding under this credit facility agreement.

- *Nomos Bank*. On 7 June 2004, we entered into a credit facility agreement with Nomos Bank under which we may borrow funds in Roubles and US Dollars on the terms agreed between the parties through the Reuters Dealing System or through negotiations. The total amount to be drawn under this agreement is US\$20 million or the Rouble equivalent of this sum, with the interest rate to be determined on a case-by case basis for each borrowing. Each of the amounts drawn down under this agreement must be repaid within 30 days of the drawdown. This agreement expires on 7 September 2005. As of 1 October 2004, no amounts were outstanding under this credit facility agreement.

- *Vneshtorgbank*. On 30 June 2004, we entered into a credit facility agreement with Vneshtorgbank. Under this facility, we may borrow funds in Roubles, Euro or US Dollars on the terms agreed between the parties through the Reuters Dealing System or through negotiations. The total amount to be drawn under this agreement is US\$30 million or the equivalent of this sum, with the interest rate to be determined on a case-by case basis for

each borrowing. Each of the amounts drawn down under this agreement is to be repaid within 30 days of the drawdown. This agreement expires on 11 May 2005. As of 1 October 2004, no amounts were outstanding under this credit facility agreement.

- *WestLB.* On 5 April 2004, we entered into a short-term credit facility agreement with WestLB Vostok Bank. Under this facility, we may borrow funds for periods of up to three months in Roubles, US Dollars or Euro on the terms agreed between the parties through the Reuters Dealing System or through negotiations. As of 1 October 2004, no amounts were outstanding under this credit facility agreement.

Rouble-Denominated Bonds

As of 15 October 2004, we had a total of RUB4 billion (US\$137.8 million) of Rouble-denominated bonds issued and outstanding, due as follows:

Principal Amount	Guarantor	Interest Rate	Maturity
RUB500 million (US\$17.2 million)	—	Floating rate tied to the Rouble/ US Dollar exchange rate set by the Central Bank	17 February 2005
RUB125 million (US\$4.3 million)	OAO Investment Group ALROSA	16.0 per cent. for the first coupon; subsequent coupons carry interest at 64.0 per cent. of the then current refinancing rate of the Central Bank	10 January 2005
RUB125 million (US\$4.3 million)	OAO Investment Group ALROSA	16.0 per cent. for the first coupon; subsequent coupons carry interest at 64.0 per cent. of the then current refinancing rate of the Central Bank	11 April 2005
RUB125 million (US\$4.3 million)	OAO Investment Group ALROSA	16.0 per cent. for the first coupon; subsequent coupons carry interest at 64.0 per cent. of the then current refinancing rate of the Central Bank	11 July 2005
RUB125 million (US\$4.3 million)	OAO Investment Group ALROSA	16.0 per cent. for the first coupon; subsequent coupons carry interest at 64.0 per cent. of the then current refinancing rate of the Central Bank	10 October 2005
RUB3.0 billion (US\$103.3 million)	OAO Investment Group ALROSA	16.0 per cent.	23 October 2005

The bonds contain limited covenants and do not restrict asset dispositions, payments to third parties or the incurrence of indebtedness, and they do not contain negative pledge covenants. The terms of the bonds are governed by Russian law.

As of 15 October 2004, the weighted average interest rate of these bonds was 14.29 per cent. RUB3 billion (US\$103.3 million) in aggregate principal amount of these bonds have a fixed interest rate of 16 per cent. RUB1 billion (US\$34.4 million) in aggregate principal amount of these bonds carry variable interest rates, other than certain fixed coupon payments, which are based on the refinancing rate of the Central Bank.

The bonds generally may not be redeemed prior to their maturity.

Commercial Paper

We have issued commercial paper, primarily to service providers as payment for their services. At 30 June 2004, there was RUB577 million (US\$19.9 million) in aggregate principal amount of commercial paper outstanding, including RUB384 million (US\$13.2 million) that will become payable within one year.

Guarantees of Indebtedness

ALROSA Ltd. has provided a number of guarantees as security for the indebtedness of its subsidiaries (other than the Issuer), affiliates and third parties. Currently, the following material guarantees are in force: (i) US\$25 million, expiring 15 December 2005; (ii) US\$31 million, expiring within a year of the date of fulfillment of the borrower's obligations under the underlying agreement, which has been fully provided for; (iii) US\$5.5 million, expiring 17 October 2004; (iv) US\$150 million, expiring 9 March 2006; (v) US\$38 million, expiring 15 December 2004; (vi) RUB400 million, expiring 30 November 2005; (vii) US\$9.8 million, expiring 30 August 2012; (viii) US\$11.6 million, expiring 27 July 2011 and (ix) US\$50 million, plus interest and penalties, if any, expiring upon the borrower's fulfillment of its obligations under the underlying agreement. In addition, we have extended a number of further guarantees, which are denominated in Roubles, US Dollars and Euro and collectively amount to RUB1.5 million (US\$51,671), US\$1 million and €2.2 million, respectively.

Subsidiaries

Material Subsidiaries and Associated Undertakings

Most of our assets are included in, and almost all of our revenues are derived from, ALROSA Ltd. However, ALROSA Ltd. has the following subsidiaries and associates which are considered to be material to its operations:

ALROSA-Nyurba. ALROSA-Nyurba was formed as an open joint stock company under Russian law. It holds the prospecting licence under which our Nyurba division operates its mines. See “Our Business – Our Mining Operations – Nyurba Division”. ALROSA Ltd. owns 86.4 per cent. and controls 86.5 per cent. of ALROSA-Nyurba, the local administration owns 10.0 per cent., 3.5 per cent. is held by our management and employees and the remaining 0.1 per cent. is treasury shares. All work at our Nyurba operations is performed by our Nyurba division pursuant to a services agreement with ALROSA-Nyurba.

Severalmaz. Severalmaz is a diamond mining company, formed as an open joint stock company under Russian law, which holds the licence to mine the Lomonosov diamond field in the Arkhangelsk region of northwestern Russia. ALROSA Ltd. owns 92.4 per cent. of Severalmaz, the administration of the Arkhangelsk Region owns 5.1 per cent. and individuals and legal entities, collectively, own the remaining 2.5 per cent. The principal business address of Severalmaz is 36, Pomorskaya Street, Arkhangelsk, 163061, Russia.

Catoca Mining Ltd. Catoca Mining Ltd. was established in 1992 as a joint venture for the purpose of mining the Catoca diamond pipe in Angola. ALROSA Ltd. currently owns a 32.8 per cent. interest in Catoca Mining Ltd. In addition, Endiama owns 32.8 per cent., Odebrest Mining Services, Inc. owns 16.4 per cent. and Daumonti Financing Company B.V. owns 18.0 per cent. of Catoca Mining Ltd. Our stake in Catoca Mining Ltd. may increase to up to 39.2 per cent. if we participate in the purchase of its shares currently held by Odebrest Mining Services later this year. See “Our Business – The Catoca Mine in Angola”. The principal business address of Catoca Mining Ltd. is Rua Major Kanhangulo, 100-4o, Luanda, Angola.

ALROSA Ltd. has a number of additional direct and indirect subsidiaries which are primarily engaged in the performance of ancillary activities relating to our diamond mining operations. Our current structure is primarily the result of our consolidation of the operations of our predecessor entities, and we have initiated a process to simplify and rationalise this corporate structure as part of our current five-year plan.

Consolidated Subsidiaries

Certain consolidated financial information for ALROSA Ltd. is set forth in “Selected Financial Information”. The consolidated subsidiaries of ALROSA Ltd. are:

Name	Percentage ownership
ZAO ALROSA-Torg	100
OAo Mirny ORS.....	100
OAo LOTK	100
OAo Aikhal ORS.....	100
OAo Irilyakhski ORS.....	100
ZAO ALROSA’s hotels.....	100
ZAO Irilyakhneft.....	100
OAo ALROSA-Lena	100
OAo Udachninski combine of food factories	100
ZAO Sanatoriy Golubaya Volna	100
OOO Almaz-Antarex	100
OOO ALROSA-Okhrana.....	100
OOO ALROSA-Spetsbureniye.....	100
OOO Mirkom.....	100
OAo Udachninski ORS	99
OAo ALROSA-Lenskstroy	98
Pension Fund Almaznaya Osen	97
OAo ALROSA-Yakutsnab.....	94
OAo Severalmaz	92
OAo Viluygesstroy	90
ALROSA – Vneshstroy Ltd	90
OOO Insurance Company ALROSA	90
Mirninsky Commercial Bank (MAK-Bank).....	88
ZAO Vostok-Kapital	88
OAo ALROSA-Nyurba	87
OAo ALROSA-Lesprom	83
OAo Vilyuiskaya GES-3	72
OAo Purnavolok Hotel	63
OAo NPP Burevestnik	60
AO Hydroshikapa Ltd.....	55
OAo ALROSA-Gas	53
ZAO ALROSA-Neva	51
OOO Orel-ALROSA	51
OOO Almazy-Anabara	51
ZAO ALROSA-Avia.....	51
OAo ALROSA-Yakutia.....	51
OAo Investment Group ALROSA	50

All of the foregoing entities were formed under the laws of Russia except for AO Hydroshikapa Ltd and ALROSA – Vneshstroy Ltd, which were formed under the laws of Angola. In addition, ALROSA Ltd. owns 100 per cent. of Alrosa Finance B.V., a private company incorporated with limited liability under the laws of The Netherlands, and Alrosa Finance B.V. owns nearly 100 per cent., less one share, of the Issuer. The percentage ownership of these entities was determined based on the voting share of ALROSA Ltd. and/or its subsidiaries in such entities. In addition to the consolidated entities, ALROSA Ltd. accounts for its minority-owned Catoca Mining Ltd. associated undertaking under the equity method, based on its 32.8 per cent. interest in Catoca Mining Ltd.

OAO Investment Group ALROSA, our subsidiary, holds an ownership interest in the voting shares of the following entities:

Name	Percentage ownership
OAO Yakutskaya Gornaya Company	100
OOO UK Almaz	100
OAO Investment Company Solex	100
OOO Media Group Sitim	100
OOO Regionsnab.....	100
OAO ALROSA-Yugra	100
OOO GRK Aldanzoloto	91

Terms and Conditions of The Notes

The following is the text of the terms and conditions of the Notes which, subject to amendment, will be endorsed on each Definitive Note (as defined below) and will be attached and (subject to the provisions thereof) apply to the Global Notes.

The US\$300,000,000 8.875 per cent. Guaranteed Notes due 2014 (the "Notes", which expression includes any further Notes issued pursuant to Condition 16 and forming a single series therewith) of ALROSA Finance S.A. (the "Issuer") were authorised by a written resolution of the Board of Directors of the Issuer dated 10 November 2004, and the guarantee of the Notes (the "Guarantee") was authorised by a resolution of the Supervisory Council of AK "ALROSA" (ZAO) (the "Guarantor") passed on 22 October 2004. The Notes are constituted by a trust deed dated 16 November 2004 (the "Trust Deed") between the Issuer, the Guarantor and J.P. Morgan Corporate Trustee Services Limited (the "Trustee", which expression shall include all persons for the time being who are the trustee or trustees under the Trust Deed) as trustee for the holders of the Notes. These terms and conditions include summaries of, and are subject to, the detailed provisions of the Trust Deed. The Issuer and the Guarantor have entered into an agency agreement dated 16 November 2004 (the "Agency Agreement") with the Trustee, JPMorgan Chase Bank, N.A., as principal paying agent (the "Principal Paying Agent"), as New York paying agent and as transfer agent, and J.P. Morgan Bank Luxembourg S.A., as registrar (the "Registrar"), as a paying agent in Luxembourg (together with the Principal Paying Agent and the New York paying agent, the "Paying Agents") and transfer agent (together with JPMorgan Chase Bank, N.A., the "Transfer Agents"). The Registrar, Paying Agents and Transfer Agents are together referred to herein as the "Agents". Copies of the Trust Deed and the Agency Agreement are available for inspection during normal business hours at the specified office of the Trustee, being at the date hereof Trinity Tower, 9 Thomas More Street, London, E1W 1YT, United Kingdom, and at the specified offices of the Agents. The Noteholders (as defined below) are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and are deemed to have notice of those provisions of the Agency Agreement applicable to them. Capitalised terms used but not defined in these Terms and Conditions shall have the respective meanings given to them in the Trust Deed.

1 Form and Denomination

The Notes are issued in fully registered form, without interest coupons attached, in denominations of US\$100,000 or integral multiples of US\$1,000 in excess thereof ("authorised denominations"). Title to the Notes shall pass by registration in the register (the "Register") which the Issuer shall procure to be kept by the Registrar. The Notes are initially issued in global, fully registered form, and will only be exchangeable for Notes in definitive, fully registered form ("Definitive Notes") in the limited circumstances set forth in the Agency Agreement and the Global Notes.

2 Guarantee and Status

(a) Guarantee

The Guarantor has in the Trust Deed unconditionally and irrevocably guaranteed the payment when due of all sums expressed to be payable by the Issuer under the Trust Deed and the Notes (the "Guarantee"). The Guarantor's obligations in respect of the Guarantee are contained in the Trust Deed.

The Guarantor has undertaken in the Trust Deed that so long as any of the Notes remains outstanding (as defined in the Trust Deed) it will not take any action for the liquidation or winding-up of the Issuer.

(b) Status

The Notes constitute (subject to Condition 4) unsecured obligations of the Issuer and shall at all times rank *pari passu* and without any preference among themselves. The payment obligations of the Issuer under the Notes and of the Guarantor under the Guarantee shall, save for such exceptions as may arise by mandatory operation of law and subject to Condition 4, at all times rank at least equally with all other present and future unsecured and unsubordinated obligations of the Issuer and the Guarantor, respectively.

3 Register, Title and Transfers

(a) Register

The Registrar shall maintain the Register in respect of the Notes in accordance with the provisions of the Agency Agreement. The Register shall be kept at the specified office for the time being of the Registrar and shall record the names and addresses of the holders of the Notes, particulars of the Notes and all transfers thereof. In these Conditions, the “holder” of a Note means the person in whose name such Note is for the time being registered in the Register (or, in the case of a joint holding, the first named thereof) and “Noteholder” shall be construed accordingly.

(b) Title

Title to the Notes will pass by and upon registration in the Register. The holder of each Note shall (except as otherwise required by a court of competent jurisdiction or applicable law) be treated as the absolute owner of such Note for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing on the Definitive Note relating thereto (other than the endorsed form of transfer) or any notice of any previous loss or theft of such Definitive Note) and no person shall be liable for so treating such holder.

(c) Transfers

Subject to Conditions 3(f) and 3(g) below, a Note may be transferred in whole or in part in an authorised denomination upon surrender of the relevant Definitive Note representing that Note, together with the form of transfer (including any certification as to compliance with restrictions on transfer included in such form of transfer endorsed thereon) (the “Transfer Form”), duly completed and executed, at the specified office of any Transfer Agent or of the Registrar, together with such evidence as such Agent or the Registrar may reasonably require to prove the title of the transferor and the authority of the persons who have executed the Transfer Form. Where not all the Notes represented by the surrendered Definitive Note are the subject of the transfer, a new Definitive Note in respect of the balance not transferred will be delivered by the Registrar to the transferor in accordance with Condition 3(d). Neither the part transferred nor the balance not transferred may be less than the applicable authorised denomination.

(d) Registration and delivery of Definitive Notes

Within five business days of the surrender of a Definitive Note in accordance with Condition 3(c) above, the Registrar shall register the transfer in question and deliver a new Definitive Note to each relevant holder at the specified office of the Registrar or (at the request of the relevant Noteholder) at the specified office of any Transfer Agent or (at the request and risk of such relevant holder) send it by uninsured first class mail (airmail if overseas) to the address specified for the purpose by such relevant holder.

(e) No Charge

The registration of the transfer of a Note shall be effected without charge to the holder or transferee thereof, but against such indemnity from the holder or transferee thereof as the Registrar may require in respect of any tax or other duty of whatsoever nature which may be levied or imposed in connection with such transfer.

(f) Closed periods

Noteholders may not require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal or interest in respect of such Note.

(g) Regulations concerning Transfer and Registration

All transfers of Notes and entries on the Register are subject to the detailed regulations concerning the transfer and registration of Notes set out in the First Schedule to the Agency Agreement. The regulations may be changed by the Issuer and the Guarantor with the prior written approval of the Trustee, the Paying Agents, the Transfer Agents and the Registrar; provided that any such change will continue to permit registration and transfer of the Notes in Luxembourg. A copy of the current regulations will be sent by the Registrar free of charge

to any person who so requests and will be available at the specified office of the Registrar in London and at the specified office of the Transfer Agent in Luxembourg.

4 Negative Pledge

So long as any of the Notes remains outstanding (as defined in the Trust Deed):

(a) neither the Issuer, the Guarantor nor any Material Subsidiary (as defined below) will create or permit to exist any mortgage, charge, pledge, lien or other form of encumbrance or security interest (a "Security Interest") other than a Permitted Security Interest upon the whole or any part of its property, assets or revenues, present or future, to secure:

(i) payment of any sum due in respect of any Indebtedness of the Issuer, the Guarantor or any Material Subsidiary; or

(ii) any payment under any indemnity or other like obligation relating to any Indebtedness of the Issuer, the Guarantor or any Material Subsidiary; and

(b) each of the Issuer and the Guarantor will procure that no person (other than the Guarantor) gives any guarantee of, or indemnity in respect of, any of the Issuer's or the Guarantor's Indebtedness (except for Indebtedness relating to a specific asset or project in respect of which a guarantee of an export development agency has been given, Project Finance Indebtedness, Trade Finance Indebtedness and Indebtedness incurred specifically to finance a particular shipment or shipments of diamonds and guaranteed by a party which has committed contractually to purchase such shipment or shipments),

without in any such case at the same time according to the Notes, to the satisfaction of the Trustee, either an equivalent and rateable security, guarantee or indemnity as is granted or is given in respect of such other Indebtedness, indemnity or other like obligations or such other security, guarantee or indemnity as the Trustee in its discretion shall reasonably deem to be not materially less beneficial to the Noteholders or as shall be approved by an Extraordinary Resolution (as defined in the Trust Deed).

The Issuer and the Guarantor have undertaken in the Trust Deed to deliver to the Trustee from time to time upon request of the Trustee certificates prepared by each of them as to compliance with this Condition 4. The Trustee is not obliged independently to monitor compliance with this Condition 4 and shall be entitled to rely on such certificates and need not enquire further as regards the circumstances then existing.

5 Covenants

(a) Asset Sales

So long as any amount remains outstanding hereunder, the Guarantor shall not, and shall ensure that no member of the Group engages in, an Asset Sale, in each case if such Asset Sale has a Material Adverse Effect.

(b) Business Activities

So long as any of the Notes remains outstanding (as defined in the Trust Deed), the Guarantor will not, and will not permit any of its Subsidiaries to, engage in any business other than a Permitted Business.

(c) Maintenance of Authorisations

So long as any of the Notes remains outstanding (as defined in the Trust Deed), the Issuer and the Guarantor shall take all necessary action to maintain, obtain and promptly renew, and do or cause to be done all things reasonably necessary to ensure the continuance of, all consents, licences, approvals and authorisations, and make or cause to be made all registrations, recordings and filings, which may at any time be required to be obtained or made in the Grand Duchy of Luxembourg and the Russian Federation (including, for the avoidance of doubt, with the Central Bank of the Russian Federation) for (i) the execution, delivery or performance of the Trust Deed, the Agency Agreement, the Notes and the Guarantee, or for the validity or enforceability thereof or (ii) the conduct by it of the Permitted Business, but only if the failure to maintain, obtain, renew or ensure the continuance of such consents, licences, approvals and authorisations, registrations, recordings and filings would have a Material Adverse Effect.

(d) Maintenance of Property

So long as any of the Notes remains outstanding (as defined in the Trust Deed), the Group shall cause all property used in the carrying on by it of its Permitted Business for the time being to be kept in good repair and working order as, in the judgement of the Guarantor, may be reasonably necessary so that the Permitted Business may be carried on, but only if the failure to keep such property in such condition would have a Material Adverse Effect.

(e) Maintenance of Insurance

So long as any of the Notes remains outstanding (as defined in the Trust Deed), the Group shall continue to maintain, with respect to those of its properties and assets which it currently insures against loss or damage, such insurance with insurers who implement good business practices and are believed by the Guarantor to be responsible against loss or damage in amounts equivalent to, and upon terms at least as favourable to the Group as, the insurance maintained by the Group on the Issue Date.

(f) Transactions with Affiliates

So long as any of the Notes remains outstanding (as defined in the Trust Deed), the Guarantor will not, and will not permit any of its Subsidiaries to, make any payment to, or sell, lease, transfer or otherwise dispose of any of its properties or assets to, or purchase any properties or assets from, or enter into or make or amend any transaction, contract, agreement, understanding, loan, advance or guarantee with or for the benefit of, any Affiliate (each, an "Affiliate Transaction") unless:

(i) such Affiliate Transaction is on terms that are no less favourable to the Guarantor or the relevant Subsidiary than those that would have been obtained in a comparable transaction by the Guarantor or such Subsidiary with an unrelated Person; and

(ii) the Guarantor:

(A) with respect to any Affiliate Transaction or series of related Affiliate Transactions to which the Guarantor or the relevant Subsidiary is a party and which constitute "interested party transactions" under applicable Russian legislation involving aggregate consideration in excess of US\$15,000,000, will deliver to the Trustee resolutions or other evidence of requisite approval by the particular governing body of the Guarantor or such relevant Subsidiary required under applicable Russian legislation to approve such Affiliate Transaction or series of related Affiliate Transactions; and

(B) with respect to any Affiliate Transaction or series of related Affiliate Transactions involving aggregate consideration in excess of US\$30,000,000, will deliver to the Trustee an opinion as to the fairness to the Noteholders of such Affiliate Transaction from a financial point of view issued by an Independent Appraiser.

The following items shall not be deemed to be Affiliate Transactions and, therefore, will not be subject to the provisions of this Condition 5(f):

(1) any compensation or employment agreement entered into by any member of the Group in the ordinary course of its business or in existence on the Issue Date (as defined below) and agreements relating to employment matters of the Guarantor and any of its Subsidiaries;

(2) transactions between or among all or any of the Guarantor and/or its Subsidiaries (including, without limitation, any Sale and Leaseback Transaction);

(3) transactions between a Receivables Subsidiary and any Person in which the Receivables Subsidiary has an Investment;

(4) payment of reasonable directors' fees to Persons who are not otherwise Affiliates of the Guarantor or its Subsidiaries;

(5) sales of Equity Interests (or grants of options for the purchase thereof) of the Guarantor or its Subsidiaries to Affiliates of the Guarantor or Affiliates of its Subsidiaries;

(6) transactions with a Person that is an Affiliate of the Guarantor or a Subsidiary of the Guarantor solely because the Guarantor or such Subsidiary owns an Equity Interest in such Person;

(7) Restricted Payments that are permitted by Condition 5(g) or Permitted Investments;

(8) transactions relating to any Social Business; and

(9) transactions pursuant to agreements and arrangements existing on the Issue Date.

(g) Restricted Payments

The Guarantor will not, and will not permit any of its Subsidiaries to, directly or indirectly:

(1) declare or pay any dividend or make any other payment or distribution (a) on account of the Guarantor's or any of its Subsidiaries' Equity Interests or (b) to the direct or indirect holders of the Guarantor's or any of its Subsidiaries' Equity Interests in their capacity as such, in each case, other than dividends, payments or distributions payable in Equity Interests (other than Disqualified Stock) of the Guarantor or payable to the Guarantor or a Subsidiary of the Guarantor;

(2) purchase, redeem or otherwise acquire or retire for value any Equity Interests of the Guarantor (other than any such Equity Interests owned by the Guarantor or a Subsidiary of the Guarantor);

(3) make any payment on or with respect to, or purchase, redeem, defease or otherwise acquire or retire for value, any Subordinated Indebtedness, except for scheduled payments of interest or payments of the principal thereof at Stated Maturity or within 30 days of the date of any such scheduled payment or Stated Maturity; or

(4) make any Restricted Investment (all such payments and other actions set forth in clauses (1) through (4) above being collectively referred to as "Restricted Payments"),

unless, at the time of and after giving effect to such Restricted Payment:

(i) no Potential Event of Default or Event of Default shall have occurred and be continuing or would occur as a consequence thereof; and

(ii) the Guarantor would, at the time of such Restricted Payment and after giving pro forma effect thereto as if such Restricted Payment had been made at the beginning of the applicable Four Quarter Period (as defined below in the definition of Fixed Charge Coverage Ratio), have been permitted to incur at least US\$1.00 of Indebtedness (including Permitted Indebtedness) pursuant to Condition 5(h); and

(iii) such Restricted Payment, together with (without duplication) the aggregate amount of all other Restricted Payments made by the Guarantor and its Subsidiaries after 1 January 2003 (excluding Restricted Payments permitted by clauses (2) and (3) of the next succeeding paragraph), shall not exceed the sum (without duplication) of:

(a) 50 per cent. of the Adjusted Consolidated Net Income of the Guarantor for the period (taken as one accounting period) from 1 January 2003 to the end of the Guarantor's most recently ended financial six-month period or year, as the case may be, for which financial statements are available at the time of such Restricted Payment (or, if such Adjusted Consolidated Net Income for such period is a deficit, less 100 per cent. of such deficit); plus

(b) 100 per cent. of the aggregate net cash proceeds (including Cash Equivalents) received by the Guarantor from the issue or sale (other than to a Subsidiary) of or from capital contributions with respect to Equity Interests of the Guarantor (other than Disqualified Stock and other than Capital Stock of the Guarantor owned by employees to the extent the purchase of such Capital Stock is financed with the proceeds of loans or advances from the Guarantor or a Subsidiary of the Guarantor), in each case after the Issue Date; plus

(c) 100 per cent. of the aggregate principal amount (or accreted value, if less) of Indebtedness of the Guarantor or any Subsidiary of the Guarantor issued for cash since the Issue Date (other than to a Subsidiary of the Guarantor) that has been converted or exchanged into Equity Interests (other than Disqualified Stock) of the Guarantor; plus

(d) 100 per cent. of the aggregate net cash and Cash Equivalents received by the Guarantor or a Subsidiary since the Issue Date (to the extent not included in Adjusted Consolidated Net Income) from a Restricted Investment, whether through interest payments, principal payments, dividends or other distributions and payments or the sale or other disposition (other than to a Subsidiary) thereof made by the Guarantor and its Subsidiary.

So long as no Potential Event of Default or Event of Default has occurred and is continuing or would be caused thereby, the preceding provisions will not prohibit:

- (5) the payment of any dividend within 12 months after the date of declaration thereof, if at the date of declaration such payment would have complied with the provisions of these Conditions;
- (6) the redemption, repurchase, retirement or other acquisition of any Subordinated Indebtedness of the Issuer or the Guarantor, or of any Equity Interests of the Guarantor in exchange for, or out of the net cash proceeds of the substantially concurrent sale (other than to a Subsidiary of the Guarantor) of, Equity Interests of the Guarantor (other than Disqualified Stock); provided that the amount of any such net cash proceeds that are utilised for any such redemption, repurchase, retirement or other acquisition shall be excluded from clause (iii)(b) of the preceding paragraph;
- (7) the payment of any dividend by a Subsidiary of the Guarantor to the holders of its ordinary Equity Interests on a pro rata basis;
- (8) the repurchase, redemption or other acquisition or retirement for value of any Equity Interests of the Guarantor held by any director or officer of the Guarantor or any of its Subsidiaries pursuant to any management equity subscription agreement or stock option agreement; provided that the aggregate price paid for all such repurchased, redeemed, acquired or retired Equity Interests shall not exceed US\$5,000,000 in any 12-month period and shall not exceed US\$10,000,000 in the aggregate;
- (9) purchases of all or a portion of any Equity Interests in a Subsidiary of the Guarantor that are held by a Person that is not a Group member;
- (10) the redemption, repurchase, retirement or other acquisition of any Permitted Indebtedness consisting of Subordinated Indebtedness, in exchange for, or out of the net cash proceeds of, an incurrence of Permitted Refinancing Indebtedness; and
- (11) Restricted Payments pursuant to agreements and arrangements existing on the Issue Date.

The amount of all Restricted Payments (other than cash) shall be the fair market value on the date of the Restricted Payment of the asset(s) or securities proposed to be transferred or issued to or by the Guarantor or such Subsidiary, as the case may be, pursuant to such Restricted Payment. The fair market value of any assets or securities that are required to be valued by this Condition 5(g) shall be determined by (i) the Management Board of the Guarantor in respect of amounts up to and including US\$25,000,000 and (ii) the Supervisory Council of the Guarantor in respect of amounts in excess of US\$25,000,000. Not later than 30 days after the date of making any Restricted Payment, the Issuer and the Guarantor shall deliver to the Trustee an Officers' Certificate stating that such Restricted Payment is permitted and setting forth the basis upon which the calculations required by this Condition 5(g) were computed, together with a copy of any fairness opinion or appraisal required by the Trust Deed.

Notwithstanding anything herein to the contrary, nothing in this Condition 5(g) shall prohibit the declaration and/or payment by the Guarantor of any dividend of the Guarantor in respect of the year ended 31 December 2003, in an aggregate amount not greater than the amount permitted under applicable Russian law.

(h) Incurrence of Indebtedness

The Guarantor will not, and will not permit any of its Subsidiaries to, directly or indirectly, create, incur, issue, assume, guarantee or otherwise become directly or indirectly liable, contingently or otherwise, with respect to (collectively, "incur") any Indebtedness (including Acquired Debt) except for Permitted Indebtedness; *provided* that the Guarantor and its Subsidiaries may also incur Indebtedness (including Acquired Debt) in addition to Permitted Indebtedness if the Fixed Charge Coverage Ratio of the Guarantor would be at least 3.5 to 1.0.

The accrual of interest and the accretion or amortisation of original issue discount will not be deemed to be an incurrence of Indebtedness for purposes of this Condition 5(h); provided, in each such case, that the amount thereof is included, as accrued, in Fixed Charges of the Guarantor.

For purposes of determining compliance with this Condition, if an item of proposed Indebtedness is entitled to be incurred pursuant to this Condition, the Issuer or the Guarantor

will be permitted to classify such item of Indebtedness on the date of its incurrence, or later reclassify all or a portion of such item of Indebtedness, in any manner that complies with this Condition.

For purposes of this Condition 5(h), the Dollar equivalent amount of any non-Dollar denominated Indebtedness will be calculated based on the relevant currency exchange rate in effect on (i) the Issue Date (in the case of Indebtedness incurred on or before the Issue Date), or (ii) the date such Indebtedness was incurred (in the case of Indebtedness incurred after the Issue Date).

(i) Financial Statements etc.

So long as any of the Notes remain outstanding (as defined in the Trust Deed), the Issuer, failing which the Guarantor, shall deliver to the Trustee:

(1) not later than seven months after the end of the Guarantor's financial year, copies of the Guarantor's audited consolidated financial statements for such financial year, prepared in accordance with IFRS consistently applied, together with the corresponding financial statements for the preceding period, and all such annual financial statements of the Guarantor shall be accompanied by the report of the Auditors thereon;

(2) not later than 120 days after the end of the first six months of each of the Guarantor's financial years, copies of its unaudited consolidated financial statements for such six-month period, prepared in accordance with IFRS consistently applied, together with the corresponding financial statements for the preceding period; and

(3) in the case of every other item referred to below, not later than 20 days after their initial distribution to any of the persons referred to below,

three copies in English of every balance sheet, profit and loss account and, to the extent permitted by applicable law, every report or other notice, statement or circular issued, or which legally should be issued, to the members or holders of securities (generally) of the Issuer or the Guarantor or any holding company thereof generally in their capacity as such.

(j) Sale and Leaseback Transactions

The Guarantor will not, and will not permit any of its Subsidiaries to, enter into any Sale and Leaseback Transaction; *provided* that the Guarantor or any of its Subsidiaries may enter into a Sale and Leaseback Transaction if:

(1) the Guarantor or such Subsidiary could have (a) incurred Indebtedness in an amount equal to the Attributable Debt relating to such Sale and Leaseback Transaction under Condition 5(h) and (b) incurred a Security Interest to secure such Indebtedness pursuant to Condition 4;

(2) the gross cash proceeds of such Sale and Leaseback Transaction are at least equal to the Fair Market Value (as determined in accordance with the definition of such term, the results of which determination shall be set forth in an Officers' Certificate delivered to the Trustee) of the property that is the subject of such Sale and Leaseback Transaction; and

(3) the transfer of assets in that Sale and Leaseback Transaction is not prohibited by Condition 5(a).

Sale and Leaseback Transactions solely between or among all or any of the Guarantor and/or its Subsidiaries shall not be subject to the provisions of this Condition 5(j).

(k) Limitation on Merger and Consolidation

The Issuer and the Guarantor shall not and the Guarantor shall procure that no other Material Subsidiary shall, without the prior consent of the Trustee, engage in the following transactions (each such transaction or series of transactions, a "Merger"):

(1) merge, consolidate, amalgamate or otherwise combine with or into another Person (whether or not the Issuer, Guarantor or such Material Subsidiary is the surviving entity); or

(2) sell, assign, transfer, convey or otherwise dispose of (or cause or permit any Material Subsidiary to sell, assign, transfer, convey or otherwise dispose of) all or substantially all of the properties or assets of the Group, in one or more related transactions, to another Person,

unless:

(A) the Issuer, the Guarantor or such Material Subsidiary, as the case may be, is the surviving entity;

(B) the Person formed by or surviving any such consolidation or merger (if other than the Issuer, the Guarantor or such Material Subsidiary) or the Person to which such sale, assignment, transfer, conveyance or other disposition shall have been made assumes all the obligations (if any) of the Issuer, the Guarantor or such Material Subsidiary, as the case may be, under the Notes, the Trust Deed and the Guarantee pursuant to agreements reasonably satisfactory to the Trustee;

(C) immediately after such transaction no Potential Event of Default or Event of Default exists; and

(D) the Guarantor or, if the Guarantor engages in a Merger, the surviving entity or the Person to which such sale, assignment, transfer, conveyance or other disposition shall have been made: (i) will have Adjusted Consolidated Net Worth immediately after the transaction equal to or greater than the Adjusted Consolidated Net Worth of the Guarantor immediately preceding the transaction and (ii) will, on the date of such transaction after giving pro forma effect thereto and any related financing transactions as if the same had occurred at the beginning of the applicable Four-Quarter Period, be permitted to incur at least US\$1.00 of additional Indebtedness pursuant to the Fixed Charge Coverage Ratio test set forth in Condition 5(h).

Notwithstanding the foregoing, nothing in these Conditions shall prohibit the reorganisation of the Guarantor involving its conversion from a "Closed Joint Stock Company" to an "Open Joint Stock Company" for purposes of the Law "On Joint Stock Companies" of 26 December 1995, as amended.

This Condition 5(k) will not apply to a Merger between or among the Guarantor and any of its Wholly Owned Subsidiaries.

(l) Changes in Covenants When Notes Rated Investment Grade

If on any date following the Issue Date:

(i) The Notes are rated Baa3 or better by Moody's and BBB- or better by S&P (or, if either such entity ceases to rate the Notes for reasons outside the control of the Guarantor, the equivalent investment grade credit rating from any other "nationally recognised statistical rating organisation" within the meaning of Rule 15c3-1(c)(2)(vi)(F) under the US Securities Exchange Act of 1934, selected by the Guarantor as a replacement agency, if any such agency exists at such time) (such ratings referred to collectively as an "Investment Grade Rating"); and

(ii) No Potential Event of Default or Event of Default shall have occurred and be continuing, then, beginning on that date and continuing at all times thereafter, regardless of any subsequent changes in the rating of the Notes, Conditions 5(a), (f), (g), (h) and (j), and Clause (D) of Condition 5(k), will no longer be applicable to the Notes.

(m) Trustee's Reliance

The Issuer and the Guarantor have undertaken in the Trust Deed to deliver to the Trustee from time to time a certificate of the Issuer or, as the case may be, of the Guarantor, as to there not having occurred an Event of Default or Potential Event of Default since the date of the last such certificate, or, if such an event had occurred, as to the details of such event, in the form set out in the Trust Deed. The Trustee will be entitled to rely on any such certificate and shall not be obliged independently to monitor compliance by the Issuer or the Guarantor with the covenants set forth in this Condition 5 and need not enquire further as regards the circumstances existing on the date of such certificate.

6 Interest

The Notes bear interest from the Issue Date at the rate of 8.875 per cent. per annum, payable in equal instalments semi-annually in arrear on 17 May and 17 November in each year, commencing on 17 May 2005. The Notes will cease to bear interest from the due date for redemption unless, upon due presentation, payment of principal is improperly withheld or

refused. In such event the Notes shall continue to bear interest at such rate (both before and after judgment) until whichever is the earlier of (a) the day on which all sums due in respect of the Notes up to that day are received by or on behalf of the relevant holder, and (b) the day seven days after the Trustee or the Principal Paying Agent has notified Noteholders of receipt of all sums due in respect of all the Notes up to that seventh day (except to the extent that there is failure in the subsequent payment to the relevant holders under these Conditions). If interest is required to be calculated for a period other than a semi-annual interest period, it will be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed.

7 Redemption and Purchase

(a) Final redemption

Unless previously redeemed, or purchased and cancelled, the Notes will be redeemed at their principal amount on 17 November 2014.

(b) Redemption for tax reasons

The Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Noteholders and, for so long as the Notes are listed on the Luxembourg Stock Exchange, to such Exchange (which notice shall be irrevocable) at the principal amount thereof, together with interest accrued to the date fixed for redemption, if (i) the Issuer satisfies the Trustee immediately prior to the giving of such notice that it (or, if the Guarantee was called, the Guarantor) has or will become obliged to pay additional amounts as provided or referred to in Condition 9 as a result of any change in, or amendment to, the laws or regulations of the Grand Duchy of Luxembourg or the Russian Federation or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after 16 November 2004 and (ii) such obligation cannot be avoided by the Issuer (or the Guarantor, as the case may be) taking reasonable measures available to it; provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer (or the Guarantor, as the case may be) would be obliged to pay such additional amounts were a payment in respect of the Notes (or the Guarantee, as the case may be) then due. Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Trustee (i) a certificate signed by two directors of the Issuer (or the President of the Guarantor, as the case may be) stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred and the Trustee shall be entitled to accept such certificate as sufficient evidence of the satisfaction of such conditions precedent, in which event it shall be conclusive and binding on the Noteholders and (ii) an opinion of independent legal advisers of recognised standing to the effect that the Issuer (or the Guarantor, as the case may be) has or will become obliged to pay such additional amounts as a result of such change or amendment. All Notes in respect of which any such notice of redemption is given under this Condition shall be redeemed on the date specified in such notice in accordance with this Condition.

(c) Redemption of 144A Notes

The Issuer may compel any beneficial owner of Notes sold pursuant to Rule 144A under the Securities Act to sell its interest in such Notes, or may sell such interest on behalf of such holder, if such holder is a US person that is not a qualified institutional buyer (as defined in Rule 144A under the Securities Act).

(d) Redemption at the option of the Issuer

The Issuer shall not be entitled to redeem the Notes otherwise than as provided in paragraphs (a), (b) and (c) above. All Notes in respect of which any such notice of redemption is given under this Condition 7 shall be redeemed on the date specified in such notice in accordance with this Condition 7.

(e) Purchase

The Issuer, the Guarantor and any of their respective Subsidiaries may at any time purchase Notes in the open market or otherwise at any price.

(f) Cancellation

All Notes redeemed or purchased pursuant to this Condition 7 shall be cancelled forthwith and may not be held or resold. Any Notes so cancelled may not be reissued.

8 Payments

(a) Principal

Payments of principal (whenever due) and interest due on redemption shall be made by the Paying Agents by US Dollar cheque drawn on a bank in New York City, or by transfer to a US Dollar account maintained by the payee with, a bank in New York City and shall only be made upon surrender (or, in the case of part payment only, endorsement) of the relevant Definitive Notes at the specified office of any Paying Agent.

(b) Interest

Payments of interest (other than interest due on redemption) shall be made by the Paying Agents by US Dollar cheque drawn on a bank in New York City, or by transfer to a US Dollar account maintained by the payee with, a bank in New York City not later than the due date for such payment.

(c) Payments subject to fiscal laws

All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations, but without prejudice to the provisions of Condition 9. No commissions or expenses shall be charged to the Noteholders in respect of such payments.

(d) Payments on business days

If the due date for any payment of principal or interest under this Condition 8 is not a business day, the holder of a Note shall not be entitled to payment of the amount due until the next following business day and shall not be entitled to any further interest or other payment in respect of any such delay. In this Condition 8, "business day" means any day on which banks are open for business in the place of the specified office of the relevant Paying Agent and, in the case of payment by transfer to a US Dollar account as referred to above, on which dealings in foreign currencies may be carried on both in New York City and in such other place.

(e) Record date

Each payment in respect of a Note will be made to the person shown as the holder in the Register at the opening of business (in the place of the Registrar's specified office) on the fifteenth day before the due date for such payment. Any cheque will be mailed to the holder of the relevant Note at his address appearing in the Register.

(f) Agents

The initial Agents and their initial specified offices are listed below. The Issuer and the Guarantor, acting together, reserve the right to vary or terminate the appointment of all or any of the Agents at any time and appoint additional or other payment or transfer agents, provided that they will maintain (i) a Principal Paying Agent, (ii) Paying and Transfer Agents having specified offices in at least two major European cities approved by the Trustee, including Luxembourg so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of such Exchange so require and (iii) a Paying Agent with a specified office in a European Union member state that will not be obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive. Notice of any such change will be provided as described in Condition 17 below.

9 Taxation

All payments of principal and interest in respect of the Notes by the Issuer or under the Guarantee by the Guarantor shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by or within the Grand Duchy of Luxembourg or the Russian Federation or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In that event, the Issuer or (as the case may be) the Guarantor shall increase the relevant payment so as to result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, except that no such additional amounts shall be payable in respect of any Note:

- (a) held by a holder which is liable to such taxes, duties, assessments or governmental charges in respect of such Note or the Guarantee by reason of its having some connection with the Grand Duchy of Luxembourg or (as the case may be) the Russian Federation other than the mere holding of such Note or the benefit of the Guarantee; or
- (b) where (in the case of a payment of principal or interest on redemption) the relevant Definitive Note is surrendered for payment more than 30 days after the Relevant Date except to the extent that the relevant holder would have been entitled to such additional amounts if it had surrendered the relevant Definitive Note on the last day of such period of 30 days; or
- (c) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (d) by or on behalf of a Noteholder who would have been able to avoid such withholding or deduction by presenting the relevant Definitive Note to another Paying Agent in a member state of the European Union.

In these Conditions, "Relevant Date" means whichever is the later of (a) the date on which the payment in question first becomes due and (b) if the full amount payable has not been received in New York City by or for the account of the Principal Paying Agent or the Trustee on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders.

Any reference in these Conditions to principal or interest shall be deemed to include any additional amounts in respect of principal or interest (as the case may be) which may be payable under this Condition.

If the Issuer or the Guarantor becomes subject at any time to any taxing jurisdiction other than (or in addition to) the Grand Duchy of Luxembourg or the Russian Federation, respectively, references in these Conditions to the Grand Duchy of Luxembourg or the Russian Federation shall be construed as references to the Grand Duchy of Luxembourg or (as the case may be) the Russian Federation and/or such other jurisdiction.

10 Events of Default

The Trustee at its discretion may, and if so requested in writing by the holders of not less than one-quarter in principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution (subject in each case to being indemnified to its satisfaction) shall, give notice to the Issuer that the Notes are, and they shall immediately become, due and repayable at their principal amount together with accrued interest if any of the following events occurs and is continuing (each, an "Event of Default"):

- (a) the Issuer fails to pay any amounts payable on any of the Notes when due and, in the case of payment of interest, such failure continues for a period of five business days; or
- (b) the Issuer or the Guarantor does not perform or comply with any one or more of its other obligations in the Notes or the Trust Deed which default (i) is (in the opinion of the Trustee) incapable of remedy and, in the case of a breach of an obligation under the Trust Deed, materially prejudicial to the interests of the Noteholders or (ii) if in the opinion of the Trustee capable of remedy, is not in the opinion of the Trustee remedied within 30 days (or

such longer period as the Trustee may in its sole discretion determine) after notice of such default shall have been given to the Issuer or the Guarantor by the Trustee; or

(c) any Indebtedness of the Issuer, the Guarantor or any Material Subsidiary is not paid when due, or within any originally applicable grace period, or any Indebtedness of the Issuer, the Guarantor or any Material Subsidiary is either declared to be or otherwise becomes due and payable prior to its specified maturity otherwise than at the option of the Issuer, the Guarantor or any Material Subsidiary (as the case may be) or (provided that no event of default, howsoever described, has occurred) any person entitled to such Indebtedness; provided, however, that the total amount of such Indebtedness which is not paid when due or becomes due and payable prior to its specified maturity is equal to or greater than US\$10,000,000 (or its equivalent in another currency) disregarding any guarantee of such Indebtedness by the Issuer, the Guarantor or any Material Subsidiary (as the case may be); or

(d) a judgment or order of a court of competent jurisdiction for the payment of any amount in excess of US\$20,000,000 or its equivalent (as reasonably determined by the Trustee, such determination to be binding on the Issuer, the Guarantor and the Noteholders) is rendered against the Issuer, the Guarantor or any Material Subsidiary and continues unsatisfied and unstayed or uncontested for a period of 45 days after the date thereof or, if later, the date therein specified for payment or on which such judgment or order otherwise becomes enforceable; or

(e) any mortgage, charge, pledge, lien or other encumbrance, present or future, created or assumed by the Issuer or the Guarantor or any Material Subsidiary in respect of any Indebtedness in an aggregate principal amount in excess of US\$20,000,000 or its equivalent (as determined by the Trustee, such determination to be binding on the Issuer, the Guarantor and the Noteholders) becomes enforceable and any step is taken to enforce it (including the taking of possession or the appointment of a receiver, manager or other similar person) and such enforcement is not stayed or discharged within 45 days (or such longer period as the Trustee may consider appropriate in relation to the jurisdiction concerned) of such step having been taken unless, and for so long as, the Trustee is satisfied that it is being contested in good faith and diligently; or

(f) (i) the Issuer or any of its Subsidiaries is unable to pay its Indebtedness as it falls due or is declared insolvent or bankrupt by a competent court or judiciary or petitions the courts for a suspension of payments or suspends payments of its Indebtedness generally or makes any agreement for the deferral, rescheduling or other readjustment of all of its Indebtedness or all of a particular type of its Indebtedness which it will or might otherwise be unable to pay when due or makes a general assignment or arrangement or composition with or for the benefit of its creditors in respect of its Indebtedness generally or a moratorium or suspension of payments is agreed or declared in respect of or affecting its Indebtedness generally; or (ii) the Guarantor or any Material Subsidiary is unable to pay its Indebtedness as it falls due or is declared insolvent or bankrupt by an appropriate judicial body or petitions the courts for a suspension of payments or suspends payments of its Indebtedness generally or makes any agreement for the deferral, rescheduling or other readjustment of all of its Indebtedness (or all of a particular type of its Indebtedness the deferral, rescheduling or other readjustment of which is, in the opinion of the Trustee, materially prejudicial to the interests of the Noteholders) which it will or might otherwise be unable to pay when due or makes a general assignment or arrangement or composition with or for the benefit of its creditors in respect of its Indebtedness generally or a moratorium or suspension of payments is agreed or declared in respect of its Indebtedness generally and, following the occurrence of any of the events specified in this clause (ii) in relation to a Material Subsidiary, the Trustee is of the opinion that such occurrence is materially prejudicial to the interests of the Noteholders; or

(g) an order of a court of competent jurisdiction is made or an effective resolution is passed for the winding-up, liquidation or dissolution of the Issuer, the Guarantor or any Material Subsidiary which (in the case of a Material Subsidiary) is (in the opinion of the Trustee) materially prejudicial to the interests of the Noteholders, or (ii) the Issuer, the Guarantor or any Material Subsidiary ceases to carry on all or a substantial part of its business or operations which cessation (in the case of a Material Subsidiary) is (in the opinion of the Trustee) materially prejudicial to the interests of the Noteholders, except, in each case, for the purpose of and followed by a reconstruction, amalgamation, reorganisation, merger or consolidation (A) on terms approved by the Trustee or by an Extraordinary Resolution of the Noteholders or

(B) in the case of a Material Subsidiary, whereby the undertaking and assets of such Subsidiary are transferred to or otherwise vested in the Issuer, the Guarantor or another of their respective Subsidiaries; or

(h) by or under the authority of any agency, authority, central bank, department, government, legislature, minister, ministry, official or public or statutory person (whether autonomous or not) of, or of the government of, a state (an "Agency") the authority of the Issuer, the Guarantor or any Material Subsidiary in the conduct of its business is wholly or substantially curtailed or any Agency seizes, compulsorily acquires, expropriates or nationalises all or any substantial part of the assets or shares of the Issuer, the Guarantor or any Material Subsidiary or any such Agency takes any step for or with a view to any of the foregoing and such curtailment, seizure, compulsory acquisition, expropriation, nationalisation or step is in the opinion (such opinion to be expressed in writing) of the Trustee materially prejudicial to the interests of the Noteholders; or

(i) the Issuer ceases (directly or indirectly) to be wholly owned and controlled by the Guarantor; or

(j) any action, condition or thing (including the obtaining or effecting of any necessary consent, approval, authorisation, exemption, filing, licence, order, recording or registration) at any time required to be taken, fulfilled or done in order (i) to enable the Issuer and the Guarantor lawfully to enter into, exercise their respective rights and perform and comply with their respective obligations under the Notes and the Trust Deed, (ii) to ensure that those obligations are legally binding and enforceable and (iii) to make the Notes and the Trust Deed admissible in evidence in the courts of the Grand Duchy of Luxembourg and the Russian Federation, is not taken, fulfilled or done; or

(k) it is or will become unlawful for the Issuer or the Guarantor to perform or comply with any one or more of its obligations under any of the Notes or the Trust Deed which is (in the opinion of the Trustee) materially prejudicial to the interests of the Noteholders; or

(l) the Guarantee is not (or is claimed by the Guarantor not to be) in full force and effect; or

(m) any event occurs with respect to any member of the Group which under the laws of any relevant jurisdiction has an analogous effect to any of the events referred to in any of the foregoing paragraphs.

The Issuer and the Guarantor have each covenanted in the Trust Deed that at any time after an Event of Default or Potential Event of Default has occurred pursuant to this Condition 10 or if the Trustee believes that such an event has occurred, they will, so far as permitted by applicable law, allow, and procure that each Material Subsidiary will allow, *inter alia*, the Trustee access to its books of account (other than books of account containing information access to which is restricted by applicable law, including Russian law).

11 Prescription

Claims for the payment of principal and interest in respect of any Definitive Note shall be prescribed unless made within 10 years (for claims for the payment of principal) or five years (for claims for the payment of interest) of the appropriate Relevant Date.

12 Replacement of Definitive Notes

If any Definitive Note is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar, subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer and the Guarantor may reasonably require. Mutilated or defaced Definitive Notes must be surrendered before replacements will be issued.

13 Meetings of Noteholders, Modification and Waiver

(a) Meetings of Noteholders

The Trust Deed contains provisions for convening meetings of Noteholders to consider matters affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of any of these Conditions or any provisions of the Trust Deed. Such meetings

shall be held in accordance with the provisions set out in the Trust Deed. Such a meeting may be convened by Noteholders holding not less than 10 per cent. in principal amount of the Notes for the time being outstanding. The quorum at any meeting convened to vote on an Extraordinary Resolution will be two or more persons holding or representing a clear majority in principal amount of the Notes for the time being outstanding, or at any adjourned meeting two or more persons being or representing Noteholders whatever the principal amount of the Notes held or represented, unless the business of such meeting includes consideration of proposals, *inter alia*, (i) to modify the maturity of the Notes or the dates on which interest is payable in respect of the Notes, (ii) to reduce or cancel the principal amount of, or interest on, the Notes, (iii) to alter the method of calculating the amount of any payment in respect of the Notes, (iv) to change the currency of payment of the Notes, (v) to modify the provisions concerning the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution, or (vi) to modify or cancel the Guarantee, in which case the necessary quorum will be two or more persons holding or representing not less than 75 per cent., or at any adjourned meeting not less than 25 per cent., in principal amount of the Notes for the time being outstanding. Any Extraordinary Resolution duly passed shall be binding on Noteholders (whether or not they were present at the meeting at which such resolution was passed).

(b) Modification and Waiver

The Trustee may agree, without the consent of the Noteholders, to (i) any modification of any of the provisions of the Trust Deed or the Notes which is, in the opinion of the Trustee, of a formal, minor or technical nature or is made to correct a manifest error, and (ii) any other modification (except as mentioned in the Trust Deed), and any waiver or authorisation of any breach or proposed breach of any of the provisions of the Notes or the Trust Deed which is in the opinion of the Trustee not materially prejudicial to the interests of the Noteholders. Any such modification, authorisation or waiver shall be binding on the Noteholders and, if the Trustee so requires, shall be notified to the Noteholders as soon as practicable.

(c) Substitution

The Trust Deed contains provisions permitting the Trustee to agree with the Issuer and the Guarantor, subject to such amendment of the Trust Deed and such other conditions as the Trustee may require, but without the consent of the Noteholders, to the substitution of certain other entities in place of the Issuer, or of any previous substituted company, as principal debtor under the Trust Deed and the Notes. In the case of such substitution, the Trustee may agree with the Issuer and the Guarantor, without the consent of the Noteholders, to a change of law governing the Notes and/or the Trust Deed, provided that such change would not in the opinion of the Trustee be materially prejudicial to the interests of Noteholders. Notice of any such substitution will be provided as described in Condition 17 below and, for so long as the Notes are listed on the Luxembourg Stock Exchange, to such Exchange. A supplement to this Offering Circular evidencing such a substitution shall be made available at the office of the Paying Agent in Luxembourg.

(d) Entitlement of the Trustee

In connection with the exercise of its functions (including but not limited to those referred to in this Condition) the Trustee shall have regard to the interests of the Noteholders as a class and shall not have regard to the consequences of such exercise for individual Noteholders and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer, the Guarantor, the Trustee or any other Person, any indemnification or payment in respect of any tax consequences of any such exercise upon individual Noteholders.

14 Enforcement

At any time after the Notes become due and payable, the Trustee may, at its discretion and without further notice, institute such proceedings against the Issuer and/or the Guarantor as it may think fit to enforce the terms of the Trust Deed and the Notes (whether by arbitration pursuant to the Trust Deed or by litigation), but it need not take any such proceedings unless (a) it shall have been so directed by an Extraordinary Resolution or so requested in writing by Noteholders holding at least one-quarter in principal amount of the Notes outstanding and

(b) it shall have been indemnified to its satisfaction. No Noteholder may proceed directly against the Issuer or the Guarantor unless the Trustee, having become bound so to proceed, fails to do so within a reasonable time and such failure is continuing.

15 Indemnification of the Trustee

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility. The Trustee is entitled to enter into business transactions with the Issuer, the Guarantor and any entity related to the Issuer or the Guarantor without accounting for any profit.

16 Further Issues

The Issuer may from time to time, without the consent of the Noteholders, create and issue further securities having the same terms and conditions as the Notes in all respects (or in all respects except for the first payment of interest) and so that such further issue shall be consolidated and form a single series with the outstanding Notes. References in these Conditions to the Notes include (unless the context requires otherwise) any other securities issued pursuant to this Condition. Any such other securities shall be constituted by a deed supplemental to the Trust Deed.

17 Notices

Notices to the Noteholders shall be valid if sent to them by first class mail (airmail if overseas) at their respective addresses on the Register. Any such notice shall be deemed to have been given on the fourth day after the date of mailing. In addition, notices will be published (so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of that exchange so require) in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*). Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which publication is made.

18 Currency Indemnity

If any sum due from the Issuer in respect of the Notes or any order or judgment given or made in relation thereto has to be converted from the currency (the "first currency") in which the same is payable under these Conditions or such order or judgment into another currency (the "second currency") for the purpose of (a) making or filing a claim or proof against the Issuer, (b) obtaining an order or judgment in any court or other tribunal or (c) enforcing any order or judgment given or made in relation to the Notes, the Issuer, failing whom the Guarantor, shall indemnify each Noteholder, on the written demand of such Noteholder addressed to the Issuer and the Guarantor and delivered to the Issuer and the Guarantor or to the specified office of the Registrar, against any loss suffered as a result of any discrepancy between (i) the rate of exchange used for such purpose to convert the sum in question from the first currency into the second currency and (ii) the rate or rates of exchange at which such Noteholder may in the ordinary course of business purchase the first currency with the second currency upon receipt of a sum paid to it in satisfaction, in whole or in part, of any such order, judgment, claim or proof.

This indemnity constitutes a separate and independent obligation of the Issuer or, as the case may be, the Guarantor and shall give rise to a separate and independent cause of action.

19 Contracts (Rights of Third Parties) Act 1999

No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

20 Arbitration

(a) Subject to Condition 20(c), any dispute or difference of whatever nature howsoever arising between the Issuer or, as the case may be, the Guarantor and any Noteholder (subject to Condition 14) under, out of or in connection with the Notes or the Guarantee (including a dispute or difference as to the breach, existence, termination or validity of the Notes or the Trust Deed or the Guarantee) (each a "Dispute") shall (regardless of the nature of the Dispute) be referred to and finally settled by arbitration in accordance with the UNCITRAL

Arbitration Rules (the “Rules”) as at present in force (which Rules are deemed to be incorporated by reference into this Condition 20(a)) by a panel of three arbitrators appointed in accordance with the Rules.

(b) The seat of arbitration shall be London, England. The procedural law of any reference to arbitration shall be English law. The language of the arbitration shall be English. The appointing authority for the purposes set forth in the Rules shall be the London Court of International Arbitration.

(c) The Issuer and the Guarantor each hereby irrevocably agrees for the benefit of each of the Trustee and the Noteholders that (i) before the giving of the notice of arbitration pursuant to the Rules or (ii) if the Trustee or the Noteholders (as the case may be) receive a notice of arbitration from the Issuer or, as the case may be, the Guarantor, within 14 days of receipt of such notice of arbitration, the Trustee or the relevant Noteholder(s) (as the case may be and, in the case of the Noteholders, subject to Condition 14) may elect, by notice in writing to the Issuer or, as the case may be, the Guarantor, that the Dispute be resolved by litigation and not by arbitration.

21 Governing Law, Jurisdiction, Consent to Enforcement and Waiver of Immunity

(a) Governing law

The Notes (including for the avoidance of doubt Condition 20) and the Trust Deed are governed by, and shall be construed in accordance with, English law.

(b) Jurisdiction

Subject to Condition 20, the courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Notes or the Trust Deed and accordingly any legal action or proceedings arising out of or in connection with the Notes or the Trust Deed (“Proceedings”) may be brought in such courts. Each of the Issuer and the Guarantor has in the Trust Deed irrevocably submitted to the jurisdiction of such courts and waives any objection to Proceedings in such courts whether on the ground of venue or on the ground that the Proceedings have been brought in an inconvenient forum. These submissions are made for the benefit of each of the Noteholders and shall not limit the right of any of them to take Proceedings in any other court of competent jurisdiction nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction (whether concurrently or not).

(c) Agent for Service of Process

Each of the Issuer and the Guarantor has appointed Law Debenture Corporate Services Limited at its registered office (being, at the date hereof, Fifth Floor, 100 Wood Street, London EC2V 7EX, England) as its agent in England to receive service of process in any Proceedings in England in connection with the Notes or the Trust Deed.

(d) Consent to enforcement etc.

The Issuer and the Guarantor consent generally in respect of any Proceedings or Disputes to the giving of any relief or the issue of any process in connection with such Proceedings or Disputes including (without limitation) the making, enforcement or execution against any property whatsoever (irrespective of its use or intended use) of any judgment or award which may be made or given in such Proceedings or Disputes.

(e) Waiver of immunity

To the extent that either the Issuer or the Guarantor may in any jurisdiction claim for itself or its assets or revenues immunity from suit, execution, attachment (whether in aid of execution, before the making of a judgment or an award or otherwise) or other legal process including in relation to the enforcement of an arbitration award and to the extent that such immunity (whether or not claimed) may be attributed in any such jurisdiction to the Issuer, the Guarantor or their respective assets or revenues, the Issuer and the Guarantor agree not to claim and irrevocably waive such immunity to the full extent permitted by the laws of such jurisdiction.

22 Definitions

In these Conditions, the following terms shall have the following meanings:

“Acquired Debt” means, with respect to any specified Person, Indebtedness of any other Person existing at the time such other Person is merged, consolidated, amalgamated or otherwise combined with or into, or becomes a Subsidiary of, such specified Person, in each case other than Indebtedness incurred in connection with, or in contemplation of, such other Person merging, consolidating, amalgamating or combining with or into, or becoming a Subsidiary of, such specified Person;

“Adjusted Consolidated Cash Flow” means, with respect to any Person for any period, the sum (without duplication) of (i) Adjusted Consolidated Net Income, (ii) to the extent Adjusted Consolidated Net Income has been reduced thereby, (A) all income taxes of such Person and its Subsidiaries paid or accrued as determined on a consolidated basis in accordance with IFRS for such period, (B) Adjusted Consolidated Interest Expense and (C) Adjusted Consolidated Non-Cash Charges, less any non-cash items increasing Adjusted Consolidated Net Income for such period, and (iii) dividends or distributions paid in cash to such Person or its Subsidiary by another Person who is not a Subsidiary of such Person;

“Adjusted Consolidated Interest Expense” means, with respect to any Person for any period, the sum (without duplication) of:

(a) the consolidated interest expense of such Person and its Subsidiaries for such period, whether paid or accrued (including, without limitation, amortisation of original issue discount, non-cash interest payments (except for payments in respect of Equity-pay Indebtedness made in the form of Capital Stock that is not Disqualified Stock), the interest component of any deferred payment obligations, the interest component of any Qualified Receivables Transaction and the interest component of all payments associated with Capital Lease Obligations, commissions, discounts and other fees and charges incurred in respect of a letter of credit or bankers’ acceptance financings, but excluding amortisation of debt issuance costs); and

(b) the consolidated interest expense of such Person and its Subsidiaries that was capitalised during such period;

“Adjusted Consolidated Net Income” means, with respect to any Person for any period, the aggregate of the net profit (or loss) of such Person and its Subsidiaries for such period, on a consolidated basis, determined in accordance with IFRS; provided that there shall be excluded therefrom, without duplication:

(a) after-tax gains and losses from Asset Sales or abandonments or reserves relating thereto;

(b) after-tax items classified as extraordinary or non-recurring gains (and, solely for purposes of calculation of Fixed Charge Coverage Ratio only, extraordinary or non-recurring losses);

(c) the net income of any Person acquired in a “pooling of interests” transaction accrued prior to the date it becomes a Subsidiary of the referent Person or is merged or consolidated with it or any of its Subsidiaries;

(d) any net income or loss of any Subsidiary, if such Subsidiary is subject to restrictions, directly or indirectly, on the payment of dividends or the making of distributions (by loans, advances, intercompany transfer or otherwise) by such Subsidiary, directly or indirectly, to the Guarantor, except that the Guarantor’s equity in the net income of any such Subsidiary for such period shall be included in such Adjusted Consolidated Net Income up to the aggregate amount of cash which could actually have been distributed by such Subsidiary during such period to the Guarantor as a dividend or other distribution (by loans, advances, intercompany transfer or otherwise) for so long as so permitted;

(e) the net income (and, solely for purposes of calculation of Fixed Charge Coverage Ratio only, losses) of any Person other than a Subsidiary;

(f) any restoration to income of any contingency reserve, except to the extent that provision for such reserve was made out of Adjusted Consolidated Net Income accrued at any time following the Issue Date; and

(g) for purposes of Condition 5(g), in the case of a successor to the referent Person by consolidation or merger or as a transferee of the referent Persons’ assets, any earnings of such successor corporation prior to such consolidation, merger or transfer of assets;

“Adjusted Consolidated Net Worth” means, with respect to any specified Person as of any date, the sum of:

(a) the consolidated equity of the common stockholders of such Person and its consolidated Subsidiaries as of such date; plus

(b) the respective amounts reported on such Person’s balance sheet as of such date with respect to any series of preferred stock (other than Disqualified Stock) that by its terms is not entitled to the payment of dividends unless such dividends may be declared and paid only out of net earnings in respect of the year of such declaration and payment, but only to the extent of any cash received by such Person upon issuance of such preferred stock;

“Adjusted Consolidated Non-Cash Charges” means, with respect to any Person for any period, the aggregate depreciation, amortisation and any other non-cash expenses of such Person and its Subsidiaries for such period determined on a consolidated basis in accordance with IFRS (excluding any such charge which requires an accrual of a reserve for a cash charge for any future period);

“Affiliate”, in respect of any specified Person, means any other Person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified Person, and, in the case of a natural Person, any immediate family member of such Person. For purposes of this definition, “control”, as used with respect to any Person, shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of such Person, whether through the ownership of voting securities, by agreement or otherwise; provided that, for purposes of Condition 5(f) and any Asset Sale, beneficial ownership of 10 per cent. or more of the Voting Stock of a Person shall be deemed to be control. For purposes of this definition, the terms “controlling”, “controlled by” and “under common control with” shall have correlative meanings. No Person (other than the Issuer, the Guarantor or any Subsidiary of the Guarantor) in whom a Receivables Subsidiary makes an Investment in connection with a Qualified Receivables Transaction will be deemed to be an Affiliate of the Guarantor or any of its Subsidiaries solely by reason of such Investment;

“Asset Acquisition” means (i) an Investment by the Guarantor or any Subsidiary in any other Person pursuant to which such Person shall become a Subsidiary of or shall be consolidated or merged with the Guarantor or any Subsidiary or (ii) the acquisition by the Guarantor or any Subsidiary of assets of any Person which constitute all or substantially all of the assets of such Person or which comprise a division or line of business of such Person;

“Asset Sale” means any sale, lease, transfer or other disposal (including, without limitation, by way of a Sale and Leaseback Transaction) in one or more transactions or series of transactions (whether related or not) by the Guarantor or any other member of the Group to a Person that is not a member of the Group of all or any of the Capital Stock of any Subsidiary or any other property, assets or revenues of the Guarantor or any other member of the Group; provided that “Asset Sale” shall not include:

(a) sales, leases, transfers or other disposals of inventory, stock-in-trade, goods, services and other current assets in the ordinary course of business, and assignments of or other arrangements over the rights or revenues arising therefrom;

(b) sales of accounts receivable and related assets of the type specified in the definition of “Qualified Receivables Transaction” to a Receivables Subsidiary for the Fair Market Value thereof, including monetary consideration (including, without limitation, payment in instalments) in an amount at least equal to 70 per cent. of the book value thereof as determined in accordance with IFRS; or

(c) transfers of accounts receivable and related assets under a Qualified Receivables Transaction; or

(d) sales, leases, transfers or other disposals of property, assets or revenues of any Social Business;

“Attributable Debt” in respect of a Sale and Leaseback Transaction means, at the time of determination, the present value of the obligation of the lessee for net rental payments during the remaining term of the lease included in such Sale and Leaseback Transactions, including any period for which such lease has been extended or may, at the option of the

lessor, be extended. Such present value will be calculated using a discount rate equal to the rate of interest implicit in such transaction, determined in accordance with IFRS;

“Board of Directors” means: with respect to the Guarantor, its Supervisory Council; with respect to a corporation, the board of directors or managers of the corporation and, in the case of any other corporation having both a supervisory board and an executive or management board, the executive or management board (except where the supervisory board is expressly indicated); with respect to a partnership, the board of directors of the general partner of the partnership; and with respect to any other Person, the board or committee of such Person serving a similar function;

“business day” means (except where expressly defined otherwise) a day on which commercial banks are open for business (including dealings in foreign currencies) in the city where the Registrar has its specified office;

“Capital Lease Obligation” means, at the time any determination thereof is to be made, the amount of the liability in respect of a capital lease that would at that time be required to be capitalised on a balance sheet in accordance with IFRS;

“Capital Stock” means: in the case of a corporation, corporate stock; in the case of a company, share capital; in the case of an association or business entity, any and all shares, interests, participations, rights or other equivalents (however designated) of corporate stock; in the case of a partnership or limited liability company, partnership or membership interests (whether general or limited); and any other interest or participation in the nature of an equity interest in the issuing Person or that confers on a Person the right to receive a share of the profits and losses of, or distributions of assets of, the issuing Person;

“Cash Equivalents” means:

(a) securities issued or directly and fully guaranteed or insured by the government of (a) any of the United States of America or any member state of the European Union or (b) any agency or instrumentality of any of the foregoing (provided that the full faith and credit of the relevant jurisdiction is pledged in support thereof) or by any European Union central bank, and in each case having maturities of not more than one year from the date of acquisition;

(b) certificates of deposit, time deposits and money market deposits with maturities of one year or less from the date of acquisition, bankers’ acceptances with maturities not exceeding six months and overnight bank deposits, in each case, with a commercial bank or trust company having one of the two highest rating categories obtainable from Moody’s or S&P;

(c) repurchase obligations with a term of not more than seven days for underlying securities of the types described in clauses (a) and (b) above entered into with any financial institution having one of the two highest rating categories obtainable from Moody’s or S&P;

(d) commercial paper having a rating at the time of the investment of at least “P-1” from Moody’s or “A-1” from S&P or, if no rating is available in respect of the commercial paper, the issuer of which has, in respect of its long-term debt obligations, an equivalent rating and in each case maturing within 12 months after the date of acquisition; and money market funds at least 95.0 per cent. of the assets of which constitute Cash Equivalents of the kinds described in clauses (a) through (d) of this definition;

“Control” shall have the meaning provided in the definition of “Affiliate” and “controlled” shall be construed accordingly;

“Disqualified Stock” means any Capital Stock that, by its terms (or by the terms of any security into which it is convertible, or for which it is exchangeable, in each case at the option of the holder thereof), or upon the happening of any event, matures or is mandatorily redeemable, pursuant to a sinking fund obligation or otherwise, or redeemable at the option of the holder thereof, in whole or in part, on or prior to the date that is 180 days after the date on which the Notes mature. Notwithstanding the preceding sentence, any Capital Stock that would constitute Disqualified Stock solely because the holders thereof have the right to require the repurchase of such Capital Stock upon the occurrence of a change of control or an asset sale shall not constitute Disqualified Stock if the terms of such Capital Stock provide that any such Capital Stock may not be repurchased or redeemed pursuant to such provisions unless such repurchase or redemption complies with Condition 5(g);

“Equity Interests” means Capital Stock and all warrants, options or other rights to acquire Capital Stock (but excluding any debt security that is convertible into, or exchangeable for, Capital Stock);

“Equity-pay Indebtedness” means Indebtedness in respect of which any and all payments of principal may be made only in the form of Capital Stock of a Person or its Subsidiaries or Affiliates that is not Disqualified Stock (provided, that any such Capital Stock must provide that any and all payments of dividends or any other amounts thereunder may be made only in the form of Capital Stock that is not Disqualified Stock and provided, that the distribution of such Capital Stock in satisfaction of obligations under Equity-pay Indebtedness must be permitted under Condition 5(g)).

“European Union” means the European Union, including the countries of Austria, Belgium, Denmark, France, Finland, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden and the United Kingdom but not including any country which becomes a member of the European Union after 6 May 2003;

“Fair Market Value” means, with respect to any property, asset or Investment, the fair market value of such asset or Investment at the time of the event requiring such determination, as determined in good faith by the Issuer or the Guarantor, or, with respect to any asset or Investment in excess of US\$10,000,000 (other than cash or Cash Equivalents), as determined by an Independent Appraiser;

“Fixed Charges” means, with respect to any Person for any period, the sum, without duplication, of:

- (i) Adjusted Consolidated Interest Expense for such period; and
- (ii) the product of (x) the amount of all dividend payments on Preferred Stock (other than dividends paid in Capital Stock that is not Disqualified Stock) of such Person or on Disqualified Stock of such Person held by Persons other than the Parent or any of its Restricted Subsidiaries paid, accrued or scheduled to be paid or accrued during such period and (y) a fraction, the numerator of which is one and the denominator of which is one minus the then current combined federal and local tax rate of such Person, expressed as a decimal, in each case, computed on a consolidated basis and in accordance with IFRS;

For the avoidance of doubt, “Fixed Charges” shall not include any amounts paid or payable in respect of Equity-pay Indebtedness.

“Fixed Charge Coverage Ratio” means with respect to any Person for the two consecutive six month fiscal periods (the “Four Quarter Period”) ending on or prior to the date of determination, the ratio of the Adjusted Consolidated Cash Flow of such Person for such period to the Fixed Charges of such Person and its Subsidiaries for such period.

For purposes of this definition, “Adjusted Consolidated Cash Flow” and “Fixed Charges” shall be calculated on a pro forma basis after giving effect to:

1. the incurrence of Indebtedness of such Person and its Subsidiaries (and the application of the proceeds therefrom) giving rise to the need to make such calculation and any incurrence (and the application of the proceeds therefrom) or repayment or redemption of Indebtedness, other than the incurrence or repayment of Indebtedness pursuant to working capital facilities, occurring at any time subsequent to the beginning of the Four Quarter Period and on or prior to the date of determination, as if such incurrence and issuance (and the application of the proceeds thereof), or the repayment or redemption, as the case may be, occurred on the first day of the Four Quarter Period;
2. any Asset Sales or Asset Acquisitions (including, without limitation, any Asset Acquisition giving rise to the need to make such calculation as a result of such Person or one of its Subsidiaries (including any Person that becomes a Subsidiary as a result of such Asset Acquisition) incurring, assuming or otherwise becoming liable for Indebtedness) at any time on or subsequent to the first day of the Four Quarter Period and on or prior to the transaction date, as if such Asset Sale or Asset Acquisition (including the incurrence, assumption or liability for any Indebtedness and also including any Adjusted Consolidated Cash Flow associated with such Asset Acquisition) occurred on the first day of the Four Quarter Period; and

3. discontinued operations determined in accordance with IFRS at any time on, or subsequent to, the first day of the Four Quarter Period and on, or prior to, the date of determination, as if such discontinued operations had occurred on the first day of the Four Quarter Period (but with respect to Fixed Charges, only to the extent that the obligations giving rise to such Fixed Charges will not be obligations of the specified Person or any of its Subsidiaries following the date of determination).

If such Person or any of its Subsidiaries directly or indirectly guarantees any Indebtedness of a third Person, the Fixed Charge Coverage Ratio shall give effect to the incurrence of such guaranteed Indebtedness as if such Person or Subsidiary had directly incurred such guaranteed Indebtedness. If, since the beginning of a Four Quarter Period, any Person that subsequently became a Subsidiary or was merged with or into the Guarantor or any of its Subsidiaries since the beginning of such Four Quarter Period shall have made any Investment in a Subsidiary, acquisition, disposition, merger or consolidation or determined a discontinued operation that would have required adjustment pursuant to this definition, then the Fixed Charge Coverage Ratio shall be calculated giving pro forma effect thereto for such period as if such Investment, acquisition, disposition, merger or consolidation or discontinued operations had occurred at the beginning of the applicable Four Quarter Period.

For purposes of this definition, whenever pro forma effect is to be given to an acquisition or disposition of assets or other transaction for purposes of calculating the Fixed Charge Coverage Ratio, the pro forma calculations shall be determined in good faith by an Officer of the Guarantor on the basis of reasonable assumptions.

Furthermore,

(i) for purposes of the calculation of "Fixed Charge Coverage Ratio", (a) "Adjusted Consolidated Cash Flow" shall not include the cash flow or other proceeds (including insurance proceeds) derived from an asset or a project with respect to which Project Finance Indebtedness has been incurred to the extent such cash flow or other proceeds were applied to service such Project Finance Indebtedness, including, but not limited to, payment of principal, interest and any applicable additional amounts, whether paid or accrued, during the relevant Four Quarter Period and (b) "Fixed Charges" shall not include interest expense, whether paid or accrued, relating to Project Finance Indebtedness; and

(ii) in calculating "Adjusted Consolidated Interest Expense" for purposes of the calculation of "Fixed Charge Coverage Ratio", interest determined on a fluctuating basis as of the date of determination (including Indebtedness actually incurred on the date of the transaction giving rise to the need to calculate the Fixed Charge Coverage Ratio) and which will continue to be so determined thereafter shall be deemed to have accrued at a fixed rate per annum equal to the rate of interest on such Indebtedness as in effect on the date of determination;

"Group" means the Guarantor and its Consolidated Subsidiaries;

"guarantee" means a guarantee other than by endorsement of negotiable instruments for collection in the ordinary course of business, direct or indirect, in any manner including, without limitation, by way of a pledge of assets or through letters of credit or reimbursement agreements in respect thereof, of all or any part of any Indebtedness;

"Hedging Obligations" means, with respect to any Person, the obligations of such Person under:

(a) interest rate swap agreements, interest rate cap agreements and interest rate collar agreements;

(b) other agreements or arrangements designed to protect such Person against fluctuations in interest rates; and

(c) any foreign currency futures contract, option or similar agreement or arrangement designed to protect such Person against fluctuations in foreign currency rates;

"IFRS" means International Financial Reporting Standards as in effect from time to time, and which are consistent with the accounting principles and practices then applied by the Guarantor, and any variation to such accounting principles and practices which is not material;

"Indebtedness" means, without duplication, with respect to any specified Person, any indebtedness of such Person, whether or not contingent (including, without limitation, guarantees):

- (a) in respect of moneys borrowed or raised;
- (b) evidenced by bonds, notes, debentures, loan stock or similar instruments or letters of credit (or reimbursement agreements in respect thereof);
- (c) in respect of bankers' acceptances;
- (d) in respect of the balance deferred and unpaid of the purchase price of any property, except any such balance that constitutes an accrued expense or trade payable;
- (e) representing Capital Lease Obligations;
- (f) representing any Hedging Obligations; and
- (g) representing the proceeds received by the Guarantor or any Subsidiary from a Qualified Receivables Transaction not otherwise giving rise to Indebtedness under items (a) through (f) above, in each case, if and to the extent any of the preceding items (other than letters of credit, guarantees and Hedging Obligations) would appear as a liability upon a balance sheet of the specified Person prepared in accordance with IFRS.

In addition, the term "Indebtedness" includes all indebtedness of others secured by a lien on any asset of the specified Person (whether or not such Indebtedness is assumed by the specified Person) and, to the extent not otherwise included, any guarantee by the specified Person of any Indebtedness of any other Person. The amount of any Indebtedness outstanding as of any date shall be: (1) the accreted value thereof, in the case of any Indebtedness issued with original issue discount; and (2) the principal amount thereof, together with any interest thereon that is more than 30 days past due, in the case of any other Indebtedness. The term "Indebtedness" does not include trade payables or current liabilities (other than short-term debt and the current portion of long-term debt), indebtedness to the federal budget, regional budgets, local budgets and non-budgetary funds on account of current taxes which are not overdue or Equity-pay Indebtedness;

"Independent Appraiser" means any of PricewaterhouseCoopers LLC, KPMG LLC, Deloitte & Touche LLP, Ernst & Young LLP or such other investment banking, accountancy or appraisal firm of international standing selected by the Guarantor (with the prior written consent of the Trustee, which consent shall not be unreasonably withheld), provided it is not an Affiliate of the Issuer, the Guarantor or any Material Subsidiary;

"Investments" means, with respect to any Person, all direct or indirect investments by such Person in other Persons (including Affiliates) in the forms of (a) Equity Interests and the making of capital contributions, (b) corporate bonds, promissory notes, commercial paper, certificates of deposit and other securities, (c) the granting of loans and the making of advances (excluding commission, travel and similar advances to officers and employees made in the ordinary course of business), (d) the extension of credit (including, without limitation, commodity credits) and (e) holding the benefit of any Indebtedness (including guarantees, indemnities or other like obligations), together with all items that are or would be classified as investments on a balance sheet prepared in accordance with IFRS. If the Guarantor or any Subsidiary of the Guarantor sells or otherwise disposes of any Equity Interests of any direct or indirect Subsidiary of the Guarantor such that, after giving effect to any such sale or disposition, such Person is no longer a Subsidiary of the Guarantor, the Guarantor shall be deemed to have made an Investment on the date of any such sale or disposition equal to the fair market value of the Equity Interests of such Subsidiary not sold or disposed of in an amount determined as provided in the final paragraph of Condition 5(g). The acquisition by the Guarantor or any Subsidiary of the Guarantor of a Person that holds an Investment in a third Person shall be deemed to be an Investment by the Guarantor or such Subsidiary in such third Person in an amount equal to the fair market value of the investment held by the acquired Person in such third Person determined as provided in the final paragraph of Condition 5(g);

"Issue Date" means 16 November 2004;

"Material Adverse Effect" means a material adverse effect on (a) the financial condition or operations of the Guarantor or any of its Material Subsidiaries, (b) the ability of the Guarantor to perform its obligations under the Guarantee, (c) the ability of the Issuer to perform its obligations under the Trust Deed and the Notes or (d) the validity or enforceability of the Trust Deed, the Notes and the Guarantee, or the rights or remedies of the Noteholders thereunder;

“Material Subsidiary” means at any relevant time a Subsidiary of the Guarantor:

(a) whose total assets or gross revenues (or, where the Subsidiary in question prepares consolidated accounts, whose total consolidated assets or gross consolidated revenues, as the case may be) represent not less than 5 per cent. of the total consolidated assets or the gross consolidated revenues of the Guarantor and its Subsidiaries, all as calculated by reference to the then latest audited accounts (or consolidated accounts, as the case may be) (in each case, produced on the basis of IFRS, consistently applied) of such Subsidiary and the then latest audited consolidated accounts of the Guarantor (produced on the basis of IFRS, consistently applied) and its consolidated Subsidiaries; or

(b) to which is transferred all or substantially all the assets and undertaking of a Subsidiary which immediately prior to such transfer is a Material Subsidiary.

For the purposes of this definition, a report of the Auditors or the Chief Accountant of the Guarantor that in their or his or her opinion a Subsidiary of the Guarantor is or is not or was or was not a Material Subsidiary shall without further enquiry or evidence and in the absence of manifest error, be conclusive and binding on the Issuer, the Guarantor, the Trustee and the Noteholders;

“Moody’s” means Moody’s Investors Service, Inc.;

“Obligations” means any principal, interest, penalties, fees, indemnifications, reimbursements, damages and other liabilities payable under the documentation governing any Indebtedness;

“OECD Asset” means shares or other equity interests (or any securities, instruments, options, or other rights convertible for, exchangeable for or exercisable for, such equity interests) in a legal entity that is organised under the laws of an OECD Country or a political subdivision thereof, or other tangible or intangible assets located in an OECD Country;

“OECD Asset Acquisition” means a purchase or acquisition by the Guarantor or a Subsidiary of an OECD Asset at its fair market value, as determined by the Management Board of the Guarantor;

“OECD Asset Acquisition Indebtedness” means any Indebtedness issued, borrowed or raised by the Issuer, the Guarantor or a Subsidiary solely in order to finance an OECD Asset Acquisition or the development and/or operation of an OECD Asset;

“OECD Country” means a country that is, at the time of the relevant OECD Asset Acquisition, a member of the Organisation for Economic Cooperation and Development;

“Officer” means, with respect to any Person, any Managing Director, Director, the Chairman of the Board, the President, any Vice President, the Chief Financial Officer, the Controller, the Treasurer or the Secretary of such Person or any general partner or other person holding a corresponding or similar position of responsibility;

“Officers’ Certificate” means, as applied to any Person, a certificate executed on behalf of such Person by two Officers; provided that every Officers’ Certificate with respect to the compliance with the Trust Deed shall include (i) a statement that the Officers making or giving such Officers’ Certificate have read such condition and any definitions or other provisions contained in the Trust Deed relating thereto, (ii) a statement that, in the opinion of the signers, they have made or have caused to be made such examination or investigation as is necessary to enable them to express an informed opinion as to whether or not such condition has been complied with, and (iii) a statement as to whether, in the opinion of the signers, such condition has been complied with;

“Permitted Business” means any business which is the same as or related, ancillary or complementary to any of the businesses of the Guarantor and its Subsidiaries on the Issue Date (including, without limitation, (i) downstream marketing activities relating to diamonds and diamond jewellery and (ii) industrial and energy related activities the primary purpose of which is the supply and support of the activities of the Guarantor and its Subsidiaries);

“Permitted Indebtedness” means the following Indebtedness (each of which shall be given independent effect):

(a) Indebtedness of up to US\$1,200,000,000 in aggregate principal amount at any time outstanding;

(b) Indebtedness owed by the Guarantor to any Subsidiary, or Indebtedness owed by any Subsidiary to the Guarantor or any other Subsidiary of the Guarantor; provided that any subsequent issuance or transfer of Equity Interests that results in any such Indebtedness being held by a Person other than a Group member and any sale or other transfer of any such Indebtedness to a Person that is not a Group member (other than a pledge or other transfer of such Indebtedness intended to create a Security Interest therein) will be deemed, in each case, to constitute an incurrence of Indebtedness that was not permitted by this paragraph (b);

(c) Permitted Refinancing Indebtedness;

(d) Project Finance Indebtedness;

(e) Trade Finance Indebtedness; and

(f) any Acquired Debt in connection with an OECD Asset Acquisition, to the extent that such Acquired Debt would not, after such OECD Asset Acquisition, form part of the consolidated Indebtedness of the Guarantor.

“Permitted Investments” means:

(a) any Investment in the Guarantor or in a Subsidiary (including in any Equity Interests of a Subsidiary);

(b) any Investment in cash or in Cash Equivalents;

(c) any Investment in securities issued or directly and fully guaranteed or insured by the Government of Russia or any agency or authority (whether federal, regional or local) or the Central Bank of the Russian Federation (provided that the full faith and credit of the Government of Russia is pledged in support thereof), or promissory notes, certificates of deposit, time deposits, money market deposits and other bank deposits with or of any Russian commercial bank included in the first category of reliability established by the Central Bank of the Russian Federation, provided that any such Investment must be capable of being liquidated, at the option of the Person making such Investment, within a period of seven days;

(d) any Investment by the Guarantor or any Subsidiary in a Person, if as a result of such Investment (a) such Person becomes a Subsidiary or (b) such Person in one transaction or a series of substantially concurrent related transactions, is merged, consolidated or amalgamated with or into, transfers or conveys substantially all of its assets to, or is liquidated into, the Guarantor or a Subsidiary;

(e) Investments solely in exchange for the issuance of Equity Interests (other than Disqualified Stock) of the Guarantor;

(f) loans or advances to officers and employees made in the ordinary course of business in an aggregate amount up to US\$10,000,000 at any time outstanding, and not otherwise excluded from the definition of Investment;

(g) Investments in stock, obligations or securities received in settlement of debts created in the ordinary course of business and owing to the Guarantor or any Subsidiary or in satisfaction of judgments or pursuant to any plan of reorganisation or similar arrangement upon the bankruptcy or insolvency of a debtor;

(h) Investments in receivables owing to the Guarantor or any Subsidiary, if created or acquired in the ordinary course of business;

(i) the acquisition by a Receivables Subsidiary in connection with a Qualified Receivables Transaction of Equity Interests of a trust or other Person established by such Receivables Subsidiary to effect such Qualified Receivables Transaction; and any other Investment by the Issuer, the Guarantor or a Subsidiary of the Guarantor in a Receivables Subsidiary or any Investment by a Receivables Subsidiary in any other Person in connection with a Qualified Receivables Transaction; provided, that such other Investment is in the form of a note or other obligation that the Receivables Subsidiary or other Person is required to repay as soon as practicable from available cash collections less amounts required to be established as reserves pursuant to contractual agreements with entities that are not Affiliates of the Issuer or the Guarantor entered into as part of a Qualified Receivables Transaction;

(j) Hedging Obligations;

(k) any Investment made as a result of the receipt of non-cash consideration from an Asset Sale that was made in compliance with Condition 5(a);

(l) Investments existing on the Issue Date;

(m) Investments not to exceed, taken together with all other Investments made pursuant to this clause (m) and at the time of determination outstanding, US\$10,000,000 in the aggregate (with the Fair Market Value of each Investment being measured at the time made and without giving effect to subsequent changes in value);

(n) completion or other guarantees or obligations entered into by the Guarantor or a Subsidiary with respect to any Project Finance Indebtedness, provided, that such guarantees or obligations are permitted under Condition 5(h); and

(o) an OECD Asset Acquisition, together with any guarantees or other obligations entered into by the Guarantor or a Subsidiary with respect to any OECD Asset Acquisition Indebtedness, provided, that such OECD Asset Acquisition Indebtedness and/or such guarantees or other obligations are permitted under Condition 5(h);

“Permitted Refinancing Indebtedness” means any Indebtedness issued in exchange for, or the net proceeds of which are used to extend, refinance, renew, replace, defease or refund, other Indebtedness (other than intercompany Indebtedness); provided that:

(a) the principal amount of such Permitted Refinancing Indebtedness does not exceed the principal amount (or accreted value, if applicable) of the Indebtedness extended, refinanced, renewed, replaced, defeased or refunded (plus all accrued interest on the Indebtedness and the amount of all expenses and premiums incurred in connection therewith);

(b) such Permitted Refinancing Indebtedness has a final maturity date equal to or later than the final maturity date of, and has a Weighted Average Life to Maturity equal to or greater than the Weighted Average Life to Maturity of, either (i) the Indebtedness being extended, refinanced, renewed, replaced, defeased or refunded or (ii) the Notes;

(c) if the Indebtedness being extended, refinanced, renewed, replaced, defeased or refunded is subordinated in right of payment to the Notes, such Permitted Refinancing Indebtedness is subordinated in right of payment to the Notes on terms at least as favourable to the Noteholders as those contained in the documentation governing the Indebtedness being extended, refinanced, renewed, replaced, defeased or refunded; and

(d) such Indebtedness is incurred by the Guarantor, the Issuer or another Group member who is the obligor on the Indebtedness being extended, refinanced, renewed, replaced, defeased or refunded;

“Permitted Security Interest” means:

(a) any Security Interest in existence on the Issue Date;

(b) any Security Interest in respect of Indebtedness created by a Person prior to it becoming a Material Subsidiary or otherwise being acquired by any Group member, provided that such Security Interest was not created in contemplation thereof or in connection therewith;

(c) any Security Interest on property existing at the time of acquisition of such property by the Guarantor or any Subsidiary, provided that such Security Interest was not created in contemplation of such acquisition or in connection therewith;

(d) any Security Interest arising from a purchase money mortgage or other purchase money lien of the Guarantor or any Material Subsidiary; provided that (i) the related Indebtedness shall not be secured by any property or assets of the Guarantor or any Material Subsidiary other than the property and assets so acquired and (ii) the Security Interest securing such Indebtedness shall be created within 90 days of such acquisition;

(e) any Security Interest created or permitted to be outstanding by the Guarantor or a Subsidiary in respect of Project Finance Indebtedness;

(f) any Security Interest in respect of Trade Finance Indebtedness created or permitted to be outstanding by a Subsidiary of the Guarantor incurring such Trade Finance Indebtedness;

(g) any Security Interest created or permitted to exist over goods and products in commercial turnover (including, without limitation, rough diamonds in their natural form and/or being processed) or over accounts receivable (whether denominated in Roubles or in US Dollars or other convertible currency) of the Guarantor or any of its Subsidiaries (including any

Receivables Subsidiary) in connection with a Qualified Receivables Transaction; provided that the aggregate value of such goods and products in commercial turnover or accounts receivable which is subject to such Security Interest or Security Interests and is securing Indebtedness due in the current financial year shall not exceed such aggregate value of such Security Interests of the type described in this clause (g) as shall secure Indebtedness in a maximum aggregate principal amount of US\$150,000,000;

(h) any other Security Interest created in respect of any other Indebtedness incurred after the Issue Date up to an aggregate principal amount of US\$30,000,000 outstanding at any time;

(i) any Security Interest in favour of the Guarantor or any of its Subsidiaries;

(j) any Security Interest created to secure liabilities under letters of credit issued in connection with the acquisition and disposal of inventory, stock in trade, goods, services and other current assets in the ordinary course of business;

(k) any Security Interest for taxes, assessments or governmental charges or claims that are not yet delinquent or that are being contested in good faith by appropriate proceedings promptly instituted and diligently conducted, provided that any reserve or other appropriate provision as may be required in conformity with IFRS or with RAR has been set aside;

(l) any Security Interest arising by operation of law, including, without limitation, Security Interests of landlords, unpaid vendors, carriers, warehousemen, mechanics, suppliers, material men or repairmen arising in the ordinary course of business for sums not yet delinquent or being contested in good faith, provided that any reserve or other appropriate provision as may be required in conformity with IFRS or with RAR has been set aside;

(m) any Security Interest to secure the performance of tenders, statutory obligations, surety or appeal bonds, bids, leases, governmental contracts, performance and return of money bonds or other obligations of a like nature (exclusive of obligations for the payment of borrowed money) incurred in the ordinary course of business;

(n) any easements, rights of way, municipal and zoning ordinances, utility agreements, reservations, encroachments, restrictions and similar charges, encumbrances, title defects or other irregularities that do not materially interfere with the ordinary course of business of the Guarantor or any of its Subsidiaries;

(o) any Security Interest granted or deposit made in the ordinary course of business in connection with workers' compensation, unemployment insurance and other types of statutory obligations, including any Security Interest securing letters of credit issued in the ordinary course of business in connection therewith; or

(p) any extension, renewal or replacement in whole or in part of any Security Interest referred to in the foregoing clauses (b) through (o), inclusive, provided, however, that the principal amount of Indebtedness secured thereby shall not exceed the principal amount of Indebtedness so secured at the time immediately preceding the time of such extension, renewal or replacement, and that such extension, renewal or replacement shall be limited to all or a part of the assets (or to similar assets of no greater value than those) which comprised the Security Interest so extended, renewed or replaced;

"Person" means any individual, corporation, partnership, joint venture, association, joint stock company, trust, unincorporated organisation, limited liability company or government or other entity;

"Potential Event of Default" means an event or circumstance which, with the giving of notice, lapse of time, issue of a certificate and/or fulfilment of any other requirement provided for in Condition 10, would constitute an Event of Default;

"Preferred Stock" of any Person means any Capital Stock of such Person that has preferential rights to any other Capital Stock of such Person with respect to dividends or redemptions or upon liquidation;

"Project Finance Indebtedness" means any Indebtedness issued, borrowed or raised by the Guarantor or a Subsidiary to finance the ownership, acquisition, development and/or operation of an asset or project where there is no recourse whatsoever for repayment thereof other than:

(a) recourse to the cash flow or net cash flow from such asset or project (including insurance proceeds); and/or

(b) recourse, for the purpose only of enabling amounts to be claimed in respect of such Indebtedness, over such asset or project or the income, cash flow or other proceeds deriving therefrom, *provided* that the extent of such recourse is limited solely to the amount of any recoveries made on any such enforcement;

provided, however, that Project Finance Indebtedness shall not include completion or other guarantees or obligations entered into by the Guarantor or any Subsidiary where recourse is not limited as described above;

“Qualified Receivables Transaction” means any transaction or series of transactions entered into by the Guarantor or any of its Subsidiaries with any Person (including, without limitation, any Receivables Subsidiary) pursuant to which the Guarantor or any of its Subsidiaries (a) creates or permits to exist any Security Interest over, (b) sells, conveys or otherwise transfers or (c) grants a participation or beneficial interest in, its goods in commercial turnover and/or accounts receivable (whether now existing or arising in the future) and any assets related thereto (including, without limitation, all collateral securing such goods in commercial turnover and accounts receivable, all contracts and all guarantees or other obligations in respect of such goods in commercial turnover and accounts receivable, the proceeds of such goods in commercial turnover and accounts receivable, and other assets which are customarily subject to the grant of a Security Interest, transferred or subject to the grant of a participation or beneficial interest, in connection with financing transactions involving goods in commercial turnover and accounts receivable);

“RAR” means accounting rules and standards generally applicable in the Russian Federation;

“Receivables Subsidiary” means a Subsidiary of the Guarantor which engages in no activities other than in connection with the financing of accounts receivable and which is designated by the Board of Directors of the Guarantor (as provided below) as a Receivables Subsidiary (a) no portion of the Indebtedness or any other obligations (contingent or otherwise) of which (i) is guaranteed by the Guarantor or any Subsidiary of the Guarantor (excluding guarantees of obligations (other than the principal of, and interest on, Indebtedness) pursuant to representations, warranties, covenants and indemnities entered into in the ordinary course of business in connection with a Qualified Receivables Transaction) and excluding guarantees by any other Receivables Subsidiary, (ii) provides recourse to or obligates the Guarantor or any Subsidiary of the Guarantor in any way other than pursuant to representations, warranties, covenants and indemnities entered into in the ordinary course of business in connection with a Qualified Receivables Transaction, or (iii) subjects any property or asset of the Guarantor or any Subsidiary of the Guarantor (other than accounts receivable and related assets as provided in the definition of “Qualified Receivables Transaction”), directly or indirectly, contingently or otherwise, to the satisfaction thereof, other than pursuant to representations, warranties, covenants and indemnities entered into in the ordinary course of business in connection with a Qualified Receivables Transaction, (b) with which neither the Guarantor nor any Subsidiary of the Guarantor has any material contract, agreement, arrangement or understanding other than on terms no less favourable to the Guarantor or such Subsidiary than those that might be obtained at the time from Persons who are not Affiliates of the Guarantor, other than fees payable in the ordinary course of business in connection with servicing accounts receivable, and (c) with which neither the Guarantor nor any Subsidiary of the Guarantor has any obligation to maintain or preserve such Subsidiary’s financial condition or cause such Subsidiary to achieve certain levels of operating results. Any such designation by the Board of Directors of the Guarantor will be evidenced to the Trustee by filing with the Trustee a certified copy of the resolution of the Board of Directors of the Guarantor giving effect to such designation and an Officers’ Certificate certifying that such designation complied with the foregoing conditions;

“Restricted Investment” means an Investment other than a Permitted Investment;

“S&P” means Standard & Poor’s, a division of The McGraw-Hill Companies, Inc.;

“Sale and Leaseback Transaction” means any direct or indirect arrangement with any Person or to which any such Person is a party, providing for the leasing to the Guarantor or any of its Subsidiaries of any property, whether owned by the Guarantor or such Subsidiary at the Issue Date or later acquired, which has been or is to be sold or transferred by the Guarantor

or such Subsidiary to such Person or to any other Person from whom funds have been or are to be advanced by such Person;

“Social Business” means any business or operations conducted by the Guarantor or any of its Subsidiaries solely for the purpose of providing transportation of materials and supplies used in mining operations (including auto transport, marine transport and aviation); electricity generation and transmission; production of natural gas and the operation of natural gas heat generation plants; production and refining of oil; and other activities in support of the employees who work in the exploration, production and transport of diamonds, including pension services, housing, road maintenance and the renovation of various social assets, such as sports complexes and cultural facilities; and other support services facilitating the infrastructure and operations of the Group; in each case in connection with the operation by the Group of the Permitted Business;

“Stated Maturity” means, with respect to any instalment of interest or principal on any Indebtedness, the date on which such payment of interest or principal was scheduled to be paid in the original documentation governing such Indebtedness, and shall not include any contingent obligations to repay, redeem or repurchase any such interest or principal prior to the date originally scheduled for payment thereof;

“Subordinated Indebtedness” means any Indebtedness of the Issuer or the Guarantor, as the case may be (whether outstanding on the Issue Date or thereafter incurred), that is subordinate or junior in right of payment to the Notes and the Guarantee, as the case may be, pursuant to a written agreement;

“Subsidiary” means, in relation to any Person (the “first person”), at any particular time, any other Person (the “second person”) (i) which the first person controls or has the power to control and (ii) which is (or is required under IFRS to be) consolidated in or with the financial statements of the first person;

“Trade Finance Indebtedness” means any Indebtedness issued, borrowed or raised by any Subsidiary of the Guarantor to finance sales of diamonds or acquisitions of diamonds to be made for sale, from the Guarantor, any Subsidiary or any third party, or related activities, where

(i) there is no recourse whatsoever for repayment thereof other than:

(a) recourse to the cash flow or net cash flow of such Subsidiary that is generated by or arises out of the sale or sales of the particular diamonds that are being financed pursuant to the relevant transaction; and/or

(b) recourse, for the purpose only of enabling amounts to be claimed in respect of such Indebtedness, over the assets or income of such Subsidiary, provided, however, that the extent of such recourse is limited solely to the amounts of any recoveries made on any such enforcement, and may not exceed the amount actually received by such Subsidiary in consideration of the sale or sales of the particular diamonds that were financed by such Indebtedness; and

(ii) such Subsidiary agrees that for so long as any Trade Finance Indebtedness is outstanding, if it purchases any diamonds or other assets from the Guarantor or any other Subsidiary of the Guarantor, it will pay the full consideration therefor prior to the delivery of such diamonds or other assets;

“US Dollars”, “dollars” or the sign “\$” means such coin or currency of the United States of America as at the time of payment shall be legal tender for the payment of public and private debts;

“Voting Stock” of any Person as of any date means the Capital Stock of such Person that is at the time ordinarily entitled to vote in the election of the Board of Directors of such Person;

“Weighted Average Life to Maturity” means, when applied to any Indebtedness at any date, the number of years obtained by dividing:

(a) the sum of the products obtained by multiplying (i) the amount of each then remaining instalment, sinking fund, serial maturity or other required payments of principal, including payment at final maturity, in respect of the Indebtedness, by (ii) the number of years (calculated to the nearest one-twelfth) that will elapse between such date and the making of such payment; by

(b) the then outstanding principal amount of such Indebtedness; and

“Wholly Owned Subsidiary” of any specified Person means a Subsidiary of such Person all of the outstanding Capital Stock or other ownership interests of which shall at the time be owned by such Person or by one or more Wholly Owned Subsidiaries of such Person.

There will appear at the foot of the Conditions endorsed on each Definitive Note the name and specified office of the Agents as set out at the end of this Offering Circular.

Summary of the Provisions Relating to the Notes in Global Form

The Regulation S Global Note and the Rule 144A Global Note contain provisions which apply to the Notes in respect of which they are issued, some of which modify the effect of the Terms and Conditions set out in this Offering Circular. Terms defined in the Terms and Conditions have the same meanings in the paragraphs below. The following is a summary of those provisions:

The Global Notes

The Notes sold in offshore transactions (as defined in Regulation S) in reliance on Regulation S will be evidenced on issue by the Regulation S Global Note deposited with, and registered in the nominee name of Chase Nominees Limited as common depository for Euroclear and Clearstream, Luxembourg. Beneficial interests in the Regulation S Global Note may be held only through Euroclear or Clearstream, Luxembourg at any time. See “– Book–Entry Procedures for the Global Notes”. By acquisition of a beneficial interest in the Regulation S Global Note, the purchaser thereof will be deemed to represent, among other things, that it is not a US person, and that, if it determines to transfer such beneficial interest prior to the expiration of the 40-day distribution compliance period, it will transfer such interest only (a) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S or (b) to be a person who takes delivery in the form of an interest in the Rule 144A Global Note. See “Plan of Distribution” and “Transfer Restrictions”.

The Notes sold to qualified institutional buyers (within the meaning of Rule 144A) will be evidenced on issue by the Rule 144A Global Note deposited with a custodian for, and registered in the name of Cede & Co., as nominee of DTC. Beneficial interests in the Rule 144A Global Note may only be held through DTC at any time. See “– Book–Entry Procedures for the Global Notes”. By acquisition of a beneficial interest in the Rule 144A Global Note, the purchaser thereof will be deemed to represent, among other things, that it is a QIB and that, if in the future it determines to transfer such beneficial interest, it will transfer such interest in accordance with the procedures and restrictions contained in the Agency Agreement. See “Plan of Distribution” and “Transfer Restrictions”.

Beneficial interests in each Global Note will be subject to certain restrictions on transfer set forth therein as set forth in Rule 144A. A beneficial interest in the Regulation S Global Note may be transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Note in denominations greater than or equal to the minimum denominations applicable to interests in the Rule 144A Global Note and only upon receipt by the Registrar of a written certification to the effect that the transferor reasonably believes that the transferee is a QIB and that such transaction meets the requirements of Rule 144A and is in accordance with any applicable securities laws of any state of the United States or any other jurisdiction. Beneficial interests in the Rule 144A Global Note may be transferred to a person who takes delivery in the form of an interest in the Regulation S Global Note only upon receipt by the Registrar of a written certification from the transferor to the effect that the transfer is being made in an offshore transaction (as defined in Regulations S) in accordance with Regulation S.

Any beneficial interest in the Regulation S Global Note that is transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Note will, upon transfer, cease to be an interest in the Regulation S Global Note and become an interest in the Rule 144A Global Note, and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in the Rule 144A Global Note for as long as it remains such an interest. Any beneficial interest in the Rule 144A Global Note that is transferred to a person who takes delivery in the form of an interest in the Regulation S Global Note will, upon transfer, cease to be an interest in the Rule 144A Global Note and become an interest in the Regulation S Global Note and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in the Regulation S Global Note for so long as it remains such an interest. No service charge will be made for any registration of transfer or exchange of notes, but the Registrar may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

Except in the limited circumstances described below, owners of beneficial interests in global notes will not be entitled to receive physical delivery of definitive notes (the “Definitive Notes”). The Notes are not issuable in bearer form.

Amendments to Conditions

Each Global Note contains provisions that apply to the Notes that they represent, some of which modify the effect of the above Terms and Conditions of the Notes. The following is a summary of those provisions:

- **Payments.** Payments of principal and interest in respect of Notes evidenced by a Global Note will be made against presentation and, if no further payment falls to be made in respect of the relevant Notes, surrender of such Global Note, to or to the order of the Principal Paying Agent or such other Paying Agent as shall have been notified to the relevant Noteholders for such purpose. A record of each payment so made will be endorsed in the appropriate schedule to the relevant Global Note, which endorsement will be *prima facie* evidence that such payment has been made in respect of the relevant Notes.
- **Notices.** So long as any Notes are evidenced by a Global Note and such Global Note is held by or on behalf of a clearing system, notices to Noteholders may be given by delivery of the relevant notice to that clearing system for communication by it to entitled account holders in substitution for delivery thereof as required by the Terms and Conditions of such Notes provided that for so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, notices will also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*).
- **Meetings.** The holder of each Global Note will be treated as being two persons for the purposes of any quorum requirements of, or the right to demand a poll at, a meeting of Noteholders and in any such meeting as having one vote in respect of each Note for which the relevant Global Note is exchangeable.
- **Trustee Powers.** In considering the interests of Noteholders while the Global Notes are held on behalf of a clearing system, the Trustee may, to the extent it considers it appropriate to do so in the circumstances, have regard to any information provided to it by such clearing system or its operator as to the identity (either individually or by category) of its accountholders with entitlements to each Global Note and may consider such interests as if such accountholders were the holders of any Global Note.
- **Cancellation.** Cancellation of any Note required by the Terms and Conditions of the Notes to be cancelled will be effected by reduction in the principal amount of the applicable Global Note.

Exchange for Definitive Notes

Exchange

Each Global Note will be exchangeable, free of charge to the holder, in whole but not in part, for Definitive Notes if: (i) in the case of a Rule 144A Global Note, DTC notifies the Issuer it is no longer willing or able to discharge properly its responsibilities as a depository with respect to the Global Notes or ceases to be a “clearing agency” registered under the Exchange Act, or if at any time it is no longer eligible to act as such, and the Issuer is unable to locate a qualified successor within 90 days of receiving notice of becoming aware of such eligibility on the part of DTC, by the holder giving notice to the Registrar or any Transfer Agent or (ii) in the case of a Regulation S Global Note, Euroclear or Clearstream, Luxembourg, as the case may be, is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so, by the holder giving notice to the Registrar or any Transfer Agent or (iii) if the Issuer would suffer a material disadvantage in respect of the Notes as a result of a change in the laws or regulations (taxation or otherwise) of any jurisdiction referred to in Condition 9 which would not be suffered were the Notes in definitive form and a notice to such effect signed by two members of the board of directors of the Issuer or by any person(s) empowered by the board of directors of the Issuer to sign on behalf of the Issuer is delivered to the Trustee, by the Issuer giving notice to the Registrar or the Transfer

Agent and the Noteholders of its intention to exchange the relevant Global Note for Definitive Notes on or after the Exchange Date (as defined below) specified in the notice.

The Registrar will not register the transfer of, or exchange of interests in, a Global Note for Definitive Notes for a period of 15 calendar days ending on the date for any payment of principal or interest in respect of the Notes.

“Exchange Date” means a day falling not later than 90 days after that on which the notice requiring exchange is given and on which banks are open for business in the city in which the specified office of the Registrar or the Transfer Agent is located.

Delivery

In such circumstances, the relevant Global Note shall be exchanged in full for Definitive Notes and the Issuer will cause individual Definitive Notes to be executed and delivered to the Registrar in sufficient quantities and authenticated by the Registrar for dispatch to the Noteholders. A person having an interest in a Global Note must provide the Registrar with (a) a written order containing instructions and such other information as the Issuer and the Registrar may require to complete, execute and deliver such Definitive Notes and (b) in the case of a Rule 144A Global Note only, a fully completed, signed certification substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, a certification that the transfer is being made in compliance with the provisions of Rule 144A to a QIB in accordance with transfer restrictions set forth in the Agency Agreement. Definitive Notes issued in exchange for a beneficial interest in a Rule 144A Global Note shall bear the legend applicable to transfers pursuant to Rule 144A, as set out under “Transfer Restrictions”.

Legends

Unless and until otherwise agreed among the Issuer, the Managers, the Trustee and the Registrar, all Definitive Notes issued in exchange for or on registration of transfer (such transfer being in compliance with the legends set forth on the face of such Note) of Notes represented by Definitive Notes bearing the transfer restriction set out in the Rule 144A Global Note or the Definitive Notes, as the case may be, (the “Rule 144A Legend”), shall also bear the Rule 144A Legend, provided that the Registrar shall, upon written request of a holder and upon delivery to the Registrar by the holder of a certificate to the effect that the transfer is being made in an “offshore transaction” (as defined in Regulation S) and in accordance with Regulation S, duly executed by the transferor, issue a Definitive Note without such legend in exchange for a Definitive Note with such legend.

Unless and until otherwise agreed among the Issuer, the Managers, the Trustee and the Registrar, all Definitive Notes issued in substitution for or on registration of transfer of Notes represented by Definitive Notes that do not bear the Rule 144A Legend shall also not bear the Rule 144A Legend, provided that the Registrar shall on presentation to it or its order of a certificate to the effect that the transferor reasonably believes that the transferee is a QIB and that such transaction meets the requirements of Rule 144A and is in accordance with any applicable securities laws of any state of the United States or any other jurisdiction, duly executed by the transferor, issue a Definitive Note with such legend in exchange for a Definitive Note without such legend.

Book–Entry Procedures for the Global Notes

Euroclear, Clearstream, Luxembourg and DTC

Custodial and depository links have been established between Euroclear, Clearstream, Luxembourg and DTC to facilitate the initial issue of the Notes and cross–market transfers of the Notes associated with secondary market trading. See “– Book–Entry Ownership – Settlement and Transfer of Notes”.

Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions through electronic book–entry transfer between their respective accountholders. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions which clear through or maintain a custodian relationship with an accountholder of either system. Euroclear and Clearstream, Luxembourg

provide various services including safekeeping, administration, clearance and settlement of internationally-traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depository and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective customers may settle trades with each other. Their customers are worldwide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Investors may hold their interests in such Global Notes directly through Euroclear or Clearstream, Luxembourg, if they are accountholders ("Direct Participants") or indirectly ("Indirect Participants" and together with Direct Participants, "Participants") through organisations which are accountholders therein.

DTC

DTC has advised the Issuer as follows: DTC is a limited purpose trust company organised under the laws of the State of New York, a "banking organisation" under the laws of the State of New York, a member of the US Federal Reserve System a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants and facilitate the clearance and settlement of securities transactions between Participants through electronic computerised book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of certificates. Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. Indirect access to DTC is available to others, such as banks, securities brokers, dealers and trust companies, that clear through or maintain a custodial relationship with a DTC Direct Participant, either directly or indirectly.

Investors may hold their interests in a Rule 144A Global Note directly through DTC if they are Direct Participants in the DTC system, or as Indirect Participants through organisations which are Direct Participants in such system.

DTC has advised the Issuer that it will take any action permitted to be taken by a holder of notes only at the direction of one or more Direct Participants and only in respect of such portion of the aggregate principal amount of the relevant Rule 144A Global Notes as to which such Participant or Participants has or have given such direction. However, in the circumstances described under "– Exchange for Definitive Notes", DTC will surrender the relevant Rule 144A Global Notes for exchange for individual Rule 144A Definitive Notes (which will bear the legend applicable to transfers pursuant to Rule 144A).

Book-Entry Ownership

Euroclear and Clearstream, Luxembourg

The Regulation S Global Note will have an ISIN and a Common Code and will be deposited with and registered in the name of the nominee for, and deposited with, the common depository for Euroclear and Clearstream, Luxembourg.

DTC

The Rule 144A Global Note will have a CUSIP number and will be deposited with a custodian for, and registered in the name of Cede & Co., as nominee of DTC. The custodian and DTC will electronically record the principal amount of the notes held within the DTC system.

Relationship of Participants with Clearing Systems

Each of the persons shown in the records of Euroclear, Clearstream, Luxembourg or DTC as the holder of a note evidenced by a Global Note must look solely to Euroclear, Clearstream, Luxembourg or DTC (as the case may be) for his share of each payment made by the Issuer to the holder of such Global Note and in relation to all other rights arising under the Global Note, subject to and in accordance with the respective rules and procedures of Euroclear, Clearstream, Luxembourg or DTC (as the case may be). The Issuer expects that, upon receipt of any payment in respect of notes evidenced by a Global Note, the common depository by whom such note is held, or nominee in whose name it is registered, will immediately credit the relevant Participants' or accountholders' accounts in the relevant clearing system with payments in amounts proportionate to their respective beneficial interests in the principal amount of the relevant Global Note as shown on the records of the relevant clearing system

or its nominee. The Issuer also expects that payments by Direct Participants in any clearing system to owners of beneficial interests in any Global Note held through such Direct Participants in any clearing system will be governed by standing instructions and customary practices. Save as aforesaid, such persons shall have no claim directly against the Issuer in respect of payments due on the Notes for so long as the Notes are evidenced by such Global Note and the obligations of the Issuer will be discharged by payment to the registered holder, as the case may be, of such Global Note in respect of each amount so paid. None of the Issuer, the Trustee or any agent thereof will have any responsibility or liability for any aspect of the records relating to or payments made on account of ownership interests in any Global Note or for maintaining, supervising or reviewing any records relating to such ownership interests.

Settlement and Transfer of Notes

Subject to the rules and procedures of each applicable clearing system, purchases of Notes held within a clearing system must be made by or through Direct Participants, which will receive a credit for such notes on the clearing system's records. The ownership interest of each beneficial owner of each such Note will in turn be recorded on the Direct and Indirect participants' records. Beneficial owners will not receive written confirmation from any clearing system of their purchase, but beneficial owners are expected to receive written confirmation providing details of the transaction, as well as period statements of their holdings, from the direct or indirect participant through which such beneficial owner entered into the transaction. Transfers of ownership interests in Notes held within the clearing system will be affected by entries made on the books of Participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in such Notes, unless and until interests in any Global Note held within a clearing system are exchanged for Definitive Notes.

No clearing system has knowledge of the actual beneficial owners of the Notes held within such clearing system and their records will reflect only the identity of the Direct Participants to whose accounts such notes are credited, which may or may not be the beneficial owners. The participants will remain responsible for keeping account of their holdings on behalf of their customers. Conveyance of notices and other communications by the clearing systems to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

The laws of some jurisdictions may require that certain persons take physical delivery in definitive form of securities. Consequently, the ability to transfer interests in a Global Note to such persons may be limited. Because DTC can only act on behalf of Direct Participants, who in turn act on behalf of Indirect Participants, the ability of a person having an interest in the Rule 144A Global Note to pledge such interest to persons or entities that do not participate in DTC or otherwise take action in respect of such interest may be affected by a lack of physical certificate in respect of such interest.

Trading between Euroclear and/or Clearstream, Luxembourg Participants

Secondary market sales of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg to purchasers of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg and will be settled using the procedures applicable to conventional eurobonds.

Trading between DTC Participants

Secondary market sales of book-entry interests in the Notes between DTC participants will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to United States corporate debt obligations in DTC's Same-Day Funds Settlement ("SDFS") system in same-day funds, if payment is effected in US Dollars, or free of payment, if payment is not effected in US Dollars. Where payment is not effected in US Dollars, separate payment arrangements outside DTC are required to be made between the DTC participants.

Trading between DTC seller and Euroclear/Clearstream, Luxembourg purchaser

When book-entry interests in the Notes are to be transferred from the account of a DTC participant holding a beneficial interest in the Rule 144A Global Note to the account of a Euroclear or Clearstream, Luxembourg accountholder wishing to purchase a beneficial interest in the Regulation S Global Note (subject to the certification procedures provided in the Agency Agreement), the DTC participant will deliver instructions for delivery to the relevant Euroclear or Clearstream, Luxembourg accountholder to DTC by 12 noon, New York time on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream, Luxembourg participant. On the settlement date, the custodian of the Rule 144A Global Note will instruct the Registrar to (i) decrease the amount of Notes registered in the name of Cede & Co. and evidenced by the Rule 144A Global Note of the relevant class and (ii) increase the amount of Notes registered in the name of the nominee of the common depositary for Euroclear and Clearstream, Luxembourg and evidenced by the Regulation S Global Note. Book-entry interests will be delivered free of payment to Euroclear or Clearstream, Luxembourg, as the case may be, for credit to the relevant accountholder on the first business day following the settlement date.

Trading between Euroclear/Clearstream, Luxembourg seller and DTC purchaser

When book-entry interests in the Notes are to be transferred from the account of a Euroclear or Clearstream, Luxembourg accountholder to the account of a DTC participant wishing to purchase a beneficial interest in the Rule 144A Global Note (subject to the certification procedures provided in the Agency Agreement), the Euroclear or Clearstream, Luxembourg participant must send to Euroclear or Clearstream, Luxembourg deliver free of payment instructions by 7:45 pm, Brussels or Luxembourg time, one business day prior to the settlement date. Euroclear or Clearstream, Luxembourg, as the case may be, will in turn transmit appropriate instructions to the common depositary for Euroclear and Clearstream, Luxembourg and the registrar to arrange delivery to the DTC participant on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream, Luxembourg accountholder, as the case may be. On the settlement date, the common depositary for Euroclear and Clearstream, Luxembourg will (a) transmit appropriate instructions to the custodian of the Rule 144A Global Note who will in turn deliver such book-entry interests in the Notes free of payment to the relevant account of the DTC participant and (b) instruct the Registrar to (i) decrease the amount of Notes registered in the name of the nominee of the common depositary for Euroclear and Clearstream, Luxembourg and evidenced by the Regulation S Global Note; and (ii) increase the amount of Notes registered in the name of Cede & Co. and evidenced by the Rule 144A Global Note.

Although Euroclear, Clearstream, Luxembourg and DTC have agreed to the foregoing procedures in order to facilitate transfers of beneficial interest in Global Notes among participants and accountholders of Euroclear, Clearstream, Luxembourg and DTC, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Issuer, the Trustee or any agent thereof will have the responsibility for the performance by Euroclear, Clearstream, Luxembourg or DTC or their respective direct or indirect participants of their respective obligations under the rules and procedures governing their operations.

Pre-issue Trades Settlement

It is expected that delivery of Notes will be made against payment thereof on the closing date thereof, which could be more than three business days following the date of pricing. Under Rule 15c6-1 under the Exchange Act, trades in the United States secondary market generally are required to settle within three business days (T+3), unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade Notes in the United States on the date of pricing or the next succeeding business days until three days prior to the relevant closing date in respect of the sale of the Notes, will be required, by virtue of the fact that the Notes initially will settle beyond T+3, to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Settlement procedures in other countries will vary. Purchasers of Notes may be affected by such local settlement practices and purchasers of Notes between the date of pricing and the relevant closing date in respect of the sale of the Notes, should consult with their own adviser.

Taxation

Prospective purchasers of the Notes are advised to consult their own tax advisers as to the consequences under the tax laws of the country of which they are resident of a purchase of Notes, including, but not limited to, the consequences of the receipt of interest and the sale or redemption of Notes. The following is a general description of certain tax laws relating to the Notes and the Intercompany Loan, as in effect on the date hereof, and does not purport to be a comprehensive discussion of the tax treatment of the Notes.

United States

General

The following summary contains a description of certain US federal income tax consequences of the purchase, ownership and disposition of the Notes by a US holder (defined below). This summary is not a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase Notes. In particular, this summary of US federal income tax matters deals only with US holders that will hold Notes as capital assets for US federal income tax purposes (generally, assets held for investment) and does not address special tax situations, such as the tax treatment of holders that are (i) subject to special tax rules (e.g. financial institutions, securities or currency dealers, brokers, insurance companies, regulated investment companies and tax-exempt organisations); (ii) holding Notes as part of a hedging or larger integrated financial transaction; or (iii) US holders with a currency other than US Dollars as their functional currency.

This summary is based upon the US Internal Revenue Code of 1986, as amended (the “Code”), Treasury regulations issued thereunder and judicial and administrative interpretations thereof, each as in effect on the date hereof, all of which are subject to change, possibly with retroactive effect. Furthermore, there can be no assurance that the US Internal Revenue Service (the “IRS”), will not assert a position contrary to those discussed herein.

Except as otherwise indicated below, this discussion is generally limited to the tax consequences to initial holders that purchased the Notes for cash at the price set forth on the cover page of this Offering Circular.

As used herein, a “US holder” means a beneficial owner of a Note who is for US federal income tax purposes (i) a citizen or resident of the United States; (ii) a corporation, or any entity treated as a corporation for US federal income tax purposes, created or organised in the United States or under the laws of the United States or of any political subdivision thereof; (iii) any estate the income of which is subject to US federal income taxation regardless of its source; and (iv) any trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more US fiduciaries have the authority to control all substantial decisions of the trust, or if a valid election is in place to treat the trust as a United States person. The tax consequences to a partner of a partnership holding the Notes generally depend on the status of the partner and the activities of the partnership. Such partner should consult its own tax adviser as to such tax consequences.

PROSPECTIVE PURCHASERS OF THE NOTES SHOULD CONSULT THEIR OWN TAX ADVISERS AS TO THE US FEDERAL TAX CONSEQUENCES OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF THE NOTES, IN ADDITION TO THE EFFECT OF ANY STATE OR LOCAL TAX LAWS OR THE LAWS OF ANY JURISDICTION OTHER THAN THE UNITED STATES.

Interest on the Notes

Stated interest on the Notes must be included in a US holder’s income at the time the interest is accrued or received, in accordance with the holder’s method of tax accounting and will be taxable as ordinary income. Interest paid on the Notes will generally constitute foreign source income.

Sale, Exchange and Redemption of Notes

US holders generally will recognise capital gain or loss upon the sale, exchange, retirement or other disposition of a Note in an amount equal to the difference between the amount realised upon such sale, exchange, retirement or other disposition and such US holder’s adjusted tax basis in the Note. A US holder’s adjusted tax basis in a Note generally will equal

such US holder's initial investment in the Note. Capital gain or loss realised by a US holder on the sale, exchange, retirement or other disposition of a Note generally will be US source if the US holder is a "United States resident" within the meaning of section 865 of the Code and generally will be long-term capital gain or loss if the Note is held for more than one year. The deductibility of capital losses is subject to limitations. Notwithstanding the foregoing, the amount of any gain or loss attributable to accrued interest will be taxable as such.

Withholding Taxes

If any foreign withholding taxes are paid with respect to payment of interest on the Notes, including under the Guarantee, the amount withheld and any Additional Amounts paid to a US holder will be included in such holder's gross income and, subject to generally applicable limitations and conditions, the taxes withheld will be treated as foreign income taxes eligible for credit against such holder's US federal income tax liability, or, at the election of the US holder, eligible for deduction in computing such US holder's taxable income. In addition to other limitations and conditions on the creditability of foreign taxes, to the extent US holders are eligible for a reduced rate of withholding under an applicable tax treaty the foreign taxes eligible for credit against the holder's US tax liability will be reduced by amounts that can be refunded and by amounts withheld in excess of the applicable treaty rate. For foreign tax credit purposes, interest income that is subject to a foreign withholding tax will generally constitute "high withholding tax interest" for US foreign tax credit purposes, unless the withholding tax applicable to the US holder is imposed at a rate below 5 per cent., in which case such income generally will constitute "passive income". The calculation of foreign tax credits and, in the case of a US holder that elects to deduct foreign taxes, the availability of deductions, involves the application of complex rules that depend on a US holder's particular circumstances. Accordingly, investors should consult their own tax advisers regarding the creditability or deductibility of those taxes.

Information Reporting and Backup Withholding

Information reporting requirements may apply to certain payments of interest and proceeds of a sale, redemption or other disposition of Notes paid within the United States or through certain US related financial intermediaries. Backup withholding may apply to such payments or proceeds if the beneficial owner fails to provide a correct taxpayer identification number or certification of exempt status. Any amounts withheld under the backup withholding rules from a payment to a beneficial owner will be allowed as a refund or credit against such beneficial owner's US federal income tax liability provided the required information is furnished in a timely manner to the IRS.

Russian Federation

General

The following is a summary of certain Russian tax considerations relevant to the purchase, ownership and disposition of Notes, including information regarding the taxation of payments on the Intercompany Loan. The summary is based on the laws of Russia in effect on the date of this Offering Circular. The summary does not seek to address the applicability of, and procedures in relation to, taxes levied by regions, municipalities or other non-federal level authorities of Russia, nor does the summary seek to address the availability of double tax treaty relief in respect of the Notes, or practical difficulties involved in obtaining such double tax treaty relief. Prospective investors should consult their own tax advisers regarding the tax consequences of investing in the Notes in their own particular circumstances. No representation with respect to the Russian tax consequences to any particular holder is made hereby.

Many aspects of Russian tax law are subject to significant uncertainty. Further, the substantive provisions of Russian tax law applicable to financial instruments may be subject to more rapid and unpredictable change and inconsistency than in jurisdictions with more developed capital markets and tax systems. In this regard, the interpretation and application of such provisions will in practice rest substantially with local tax inspectorates.

For the purposes of this summary, a "non-resident holder" means an individual actually present in Russia for an aggregate period of less than 183 days in a given calendar year

(excluding days of arrival into Russia but including days of departure from Russia) or a legal entity or organisation in each case not organised under Russian law which holds and disposes of the Notes other than through its permanent tax establishment in Russia.

The Russian tax treatment of interest payments made by ALROSA Ltd. to the Issuer under the Intercompany Loan Agreement may affect the holders of the Notes. See “– Taxation of Interest on the Intercompany Loan”.

Taxation of the Notes

Non-Resident Holders

A non-resident holder will not be subject to any Russian taxes in respect of payments of interest and principal on the Notes received from the Issuer.

A non-resident holder also generally should not be subject to any Russian taxes in respect of gain or other income realised on redemption, sale or other disposition of the Notes outside of Russia, provided that the proceeds of such disposition are not received from a source within Russia.

In the event that proceeds from a disposition of Notes are received from a source within Russia, a non-resident holder that is a legal entity or organisation should not be subject to any Russian taxation in respect of such proceeds, although there is some residual uncertainty regarding the treatment of the portion of proceeds, if any, that is attributable to accrued interest. Subject to reduction or elimination under provisions of an applicable tax treaty that are related to interest income, proceeds attributable to accrued interest may be taxed at a rate of 20 per cent., even if the disposal results in a capital loss. To obtain the benefit of such tax treaty provisions, a holder would need to provide to the payer a certificate of tax domicile issued by a competent tax authority of the relevant treaty country. Non-resident holders that are legal entities or organisations should consult their own tax advisers with respect to the tax consequences of the receipt of proceeds from a source within Russia in respect of a disposition of the Notes.

Subject to any available tax treaty relief, the receipt of proceeds by a non-resident individual from a source within Russia in respect of a disposition of the Notes may be subject to personal income tax at a rate of 30 per cent. of the gross proceeds less any available cost deduction (including the original purchase price) because such payments are likely to be treated as Russian source income for Russian personal income tax purposes. The tax may be withheld at source of payment or, if the tax is not withheld, then the non-resident individual may be liable to pay the tax. Due to the complexity of the tax exemption procedure in respect of Russian source income paid to foreign individuals, it is not certain that an advance relief will be available and obtaining a refund can be extremely difficult, if not impossible. There is also a risk that any gain realised on a disposition of the Notes may be affected by changes in the exchange rates between the currency of acquisition of the Notes, the currency of sale of the Notes and Roubles. There is some uncertainty regarding the treatment of the portion of proceeds attributable to accrued interest. Subject to reduction or elimination under provisions of an applicable tax treaty related to interest income, proceeds attributable to accrued interest may be taxed at a rate of 30 per cent., even if the disposal results in a capital loss. Non-resident holders who are individuals should consult their own tax advisers with respect to the tax consequences of the receipt of proceeds from a source within Russia in respect of a disposition of the Notes.

Resident Holders

A holder of a Note who is an individual resident in Russia for tax purposes or an organisation which is not a non-resident in Russia is subject to all applicable Russian taxes in respect of gains from a disposition of the Notes and interest received on the Notes.

Taxation of Interest on the Intercompany Loan

In general, payments of interest on borrowed funds by a Russian entity to a non-resident entity are subject to Russian withholding tax at the rate of 20 per cent. of the gross interest payment, subject to reduction or elimination pursuant to the terms of an applicable tax treaty. Based on professional advice it has received, ALROSA Ltd. believes that payments of interest on the Intercompany Loan should not be subject to Russian withholding taxes under the terms of the tax treaty between Russia and Luxembourg. However, there can be no

assurance that such relief will be obtained. In addition, if interest under the Intercompany Loan becomes payable to the Trustee pursuant to the Terms and Conditions, any benefit of the tax treaty between Russia and Luxembourg will cease and payments of interest could be subject to Russian withholding tax.

Prior to 1 January 2002, a claim for treaty relief from Russian withholding tax was subject to preliminary approval by the Russian tax authorities after review of relevant contracts and tax residency certificates. As of 1 January 2002, such preliminary approval from and contract disclosure to the Russian tax authorities is no longer required. However, as a result of this new procedure, the Russian tax authorities may review the Issuer's eligibility for treaty relief in greater detail during tax audits of ALROSA Ltd.

If payments under the Intercompany Loan are subject to any withholding of Russian tax (as a result of which the Issuer would reduce payments under the Notes in the amount of such withholding), ALROSA Ltd. is obliged (subject to certain conditions) to increase payments as may be necessary so that the net payments received by holders will be equal to the amounts they would have received in the absence of such withholding. It should be noted, however, that tax gross-up provisions might not be enforceable under Russian law. If ALROSA Ltd. is obliged to increase payments, it has the right, subject to certain conditions, to prepay the Intercompany Loan in full. In such case, all outstanding Notes would be redeemable at par with accrued interest.

VAT is not applied to the rendering of financial services involving the provision of a loan in monetary form. Therefore, no VAT will be payable in Russia on any payment of interest or principal on the Intercompany Loan.

Taxation of Payments under the Guarantee

Payments of interest on the Notes under the Guarantee are likely to be characterised as Russian source income. Accordingly, such payments should be subject to withholding tax at a rate of 20 per cent. in the event that a payment under the Guarantee is made to a non-resident holder that is a legal entity or organisation and at a rate of 30 per cent. in the event that a payment under the Guarantee is made to a non-resident individual, subject to reduction or elimination under any applicable tax treaty. We cannot offer any assurance that such withholding tax would not be imposed upon the full payment under the Guarantee, including with respect to the principal amount of the Notes.

Payments under the Guarantee should not be subject to Russian VAT.

Luxembourg

The following is a general discussion of certain Luxembourg income tax consequences of the acquisition, ownership and disposition of Notes by original purchasers who are not residents of Luxembourg. For this purpose, a tax resident of Luxembourg is a person whose residence, customary place of abode, seat or place of management is located in Luxembourg. The summary is based on laws currently in force and as applied in practice on the date of this Offering Circular, all of which are subject to change, possibly with retroactive effect. The information provided below does not purport to be a complete, exhaustive or final summary of the tax law and practice currently applicable in Luxembourg, and prospective investors should consult their own tax advisers regarding the tax consequences of investing in the Notes in their own particular circumstances.

Payments of interest on the Notes to persons who are not tax residents of Luxembourg and have no connection with Luxembourg other than the receipt of such payments will generally be exempt from Luxembourg taxation. All payments of interest and principal on the Notes will be made free of withholding, or deduction for, or on account of any taxes imposed, levied, withheld, or assessed by Luxembourg or any political subdivision or taxing authority thereof or therein.

Persons who are not tax residents of Luxembourg and have no connection with Luxembourg other than the holding of the Notes will not be subject to Luxembourg tax on any capital gains from a sale or other disposition of Notes.

There is no Luxembourg registration tax, capital tax, stamp duty or any other similar tax or duty (other than nominal court fees and contributions for registration with the Chamber of

Commerce) payable in Luxembourg in respect of or in connection with the execution, delivery and enforcement by legal proceedings (including any foreign judgment in the courts of Luxembourg) of the Notes or the performance of the Issuer's obligations under the Notes, except that in the case of court proceedings in a Luxembourg court or the presentation of the documents relative to the Note issue to an *autorité constituée*, such court or *autorité constituée* may require registration thereof, in which case the documents will be subject to registration duties depending on the nature of the documents and, in particular, a loan will be subject to an *ad valorem* registration duty of 0.24 per cent., calculated on the amounts mentioned therein.

European Union

On 3 June 2003, the council of the European Union adopted a directive on the taxation of savings income (Directive 2003/48/EC) (the "Directive") under which each member state of the European Union ("Member State") will generally be required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to or for an individual (the "Beneficiary") resident in that other Member State. Exceptionally (and for a transitional period only, which will end after agreement on exchange of information is reached between the European Union and certain non-European Union States), Belgium, Luxembourg and Austria will instead be required to impose a withholding tax (at a rate of 15 per cent. during the first three years from the date of application of the Directive, at a rate of 20 per cent. for the subsequent three years and at a rate of 35 per cent. thereafter) on such payments unless the Beneficiary authorises the person making the payment to report the payment or presents a certificate from the relevant tax authority establishing exemption therefrom. The Directive will, subject to certain conditions being satisfied, apply from a date not earlier than 1 July 2005. Noteholders should consult their own tax advisers regarding the implications of this Directive in their own particular circumstances.

Plan of Distribution

J.P. Morgan Securities Ltd. ("JPMorgan"), ING Bank N.V., London Branch ("ING"), Barclays Bank PLC ("Barclays") and OAO Web-invest Bank ("Web-invest", and together with JPMorgan, ING and Barclays, the "Managers") have, pursuant to a Subscription Agreement dated 11 November 2004 (the "Subscription Agreement"), jointly and severally agreed with the Issuer and the Guarantor, subject to the satisfaction of certain conditions, to subscribe and pay for the Notes at the issue price of 99.511 per cent. of their principal amount, less a combined management, underwriting and selling commission of 0.85 per cent. of such principal amount. In addition, the Guarantor has agreed to reimburse the Managers for certain of their expenses in connection with the issue of the Notes. The Subscription Agreement entitles the Managers to be released and discharged from their obligations thereunder in certain circumstances prior to payment being made to the Issuer.

The Issuer has agreed to sell to the Managers the aggregate principal amount of the Notes set out opposite their respective names below:

Managers⁽¹⁾	Aggregate Principal Amount of Notes
JPMorgan.....	US\$217,125,000
ING.....	US\$72,375,000
Barclays.....	US\$1,500,000
Web-invest.....	US\$9,000,000
Total	US\$300,000,000

Note:

(1) Sales in the United States will be made through affiliates of the Managers listed above.

United States

The Notes and the Guarantee have not been and will not be registered under the Securities Act and may not be offered or sold in the United States except in certain transactions exempt from or not subject to the registration requirements of the Securities Act. The Notes are being offered and sold outside of the United States in offshore transactions in reliance on Regulation S. The Subscription Agreement provides that the Managers may directly or through their respective US broker-dealer affiliates arrange for the offer and resale of Notes within the United States only to QIBs in reliance on Rule 144A. Terms used above and below have the meanings assigned to them in Regulation S. Each purchaser of the Notes offered hereby in reliance on Rule 144A will, by such purchase, be deemed to have made certain acknowledgements, representations, warranties and agreements set forth under "Transfer Restrictions".

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of the Notes within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

This Offering Circular has been prepared by the Issuer for use in connection with the offer and sale of the Notes outside the United States, the resale of the Notes in the United States and for the Listing of the Notes on the Luxembourg Stock Exchange. The Issuer and the Managers reserve the right to reject any offer to purchase the Notes, in whole or in part, for any reason. This Offering Circular does not constitute an offer to any person in the United States, other than any QIB to whom an offer has been made directly by any of the Managers or their US broker-dealer affiliates. Distribution of this Offering Circular by any QIB in the United States to any other person within the United States, other than any QIB and those persons, if any, retained to advise such QIB with respect thereto, is unauthorised and any disclosure without the prior written consent of the Issuer of any of its contents to any person within the United States, other than any QIB and those persons, if any, retained to advise such QIB, is prohibited.

United Kingdom

Each Manager has represented, warranted and agreed that:

- (a) it has not offered or sold and, prior to the expiry of a period of six months from the issue date of the Notes, will not offer or sell, any Notes to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995;
- (b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer or the Guarantor; and
- (c) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

The Russian Federation

This Offering Circular is being distributed to a limited circle of persons only and is provided for your own information and is not to be provided or otherwise made available by you to any other person or entity. The information provided in this Offering Circular is not an advertisement of the Notes in Russia and is not intended to create or maintain an interest in Alrosa Finance S.A., ALROSA Ltd. or the Notes or facilitate any sale, exchange or transfer of the Notes in Russia or to any Russian person or entity.

The Notes are securities of a foreign issuer under Russian law. No sale, exchange or transfer of the Notes may take place in Russia or to any Russian person or entity. Neither the issue of the Notes nor a securities prospectus in respect of the Notes has been, or is intended to be, registered with the Federal Service for Financial Markets of the Russian Federation. The information provided in this Offering Circular is not an offer, or an invitation to make offers, to sell, exchange or otherwise transfer the Notes in Russia or to any Russian person or entity.

Each Manager has represented, warranted and agreed that the Notes will not be offered, sold or otherwise transferred as part of their initial distribution or at any time thereafter to or for the benefit of any persons (including legal entities) resident, incorporated, established or having their usual residence in Russia or to any person located within the territory of Russia unless and to the extent otherwise permitted under Russian law.

Luxembourg

Each Manager has represented and agreed that the Notes have not been and are not being offered to the public in Luxembourg and each Manager has represented, warranted and agreed that it will not offer the Notes or cause the offering of the Notes or contribute to the offering of the Notes to the public in Luxembourg, unless all the relevant legal and regulatory requirements have been complied with. In particular, this offer has not been and will not be announced to the public and offering material will not be made available to the public. A listing of the Notes on the Luxembourg Stock Exchange does not necessarily imply that a public offering in Luxembourg has been authorised.

The Netherlands

Each Manager has represented and agreed that the Notes may not, directly or indirectly, be offered, sold, transferred or delivered in or from The Netherlands, whether at their initial distribution or at any time thereafter, and neither the Offering Circular nor any other document in respect of the offering may be distributed or circulated in or from The Netherlands, other than to individuals or legal entities who or which trade or invest in securities in the conduct of their profession or trade (which includes banks, investment institutions, securities intermediaries, insurance companies, pension funds, other institutional investors and treasury departments and finance companies of large enterprises), in which case it must be made clear upon making the offer and from any documents or advertisements in

which a forthcoming offering of Notes is publicly announced that the offer is exclusively made to the said individuals or legal entities.

France

Each of the Managers and the Issuer has represented, warranted and agreed that (i) it has not offered or sold and will not offer or sell, directly or indirectly, any Notes to the public in the Republic of France, and (ii) offers and sales of Notes will be made in the Republic of France only to qualified investors as defined in and in accordance with Articles L.411-1 and L.411-2 of the French *Code monétaire et financier* and Decree No. 98-880 dated of 1 October 1998 relating to offers to qualified investors.

In addition, each of the Managers, the Issuer and the Guarantor has represented, warranted and agreed that it has not distributed or caused to be distributed and will not distribute or cause to be distributed in the Republic of France, this Offering Circular or any other offering material relating to the Notes other than to investors to whom offers and sales of Notes in the Republic of France may be made as described above.

Germany

The Notes have not been and will not be publicly offered in the Federal Republic of Germany ("Germany") and, accordingly, no securities sales prospectus (*Verkaufsprospekt*) for a public offering of the Notes in Germany in accordance with the Securities Sales Prospectus Act of 9 September 1998, as amended (*Wertpapier-Verkaufsprospektgesetz*, the "Prospectus Act"), has been or will be published or circulated in Germany. Each Manager has represented and agreed that it has only offered and sold and will only offer and sell the Notes in Germany to persons who purchase and sell securities as part of their profession or business either for their own account or for the account of a third person pursuant to Section 2, No. 1 of the Prospectus Act, and in accordance with the provisions of the Prospectus Act and any other laws applicable in Germany governing the issue, sale and offering of securities. Any resale of the Notes in Germany may only be made in accordance with the provisions of the Prospectus Act and any other laws applicable in Germany governing the sale and offering of securities.

Italy

Each Manager has represented, warranted and agreed that the offering of the Notes in Italy has not been registered with the CONSOB pursuant to Italian securities legislation and, accordingly, that it has not offered, and will not offer, any Notes in Italy in a solicitation to the public at large (*sollecitazione all'investimento*) within the meaning of Article 1, paragraph 1, letter (t) of Legislative Decree no. 58 of 24 February 1998, that such Notes shall not be placed, sold and/or offered, either in the primary or in the secondary market, to individuals resident in Italy and that sales of Notes in Italy will only be:

- (a) negotiated on an individual basis with "Professional Investors" (*operatori qualificati*), as defined under Article 31, paragraph 2, of CONSOB Regulation no. 11522 of 1 July 1998, as amended;
- (b) effected in compliance with Article 129 of the Legislative Decree no. 385 of 1 September 1993 and the implementing instructions of the Bank of Italy, pursuant to which the issue or offer of securities in Italy is subject to prior notification to the Bank of Italy, unless an exemption, depending *inter alia* on the amount of the issue and the characteristics of the securities, applies;
- (c) effected in accordance with any other Italian securities, tax and exchange control and other applicable laws and regulations and any other applicable requirement or limitation which may be imposed by CONSOB or the Bank of Italy; and
- (d) made by an investment firm, bank or financial intermediary permitted to conduct such activities in Italy in accordance with the relevant provisions of Italian law.

Austria

Each Manager has acknowledged that the Notes may not be publicly offered pursuant to the Austrian Capital Markets Act (*Kapitalmarktgesetz*, "KMG") in Austria (whether presently or in the future), and that no public advertisements relating to the Notes may be made. Each Manager has represented, warranted and agreed that it will not make publicly available or

distribute in any way any offering or marketing materials relating to the Notes which could constitute a public offer pursuant to the KMG.

Hong Kong

Each Manager has represented and agreed that (i) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Notes other than to persons whose ordinary business is to buy or sell shares or debentures, whether as principal or agent, or in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32) of Hong Kong; and (ii) it has not issued and will not issue any advertisement, invitation or document relating to the Notes, whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” within the meaning of the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made thereunder.

Philippines

Each Manager has represented, warranted and agreed that (i) the Notes are not intended to be registered with the Philippine Securities and Exchange Commission under the Philippines’ Republic Act No. 8799 (the “Securities Regulation Code”), pursuant to which securities are not permitted to be sold or offered for sale or distribution within the Philippines, without a registration statement duly filed with, and approved by, the Philippine Securities and Exchange Commission unless such securities are exempt securities under Section 9 of the Securities Regulation Code or are sold in an exempt transaction under Section 10 of the Securities Regulation Code and that (ii) accordingly, each Manager may offer the Notes in the Philippines under an exempt transaction pursuant to Section 10.1(L) of the Securities Regulation Code.

Singapore

Each Manager has acknowledged that this Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, each Manager has represented, warranted and agreed that it has not circulated or distributed nor will it circulate or distribute this Offering Circular and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of any Notes, nor has it offered or sold or caused such Notes to be made the subject of an invitation for subscription or purchase and will not offer or sell such Notes or cause such Notes to be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor specified in Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the “Securities and Futures Act”), (ii) to a sophisticated investor and in accordance with the conditions specified in Section 275 of the Securities and Futures Act or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provisions of the Securities and Futures Act.

General

Each Manager has agreed that it has, to the best of its knowledge and belief, complied and will comply with all applicable laws and regulations in each country or jurisdiction in which it purchases, offers, sells or delivers Notes or distributes this Offering Circular (and any amendments thereof and supplements thereto) or any other offering or publicity materials relating to the offering of the Notes, the Notes, the Issuer and ALROSA Ltd.

All applicable laws and regulations must be observed in any jurisdiction in which the Notes may be offered, sold or delivered. No person may directly or indirectly offer, sell, resell, reoffer or deliver the Notes or distribute this Offering Circular (and any amendments thereof and supplements thereto) or any other offering or publicity materials relating to the Notes, the Issuer or ALROSA Ltd. in any country or jurisdiction except under circumstances that will result, to the best of its knowledge and belief after due inquiry, in compliance with all applicable laws and regulations.

JPMorgan, ING and their respective affiliates have engaged in transactions with and performed various investment banking, financial advisory and other services for us, for which they received customary fees, and JPMorgan, ING and their respective affiliates may provide such services in the future. Furthermore, on 8 August 2003, we entered into a framework credit facility agreement with JP Morgan Bank International, an affiliate of JPMorgan, under which we have borrowed US\$20 million as of 17 April 2004, that we intend to repay with the proceeds of this offering. On 9 March and 9 April 2004, ING Bank N.V. issued the Credit Linked Notes, the proceeds of which were used to extend the Loan to Severalmaz. The Loan bears interest at 8.875 per cent. per annum. In the event Severalmaz is unable to repay its indebtedness under the Loan, the holders of the Credit Linked Notes can require ALROSA Ltd. to purchase the Credit Linked Notes.

Transfer Restrictions

Because of the following restrictions, you are advised to consult legal counsel prior to making any offer, resale or other transfer offered hereby.

Rule 144A Notes

Each purchaser of Rule 144A Notes within the United States, by accepting delivery of this Offering Circular and the Rule 144A Notes, will be deemed to have represented, agreed and acknowledged that:

1. It is (a) a QIB, (b) acting for its own account, or for the account of another QIB and (c) aware, and each beneficial owner of such Rule 144A Notes has been advised, that the sale of such Rule 144A Notes to it is being made in reliance on Rule 144A.
2. It understands that the Rule 144A Notes have not been and will not be registered under the Securities Act and may not be offered, sold, pledged or otherwise transferred except as permitted below.
3. It agrees that if it decides to offer, sell or otherwise transfer such Rule 144A Notes, it will do so only in compliance with the Securities Act and applicable securities laws of the United States and other relevant jurisdictions and only (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or for the account of a QIB, (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S or (c) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available).
4. The Notes sold pursuant to Rule 144A will bear the following legend:

THIS NOTE AND THE GUARANTEE IN RESPECT HEREOF HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE US SECURITIES ACT OF 1933 (THE "SECURITIES ACT") OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND THIS NOTE MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT ("RULE 144A") TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A (A "QIB") PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QIB, (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT OR (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF APPLICABLE) IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR REALES OF THIS NOTE.

THIS RULE 144A GLOBAL NOTE IS REGISTERED IN THE NAME OF A NOMINEE OF THE DEPOSITORY TRUST COMPANY ("DTC"). UNLESS THIS RULE 144A GLOBAL NOTE IS PRESENTED BY AN AUTHORISED REPRESENTATIVE OF DTC, TO THE ISSUER OR ITS AGENT FOR REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY RULE 144A DEFINITIVE NOTE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORISED REPRESENTATIVE OF DTC (AND ANY PAYMENT IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORISED REPRESENTATIVE OF DTC), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL IN AS MUCH AS THE REGISTERED OWNER HEREOF, CEDE & CO. OR, AS THE CASE MAY BE, SUCH OTHER PERSON, HAS AN INTEREST HEREIN.

BY ACCEPTANCE OF THIS NOTE BEARING THE ABOVE LEGEND, WHETHER UPON ORIGINAL ISSUANCE OR SUBSEQUENT TRANSFER, EACH HOLDER OF THIS NOTE ACKNOWLEDGES THE RESTRICTIONS ON THE TRANSFER OF THIS NOTE SET FORTH ABOVE AND AGREES THAT IT SHALL TRANSFER THIS NOTE ONLY AS PROVIDED HEREIN AND IN THE TRUST DEED (AS DEFINED BELOW).

5. It acknowledges that ALROSA Ltd., the Issuer, the Registrar, the Managers and their respective affiliates, and others will rely upon the truth and accuracy of the above acknowledgements, representations and agreements and agrees that, if any of the acknowledgements, representations or agreements deemed to have been made by it by its

purchase of Rule 144A Notes is no longer accurate, it shall promptly notify ALROSA Ltd., the Issuer and the Managers. If it is acquiring any Rule 144A Notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each of those accounts and that it has full power to make the above acknowledgements, representations and agreements on behalf of each account.

6. It understands that the Rule 144A Notes will be evidenced by Rule 144A Global Note. Before any interest in the Rule 144A Global Note may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Regulation S Global Note, it will be required to provide a written certification (in the form provided in the Agency Agreement) as to compliance with applicable securities laws.

Prospective purchasers are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.

The Notes offered and sold hereby pursuant to Rule 144A will constitute “restricted securities” within the meaning of Rule 144(a)(3) of the Securities Act and any sale pursuant to Rule 144 will be subject to the requirements of that rule, including its holding period requirements. No representations can be made as to the availability of the exemption provided by Rule 144 under the Securities Act for the resale of the Notes.

Regulation S Notes

Each purchaser of Regulation S Notes outside the United States pursuant to Regulation S and each subsequent purchaser of Regulation S Notes in resales prior to the expiration of the distribution compliance period, by accepting delivery of this Offering Circular and the Regulation S Notes, will be deemed to have represented, agreed and acknowledged that:

1. It is, or at the time Regulation S notes are purchased will be, the beneficial owner of such Regulation S Notes and (a) it is purchasing the Regulation S Notes in an “offshore transaction” (as defined in Regulation S) and (b) it is not an affiliate of ALROSA Ltd., the Issuer or a person acting on behalf of such an affiliate.

2. It understands that the Regulation S notes have not been and will not be registered under the Securities Act and, it will not offer, sell, pledge or otherwise transfer such Regulation S Notes except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or the account of a QIB and to whom notice is given that such offer, sale, pledge or transfer is being made in reliance on Rule 144A or (b) in an offshore transaction in accordance with Regulation S, in each case in accordance with the Securities Act and applicable securities laws of the United States and other relevant jurisdictions.

3. It understands that the Regulation S Notes will be evidenced by a Regulation S Global Note. Before any interest in the Regulation S Global Note may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Note, it will be required to provide a written certification (in the form provided in the Agency Agreement) as to compliance with applicable securities laws.

4. It acknowledges that ALROSA Ltd., the Issuer, the Registrar, the Managers and their respective affiliates, and others will rely upon the truth and accuracy of the above acknowledgements, representations and agreements and agree that, if any of the acknowledgements, representations or agreements deemed to have been made by it by its purchase of Regulation S Notes is no longer accurate, it shall promptly notify ALROSA Ltd., the Issuer and the Managers. If it is acquiring any Regulation S Notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each of those accounts and that it has full power to make the above acknowledgements, representations and agreements on behalf of each account.

Independent Accountants

Our consolidated financial statements as of 31 December 2001, 2002 and 2003 and for each of the three years in the period ended 31 December 2003, included in this Offering Circular, have been audited by ZAO PricewaterhouseCoopers Audit, independent accountants, as stated in their report appearing herein.

Legal Matters

Certain legal matters in connection with the offering of the Notes will be passed on for the Issuer and ALROSA Ltd. by Cleary, Gottlieb, Steen & Hamilton, London, England, as to matters of English law, Paris, France, as to matters of US law and Moscow, Russia, as to matters of Russian law. Certain legal matters in connection with the offering of the Notes will be passed on for the Issuer and ALROSA Ltd. by Arendt & Medernach as to matters of Luxembourg law. Certain legal matters in connection with the offering of the Notes will be passed on for the Managers by Linklaters, London, England and Moscow, Russia.

Industry Overview

Data on diamond reserves and production output in Russia are an official state secret. See “Risk Factors – Risks Related to Our Business – We are prohibited from disclosing our Russian diamond reserves and other information which may be considered material by investors”. Accordingly, any data discussed below in respect of diamond reserves or production in Russia is based on non-Russian sources.

Introduction

The diamond industry is comprised of several distinct segments, including prospecting, mining, sorting, production, cutting, polishing and selling. After gold, diamonds are the second highest contributor to revenue from newly mined precious metals and minerals. In 2002, according to Terraconsult, a group of geological consultants specialising in the evaluation of diamond deposits, total revenue from diamond mining was US\$7.5 billion. According to Diamond Intelligence Briefs, total revenue from diamond mining was US\$8.9 billion in 2003.

Origin of Diamonds

Diamonds are the hardest naturally occurring substance. Chemically, diamonds are carbon in relatively pure form. However, during crystallisation, various elements other than carbon may be incorporated into the diamond matrix. These impurities may have a significant effect on the physical properties of a diamond.

Primary diamond deposits are located on the cratons of present-day continents. A craton consists of the exposed pre-Cambrian Shield and surrounding platform sedimentary rocks which form the nucleus of a continent. Diamonds are brought to the earth’s surface through a few relatively small, explosive volcanoes whose magma is known as peridotite or lamproite. These volcanoes are a rare phenomenon and only about 5,000 are known around the world. Fewer than 1,000 of these contain any measurable amount of diamonds and only 60 or so have been economic to mine so far.

Diamonds are mostly found, and have their origin, in a dark, green-blue, soft, weathered and mica-bearing ultramafic rock. This rock was named “kimberlite” after the town of Kimberley which had been established near the diamond diggings on the farm of Jan de Beer in South Africa. All subsequent primary diamond deposits were found in similar kimberlitic rocks until 1978 when a significant diamond deposit was discovered at Argyle in northwestern Australia, in lamproite, another type of ultramafic rock.

Typically, diamond pipes occur in fields some 50 kilometres or more in diameter, each containing between 50 and 100 individual kimberlitic intrusions randomly scattered with a variety of diamond and indicator mineral content. Within a field, clusters of one to 20 distinct diamond pipes can occur within one kilometre of each other, separated by two kilometres or more from another cluster. The discovery of one diamond pipe therefore generally indicates that others will be found in the vicinity. The classic diamond pipe has an almost circular horizontal section commonly less than 500 metres in diameter at its widest, which in three dimensions has a conical shape. Experience has shown that where some diamond pipes in the cluster are diamondiferous, the largest diamond pipe in the cluster is most likely to be economically suitable for mining. Evaluation of kimberlite demonstrates that there is little correlation between the number of diamond pipes, the percentage of those that are diamondiferous and the percentage that are economically suitable for mining.

Identification of Diamond Deposits

The process of finding diamond deposits is laborious, often involves work under severe environmental conditions, and commences with geophysical surveys. Surface sampling then occurs and sampling for kimberlite indicator minerals. Core drilling takes place, particularly with respect to the most promising anomalies, and small test amounts of core are processed for diamonds. The best diamond pipes are subjected to bulk sampling through which it is possible to estimate the value of the diamond-bearing rock and the approximate minimal value of diamonds that can be recovered.

The World Diamond Industry

World Diamond Reserves

Total world diamond reserves are estimated at 7,910 million carats, excluding proven Russian reserves. Outside Russia, central Africa has the largest diamond reserves estimated at 1,540 million carats, followed by southern Africa with estimated reserves in the region of 1,450 million carats.

Diamond Mine Evaluation

In addition to the importance of overall tonnage and grade in evaluating a diamond deposit, the value per carat of individual stones is also an important economic factor. The term "grade" refers to the number of carats per specified weight of ore. Typically, grade is based on carats per tonne (ct/t) and carats per 100 tonnes (CPHT). The value per carat is the value of the diamonds in the deposit divided by the number of carats they represent. In the case of alluvial deposits, industry practice is to quote grades in carats per tonne or carats per cubic metre. In terms of quality, the diamonds from a mine are broadly categorised as gem, near-gem and industrial, with gem diamonds varying in value according to their carat weight, clarity and colour.

Because the overall value of production depends on the quality and, therefore, value of the stones, high-grade diamond pipes with low-quality diamonds can have ore of less value than low-grade diamond pipes with a large percentage of gems. For example, the Argyle diamond deposit in Australia has an extremely rich grade at 600 CPHT but most of the diamonds are of the industrial variety, with the result that the average value per carat mined is only US\$11. In contrast, the Kimberley mine in South Africa has a grade of 100 CPHT, but many stones are gem quality and the average value per carat mined is US\$110.

Structure of World Diamond Output

There are more than 5,000 recognised types of diamonds with a wide variety of characteristics and grades, and significantly different values. Prices vary from US\$0.5 per carat for poor quality industrial stones to tens of thousands of Dollars per carat for large, uncut diamonds. The following table gives information in respect of world diamond output by quality in 2002, the most recent year for which such information is available:

	By weight	By value	Avg. price per carat
	(in per cent.)		(amounts in US\$)
Gems	15	75	31.9
Near-gems	39	20	30.7
Industrial diamonds	46	5	2.7

Source: Note on World Diamond Industry, published by ALROSA Ltd.

Supply of Diamonds

The following table gives information as to global rough diamond output in millions of carats from 1890 to 2003:

1890	1900	1910	1920	1930	1940	1950	1960	1970	1980	1990	2000	2001	2002	2003
2.5	2.1	5.7	3.2	7.5	13	15.2	27.7	42.5	43	101.6	107.5	117	132.6	143.1

Source: Yorkton Securities; US Geological Survey Minerals Handbook, 2001; ALROSA Ltd.; Diamond Intelligence Briefs.

It is estimated that more than 95 per cent. of the diamonds that have ever been produced have been produced since 1900. However, despite the fact that the number of diamond producing countries has increased in recent years, the bulk of rough diamond production is concentrated in seven countries which together accounted for 87 per cent. of output by volume in 2003. In order of volume, the main diamond producers are Botswana, Russia, Canada, South Africa, the Democratic Republic of Congo, Angola and Namibia. In order of value (according to estimates made by Rio Tinto) they are Botswana, Russia, Canada, South Africa, Angola and the Democratic Republic of Congo. According to Natural Resources

Canada, in 2003, the top three diamond producing countries were Botswana, Russia and Canada, with each producing diamonds worth in excess of US\$1 billion.

Major Producers of Rough Diamonds

There are more than 100 companies involved in various aspects of diamond mining, including exploration. The largest diamond producers in the world by value are Debswana, ALROSA, De Beers, Namdeb, Democratic Republic of Congo, BHP, Rio Tinto, ASCORP and Trans Hex. De Beers owns Debswana jointly with the government of Botswana and Namdeb jointly with the government of Namibia.

De Beers has been involved in all areas of the diamond industry for more than 100 years. Today, De Beers is the largest diamond mining organisation in the world, producing about half of the world's gem diamonds, by value, from its mines in South Africa and, in partnership with the respective governments, in Botswana, Namibia and Tanzania. In southern Africa, De Beers is currently involved in 18 diamond mining operations including open-pit, underground, alluvial, coastal and subsea mines. De Beers, through its mines in South Africa and through Debswana and Namdeb, accounts on average for 25 per cent. in carats and about 50 per cent. by value of all diamonds produced. Botswana diamond production is controlled by Debswana, a joint venture between De Beers and the government of Botswana. Diamonds sold from Debswana account for over 20 per cent. of the world's gem-quality diamonds. In 2003, we produced approximately 19 per cent. of the world's rough diamond output, measured as a multiple of average market prices.

ASCORP is a joint venture, which was established in 2000 among Sodiam, Angola's state-owned diamond monopoly, Lev Leviev and Sylvain Goldberg. ASCORP markets all of the diamonds produced in Angola, including those produced by the Catoca mine, which accounts for approximately 2.4 per cent. by value of all diamond output produced worldwide.

Rio Tinto is relatively new to the diamond industry; however, it has a strong mineral resources base, containing 100 million tonnes of commercial ore reserves and 217.5 million carats of diamonds with an average value of US\$30 per carat. Rio Tinto owns 100 per cent. of the Argyle mine in Australia, 78 per cent. of the Murowa mine in Zimbabwe and 60 per cent. of the Diavik mine in Canada. In addition, Rio Tinto owns the Argyle European Selling Office ("AESO"), which markets almost all of the diamonds produced from the Argyle and Merlin mines. Collectively, Rio Tinto accounted for approximately 10 per cent. of world diamond production by value in 2003 and 25 per cent. in carats. In 2001, it mined approximately US\$400 million worth of rough diamonds. The majority of Rio Tinto's production is supplied to the Indian market.

BHP owns 80 per cent. of the Ekati mine in the Northwest Territories, Canada. Similar to Rio Tinto, BHP has been present in the rough diamond market for only a short time. It currently has all of the marketing rights to the Ekati production. BHP accounted for approximately 6 per cent. by value in 2003 of all diamond output produced worldwide.

The Democratic Republic of Congo is another major source of diamonds to the world market, supplying approximately 2.5 per cent. to 5 per cent. by value of all diamond output produced worldwide.

Trans Hex is the second largest rough diamond producer in South Africa, specialising in very high-quality diamonds. In 2003 it supplied less than 1 per cent. by value of all world diamond output.

Marketing and Role of the Diamond Trading Company

The marketing structure, which was established under the guidance and supervision of De Beers, has been aimed at reducing price volatility and the efficient operation of the market through aggregating supply and demand. The Diamond Trading Company, a wholly owned subsidiary of De Beers, buys, sorts and values diamonds prior to marketing. The Diamond Trading Company is involved in approximately 60 per cent. to 65 per cent. of rough diamond sales internationally.

The Diamond Trading Company sells uncut gem diamonds at regular, approximately five-week intervals, 10 times per year. These sales, known as "sights", are held in London, with smaller offerings made in Kimberley, South Africa and Lucerne, Switzerland. The uncut gemstones offered in these sights are generally offered in lots, or "boxes", which are individually

tailored to reflect the Diamond Trading Company's perception of market conditions and the individual requirements of each attendee as communicated to the Diamond Trading Company prior to the sight. The Diamond Trading Company only plays a modest role in the cut diamond market, mainly through its Antwerp-based polishing company Diatrada.

In addition to agreements with mines operated by De Beers in Botswana, Namibia and South Africa, the Diamond Trading Company has contractual agreements for the majority of diamond exports from Russia and Tanzania. The Diamond Trading Company's agents compete with independent dealers, buying much of the production (mostly locally, but also in the major diamond centres such as Antwerp and Amsterdam) from a number of placer deposits in countries such as Angola, Ghana, Guyana, Liberia, Sierra Leone, Venezuela and the Democratic Republic of Congo. The Diamond Trading Company fulfils an important role in the world rough diamond market by purchasing diamonds, largely regardless of the state of the diamond market and world economy and by global advertising of diamonds.

In 1999, De Beers began to reduce its stocks of diamonds and, in 2003, reached minimum levels of inventory. As a result, the volume of diamonds sold on the market is increasingly dependent on production volumes. In addition, De Beers is gradually reducing its role in the regulation of the world diamond market and the marketing of diamonds. It is expected that, in the future, diamond producers will assume a greater role in diamond sales and marketing.

Demand for Diamonds

Since 1980, world consumption of retail diamonds, expressed in terms of aggregate sales in nominal US Dollars, has more than doubled, from an estimated US\$21.4 billion in 1980 to approximately US\$55.9 billion in 2001. The following table shows diamond consumption by region in billions of US Dollars from 1980 to 2003:

	U.S.A.	Europe	Japan	South East Asia	Others	Total
	<i>(amounts in US\$ billions)</i>					
1980	6.5	3.8	5.6	0.6	4.8	21.4
1985	10.8	2.8	5.8	0.6	4.7	24.7
1990	14.2	8.2	15.0	2.1	7.8	47.3
2000	26.0	8.2	10.8	3.0	10.8	58.8
2001	25.7	7.9	9.4	2.7	10.1	55.9
2002	28.7	7.9	8.5	—	11.8 ⁽¹⁾	56.9
2003	28.7	7.9	8.5	—	11.9 ⁽¹⁾	57.0

Source: De Beers and the World Diamond Industry, Directory and Yearbook; Index Magazine, Tacy Ltd.

Note:

(1) Includes Asia, the Middle East and other regions not listed elsewhere in the table.

Russian Diamond Industry and Regulation

Overview

The modern diamond industry in Russia dates from the mid-1950s with the discovery of the Zarnitsa and Mir diamond pipes. The former Soviet diamond mining company was established in January 1957 and sold its first lot of diamonds on the world market in 1959. Since then, the Russian diamond industry has gone through five major phases.

During the first phase, which lasted until the late 1960s, exploration and mining operations were developed. Industrial diamonds were widely used in this period, especially in the strategically important Russian defence industries. During this period, rough diamonds were also increasingly sold into the world diamond markets.

The second phase, from the late 1960s to the mid-1980s, was characterised by the expansion and development of domestic cutting and polishing operations. During this period, large cutting factories were built and a domestic training system was established for the education of diamond cutters. As a result, high-quality polished diamonds were produced in large quantities, with most of the output sold in the export markets. Quality diamonds gave a strong boost to the development of the domestic jewellery industry which started to emerge during this period.

The third phase commenced in 1988 with the Government of the Soviet Union's decision to establish Glavalmazoloto, the State Committee of the Soviet Union for Diamonds and Gold, and ended in 1991 with the dissolution of the Soviet Union. The main objective of Glavalmazoloto was to manage the production of gold, rough diamonds, cut diamonds and jewellery and the wholesale trade in rough and cut diamonds. This integration failed fully to attain those objectives, mainly due to the fact that, under the Glavalmazoloto system, retail trade was separated from jewellery production. As a result of the lack of communication between retail and cutting and polishing centres, Russian diamond cutting enterprises produced valuable gem diamonds which were mismatched to domestic market demand.

The fourth phase started in 1992 and lasted until 1995. The main feature of this period was a general lack of direction and co-ordination in the activities of the Russian diamond industry. The dissolution of Glavalmazoloto in 1991 left the industry with no effective co-ordinating body, whilst at the same time communication between segments of the industry was further hampered by the general decline in economic activity in the country. In 1992 we were established as a closed joint stock company by Russia and Yakutia in order to manage the production of rough diamonds in Russia.

The fifth and current phase started in 1996 and has been characterised by an industry-wide effort to consolidate resources. Once established, we played a pivotal role in contributing to the initiation of this phase, which has included the development of a medium- to long-term policy of restructuring and modernising all sectors of the Russian diamond industry. In addition, we have been engaged in continuous dialogue with the Government of Russia and De Beers.

Gokhran and Roskomdragmet

Until 1991, the Precious Metals and Precious Stones Depository of the former Soviet Union, known as Gokhran, had been responsible for the management of state reserves of precious metals and precious stones, and Almazruvelirexport had been responsible for the export of these reserves in accordance with government policy. In 1992, Gokhran and the Precious Metals and Precious Stones Committee were merged to form a new State Committee of Russia for Precious Metals and Stones, known as Roskomdragmet. This merger marked the first time that the functions of control over transactions related to diamonds, on the one hand, and the sale of them from state reserves, on the other, had come under the jurisdiction of a single entity. After the abolition of Glavalmazoloto in 1991, Roskomdragmet also assumed responsibility for the management of diamond cutting firms. Roskomdragmet was disbanded in 1996 and Gokhran resumed its role as Russia's diamond depository.

Creation of Cutting Factories with Foreign Capital Participation

Following its establishment, Roskomdragmet began to involve foreign diamond cutters in Russian operations and, in 2003, there were more than 130 diamond cutting factories registered in Russia, with an aggregate annual production capacity to produce between US\$650 million and US\$800 million of polished diamonds. These enterprises were provided with priority access to rough diamonds, 40- to 60-day delayed payment terms for diamonds supplied from state reserves, the right to export some rough diamonds and prices fixed at 10 per cent. below world prices. These incentives led to a growth in the number of domestic cutters operating outside the Diamond Trading Company's marketing system. Most of the gems polished in Russia are exported to foreign markets.

Restrictions on Foreign Ownership of Russian Diamond Mining Companies

Under Article 4(2) of the Law on Precious Stones, no person may engage in the business of mining diamonds within Russia except an entity in which the majority of the voting capital is held solely or in the aggregate by: (i) the Government of Russia or the government of a regional territory within Russia, (ii) Russian persons or (iii) Russian entities without foreign shareholders.

The Secrecy Law

The Secrecy Law was enacted in 1993. Prior to 20 February 2004 the types of information that were considered a state secret under the Secrecy Law included information about volumes of diamond reserves, as well as extraction, production, delivery and consumption of natural diamonds. With effect from 20 February 2004 the above information in the Secrecy Law's list

of state secret data was replaced with the information about reserves of natural diamonds held with the State Fund for Precious Metals and Precious Stones of the Russian Federation and the Central Bank, as well as information about volumes of reserves, extraction, production and consumption of strategic mineral resources specifically identified by the Government of Russia. As of the date of this Offering Circular the Government of Russia has not identified diamonds as a “strategic mineral resource”. However, under the Secrecy Law the President of Russia has the authority to approve a list of data that is a state secret, based on the list of data set out in the Secrecy Law.

The 1995 Presidential Decree specifically provides for secrecy as to deposits of precious stones (including diamonds) in Russia, certain production data relating to Russian state diamond reserves and data relating to deposits of diamonds in excess of 25 million carats. The 1995 Presidential Decree has not been revised following enactment of the above-mentioned amendments to the Secrecy Law that became effective on 20 February 2004. As a result, pending waiver of secrecy with respect to the relevant information set out in the 1995 Presidential Decree, we are prohibited from disclosing such information to you. See “Risk Factors – Risks Related to Our Business – We are prohibited from disclosing our Russian diamond reserves and other information which may be considered material by investors”.

Calculation of Diamond Reserves

We estimate our diamond reserves in accordance with standard Russian methodology, which differs in some material respects from the methodology used in other countries. The primary difference is that the Russian methodology relies on “geometrical” methods to determine reserves, as opposed to international practice, which utilises sampling and extrapolation techniques. As a result, Russian geometrical calculations can be verified by physical analysis, which allows the Ministry of Natural Resources of Russia to independently verify our reserve calculations. We believe that the Russian method of verifying reserves is more conservative than international methodology, as it generally results in a smaller portion of total reserves being classified as proven rather than probable.

Russian Methodology for the Calculation of Mineral Reserves

According to Russia’s 1997 Classification of Solid Mineral Reserves and Forecast Resources, mineral resources are separated into different categories, depending on the methods used to evaluate those resources. Initially, these resources are grouped within one of the following four classes, based on the complexity of their geological structure:

First. The first class consists of deposits with a simple geological structure. These include very large, large or, more rarely, medium-sized mineral bodies having an unbroken, or almost unbroken, bedding. These deposits are characterised by a consistent thickness, internal fabric and mineral quality, as well as an even distribution of basic valuable components.

Second. The second class consists of deposits having a more complex geological structure. These are large and medium-sized mineral bodies with a broken bedding. This class is characterised by an inconsistent thickness, internal fabric and mineral quality, as well as an uneven distribution of basic valuable components. The second class also comprises deposits of coal, fossils, salt and other minerals, which make mining conditions difficult or very difficult.

Third. The third class consists of deposits with a complex geological structure. These are medium-sized or small mineral bodies with a heavily disrupted bedding. The third class is characterised by a widely varied thickness and internal fabric, a substantially inconsistent mineral quality and an uneven distribution of basic valuable components.

Fourth. The fourth class consists of deposits with a very complex geological structure. These are small or, more rarely, medium-sized mineral bodies which have an extremely disrupted bedding. Fourth-class deposits are characterised by abrupt variations in thickness and internal fabric, extremely inconsistent mineral quality and uneven distribution of basic valuable components.

The complexity classification may take into account quantitative results measuring the inconsistencies in the basic features of mineralisation (i.e., classification of diamonds according to their size and average content in the rock). This initial classification is intended to identify those resources warranting further study. Depending on the extent of further exploration, mineral resources are subsequently divided between “proven” and “evaluated” reserves.

Proven reserves are those which have been sufficiently explored to proceed with a feasibility study relating to commercial development. Evaluated reserves are those which have been explored to the extent necessary to determine whether continued exploration is warranted. Identified resources that fail to meet the criteria of proven and evaluated reserves are deemed to be only projected resources.

Proven and evaluated reserves are further categorised based on the type, quantity and quality of the measurements taken to evaluate the reserves. Proven reserves are divided into Categories A, B and C₁ while Category C₂ relates to evaluated reserves.

Category A (proven reserves). Category A reserves include only proven deposits falling within the first complexity class described above. Category A reserves must meet the following criteria:

1. the sizes, forms and bedding conditions of the mineral body have been determined; the nature and regularities in their morphology and internal fabric have been studied; the barren and off-grade segments within the mineral bodies have been detected and mapped; and the locations and fault amplitudes of dislocations with a break have been identified;
2. the natural varieties of the minerals within the body have been determined; its categories and grades have been identified and mapped; its compositions and properties have been verified; and the quality of all categories and grades of the identified minerals have been characterised in terms of all parameters stipulated by industrial regulations;
3. the distribution and forms of those valuable and noxious components found in the mineral body and products of its processing have been investigated; and
4. the mineral reserves have been mapped based on test wells, mine workings and detailed trial runs.

Category B (proven reserves). Category B reserves include only proven deposits falling within the first and second complexity classes described above. Category B reserves have been subject to a high level of investigation; however, their boundaries have been determined with less accuracy than Category A reserves. Category B reserves meet the criteria established for Category A, except that Category B reserves may contain a limited extrapolation zone that is substantiated on the basis of geological criteria and geophysical and geochemical research.

Category C₁ (proven reserves). Category C₁ reflects a slightly lower level of accuracy than the determination of Category B reserves. Most of the proven deposits within the first three complexity classes are Category C₁ reserves. Category C₁ reserves meet the criteria established for Category B, except that additional extrapolation is permitted in mapping the mineral deposit.

Category C₂ (evaluated reserves). Category C₂ reserves are identified, but are not considered to have been proven, and these constitute the bulk of reserves within the fourth complexity class. Category C₂ reserves must meet the criteria established for Category C₁, except that:

1. the sizes, forms, internal fabric and bedding conditions of the mineral body are confirmed by means of only a limited number of test wells and core samples; and
2. the boundaries of the deposit (including core samples and outcroppings) are mapped based on data gathered from only a limited number of test wells, and a geologically substantiated extrapolation of deposit parameters is permitted.

Our Calculation of Reserves

Due to the unique geological conditions of diamond pipes, we do not use Category A with respect to these deposits. Accordingly, we use only Categories B, C₁ and C₂ in our reserve determinations. However, we will only proceed with the commercial development of deposits which have been classified as Category C₁ or above. In addition, only Categories B and C₁ were considered in connection with the confirmations of the Russian Federal Geological Fund of the Ministry of Natural Resources of Russia set forth in "Appendix A – Certification of Diamond Deposits".

We calculate our reserves based on standard Russian methodology. These reserves have not been presented in accordance with Industry Guide 7 of the Securities Act, and are not based on the definitions adopted by the Society for Mining, Metallurgy and Exploration ("SME") or the Council of Mining and Metallurgical Institutions ("CMMI"). Accordingly, our reserve

information is not comparable to the reserve information of other mining companies that follow Industry Guide 7 under the Securities Act or the practices of the SME or CMMI.

Underground and Extracted Resources

Federal legislation gives a measure of autonomy to regional and local authorities in relation to the exercise of rights over the use of land and natural resources and provides that the use of the subsoil is under the joint jurisdiction of the federal and regional authorities. In general, authorities at the regional and local level, with jurisdiction over the specific area in which a development project or other enterprise is located, have substantial powers. Such authorities grant subsoil resource licences in co-operation with the relevant federal authority. In addition, such authorities usually control local land use-transfer and have powers in respect of employees' health and safety, social security and certain fiscal matters. The conditions applicable to our operations in a particular locale will depend in large measure on the relationships among the relevant federal, regional and local authorities and between us and each of such authorities.

Prospecting and Licencing

The Subsoil Law contains a licencing system for geological survey, exploration and production of mineral resources. The use of subsoil in Russia is based on the following main principles:

1. joint ownership of subsoil by Russia and its regions;
2. licencing of mining concessions; and
3. payment for concessions.

For more information, see "Our Business – Regulatory and Environmental Matters – Subsoil Licences".

Environmental Regulations

There are a number of federal laws and regulations establishing environmental rules and standards, including one which establishes a "pay-to-pollute" regime administered by the Ministry of Ecology and local authorities. Fees are assessed for exceeding agreed limits on emissions and effluents and the revenues are divided between federal and local budgets. Currently these fees are generally small in relation to the cost of environmental protection equipment and it is generally less expensive to pay the fees than to install anti-pollution devices. Further, this law does not generally include clear clean-up requirements and, when clean-up is required, the applicable laws provide no guidance as to the extent to which the clean-up must be carried out. However, as the economic situation in Russia improves, enforcement of existing legislation and licences may become more stringent and more comprehensive legislation may be adopted.

In connection with obtaining a licence to explore or develop mining deposits, we are generally required to make environmental commitments. The fees for failing to comply with these commitments are generally low and any clean-up requirements are generally limited. In addition, we contribute to a restoration fund under the terms of our licence agreement with the Government of Yakutia. See "Our Business – Regulatory and Environmental Matters – Lease Agreement".

Liberalisation of the Russian Diamond Market

On 30 November 2002, the Russian President signed the 2002 Decree liberalising the Russian diamond market. The 2002 Decree, which became effective on 6 February 2003, provides for the following changes:

Exports of Rough Diamonds

The 2002 Decree authorises all diamond mining enterprises in Russia to export their rough diamond production in accordance with any applicable subsoil licences; provided that: (i) diamonds weighing 10.8 carats or more must be sold pursuant to the established auction process; (ii) diamonds with "special characteristics" can be sold only to the Government of Russia; and (iii) sales of control parcels under our agreements with De Beers are to be sold only through Almaziuvelirexport, a Government of Russia-owned jewellery exporter. Prior to

the 2002 Decree, only we and Almaziuvelirexport were allowed to export rough diamonds from Russia.

Diamond Auction Participants

Non-Russian entities are authorised to participate as bidders in our auctions of rough diamonds weighing 10.8 or more carats and to export such diamonds, so long as the purchase price is above the minimum price set by us and the Ministry of Finance of Russia.

Multi-year Export Quotas

The 2002 Decree authorises multi-year export quotas of up to five years, which may be granted by the Government of Russia in "exceptional cases".

Exports by Diamond Cutting Companies

Diamond cutting entities may export up to 15 per cent., by value, of the rough diamonds they purchase in any year from Russian diamond mining companies or from the Government of Russia's diamond stocks, provided that: (i) the diamonds are offered for sale on the domestic market and are not sold within 10 business days; and (ii) the export sale price is at least as high as the price at which the diamonds were offered on the domestic market.

Industrial Diamond Sales

The 2002 Decree allows the direct sale of industrial diamonds to third parties. Previously, industrial diamonds could be sold only through Almaziuvelirexport.

Importation of Diamonds

Russian companies are authorised to import rough and cut diamonds without restriction or licence, provided that the imported diamonds are sorted by a state organisation organised under the Ministry of Finance of Russia and Russian customs law is observed.

Reclassification of Small Diamonds

The 2002 Decree also lowered the minimum size for a diamond to be deemed suitable for use in jewellery. This change is expected to result in more of our small diamonds being classified as gem and near-gem stones rather than less valuable industrial diamonds.

Notwithstanding the 2002 Decree, we remain subject to various governmental controls, including, amongst other things, export quotas, secrecy laws regarding reserves and production expressed in carats, a mandatory price list and restrictions on our ability to sell larger diamonds (10.8 carats or more).

Based on our discussions with officials of the Government of Russia, we expect additional liberalisation measures to be adopted in the future, which may result from Russia's application for membership in the WTO, and our strategy considers ways in which we could capitalise on the additional flexibility that liberalisation of the Russian diamond industry would create. See "Our Business – Strategy". However, we can offer no assurance as to when, or if, further liberalisation will be adopted.

General Information

1. The issue of the Notes has been authorised by a resolution dated 10 November 2004 of the board of directors of ALROSA Finance S.A. The Guarantee was authorised by a resolution dated 22 October 2004 of the Supervisory Council of ALROSA Ltd.

2. Application has been made to list the Notes on the Luxembourg Stock Exchange. In connection therewith, the charter documents of the Issuer and ALROSA Ltd., as well as a legal notice relating to the issuance of the Notes, have been deposited prior to listing with the *Régistre de Commerce et des Sociétés à Luxembourg*, from which copies thereof may be obtained on request.

3. The Notes have been accepted for clearance through DTC, Euroclear and Clearstream, Luxembourg. The Common Code for the Regulation S Notes is 020582847 and the ISIN for the Regulation S Notes is XS0205828477. The CUSIP number for the Rule 144A Notes is 02109TAA0, the Common Code for the Rule 144A Notes is 020582863 and the ISIN for the Rule 144A Notes is US02109TAA07.

4. Except as disclosed or provided for herein, there has been no material adverse change in the consolidated financial or trading position of ALROSA Ltd. since 30 June 2004 and no material adverse change in the financial or trading position of the Issuer since 30 June 2004.

5. Application has been made to list the Notes on the Luxembourg Stock Exchange. So long as any Notes are listed on the Luxembourg Stock Exchange and the rules governing the listing of the Notes on such exchange so require, we will maintain a paying agent and a transfer agent in Luxembourg. We have appointed J.P. Morgan Bank Luxembourg S.A. as our listing agent, paying agent, registrar and transfer agent in Luxembourg. We have also appointed JPMorgan Chase Bank, N.A. as principal paying agent and transfer agent in London, England and as paying agent and transfer agent in New York, the United States of America. We reserve the right to vary such appointments. The paying agent in Luxembourg will act as intermediary between the Noteholders and us.

6. Neither ALROSA Ltd. nor any of its subsidiaries, including the Issuer, is involved in, nor do we have knowledge of any threat of, any legal, arbitration, administrative or other proceedings (whether as defendant or otherwise) the outcome of which may be material in the context of the issue of the Notes.

7. Each of the Issuer and ALROSA Ltd. has agreed that, for so long as any Notes are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act, they will, during any period in which they are neither subject to Section 13 or 15(d) of the Exchange Act, nor exempt from reporting pursuant to 12g3-2(b) thereunder, provide to any holder or beneficial owner of such restricted securities or to any prospective purchaser of such restricted securities designated by such holder or beneficial owner or to the Trustee for delivery to such holder, beneficial owner or prospective purchaser, in each case upon the request of such holder, beneficial owner, prospective purchaser or Trustee, the information required to be provided by Rule 144A(d)(4) under the Securities Act.

8. So long as the Notes are listed on the Luxembourg Stock Exchange and the rules of such stock exchange shall so require, copies of the following will be available for inspection, and may be obtained free of charge, during normal business hours on any weekday, at the specified office of the paying agent in Luxembourg:

- the charter documents of the Issuer and ALROSA Ltd.;
- the Trust Deed expected to be entered into with the Trustee on 16 November 2004, which includes the Guarantee;
- the Paying Agency Agreement expected to be entered into with the paying agents and the Trustee; and
- copies of all of our most recent IFRS accounts and interim financial statements.

We prepare and publish annual consolidated financial statements, which are audited in accordance with IFRS, and annual unconsolidated financial statements, which are prepared in accordance with Russian Accounting and Reporting Rules and audited in accordance with the Russian Federal Law No. 119-FZ "On Auditing Activity", dated 7 August 2001 and Russian Auditing Standards. We also prepare, but do not publish, non-consolidated unaudited

quarterly financial statements in accordance with Russian Accounting and Reporting Rules. We do not expect to prepare or publish any other financial statements. Our most recent annual consolidated financial statements will be made available, without charge, at the specified office of the paying agent in Luxembourg.

The Issuer will only prepare and publish annual audited non-consolidated financial statements. The Issuer does not expect to prepare or publish any other financial statements.

Our first published financial statements after this Offering will be those for the year ended 31 December 2004, which will be made available, without charge, at the specified office of the paying agent in Luxembourg on or about 30 June 2005.

9. The Guarantor was established for the purpose of generating profit and meeting the interests of its shareholders as set out in Clause 3.1 of its Charter. The Guarantor was included in the Unified State Register of Legal Entities maintained by the State Tax Service and certified by the Ministry of Taxes and Duties on 17 July 2002 under registration number 1021400967092.

Appendix A – Certification of Diamond Deposits

MINISTRY OF NATURAL RESOURCES OF THE RUSSIAN FEDERATION
FEDERAL STATE UNITARY RESEARCH AND PRODUCTION ENTERPRISE
“RUSSIAN FEDERAL GEOLOGICAL FUND”

38 3rd Magistralnaya Street, Moscow 123007

Telegraph address: Moscow 7 Rosgeolfund

Tel.: 259 4060, Fax: 259 5973

E-mail: rfgf@rfgf.ru

29 April 2004 No. K-01/576

In response to No. AN-01/1-466 dated 26 April 2004

To First Vice President

of AK ALROSA

A.O. Nichiporuk

119017 Moscow, 1st Kazachy, per. 10-12

In accordance with your letter No. AN-01/1-466 dated 26 April 2004, the Federal State Unitary Research and Production Enterprise Russian Federal Geological Fund of the Ministry of Natural Resources of the Russian Federation (“FGUNPP Rosgeolfond”) advises you of the following.

In connection with ALROSA’s decision to issue the company’s Eurobonds and the related process of issuance and listing of securities, Rosgeolfond hereby confirms that:

- ALROSA’s category B + C₁ diamond reserves recorded in the Russian State Balance of Mineral Reserves will enable ALROSA to extract over the next 25 years, i.e., until 31 December 2029, an average annual volume of diamonds at least as great as that extracted during 2003;
- the average quality of diamonds extracted by ALROSA in each of the next 25 years will not be materially lower than the average quality of diamonds extracted by ALROSA during the year ended on 31 December 2003.

FGUNPP Rosgeolfond hereby agrees that this letter and the information and statements herein may be included in the Offering Circular and other documents that will be prepared in connection with the proposed issuance of unsecured bonds guaranteed by ALROSA, as well as that such information may be included in the Offering Circular as an official statement made within the limits of its powers.

Nothing in this letter may be construed as a commitment by FGUNPP Rosgeolfond or any other agency or governmental authority of the Russian Federation to guarantee the performance of any payment obligations with respect to interest on or principal of ALROSA’s securities, and no such securities contain any obligations or guarantees of any such authority.

First Deputy

General Director

and Chief Geologist

[seal]

/s/ A.D. Fedin

A.D. Fedin

The Ministry of Finance of the Russian Federation

DEPUTY MINISTER

9 Ilyinka Street, Moscow 103097

Teletype: 112008

Telefax: 9250889

Date: 21 April 2004

No. 23-02-03/292

To: A.O. Nichiporuk

First Vice President

AK ALROSA

10-12 1st Kazachy per.

109017 Moscow

Dear Alexander Olegovitch

In connection with the resolution of AK ALROSA relating to the offering of its eurobonds and the related issue and listing of the securities, the Ministry of Finance of the Russian Federation hereby confirms that AK ALROSA's proven reserves of natural diamonds (categories A, B and C₁) are sufficient to permit mining of diamonds during the next 25 years, i.e., until 31 December 2028, in an annual average volume that is not less than the volume of diamonds produced during 2003.

The Ministry of Finance of the Russian Federation hereby consents to the inclusion of this letter and the information and statements set forth herein in the Offering Circular and acknowledges that such information will be included in the Offering Circular as a public official statement made within the authority of the Ministry of Finance of the Russian Federation.

For the avoidance of doubt, nothing contained herein shall imply any undertaking by the Ministry of Finance of the Russian Federation or any other agency or state authority of the Russian Federation to guarantee the payment of any obligations in respect of amounts of interest and principal owing on the securities of AK ALROSA, and the securities do not represent obligations of any such authority.

By: /s/ T.A. Golikova

T.A. Golikova

Appendix B – Glossary of Technical Terms

Alluvial	Pertaining to material eroded from its primary source, transported by natural earth processes and deposited in stream sediments.
Carat	A unit of weight for diamonds, equivalent to 0.2 of a gram.
Dredge	A floating vessel used to recover valuable minerals from stream sediments.
Flush water	Water used to assist the flow of materials in chutes, such as in the process of gravitational separation.
Froth flotation	A water-borne stream of finely ground ore is discharged into a tank (cell) of water mixed with an oily reagent. Air is injected into the bottom of the cell to form bubbles which rise to the surface. The diamonds adhere to the bubbles and are collected from the froth discharged from the top of the cell. Waste material is drawn off from the bottom of the cell.
Grainer	A unit of weight measurement with respect to diamonds of 1.8 carats or less. There are four grainers in one carat.
Ground subsidence	Where the ground sinks gradually, generally caused by draining underground water, natural gas and water for irrigation, and the settling of structures.
Jigs and jigging	The treatment of a stream of ore materials by passing it over a screen bed mounted near the top of a water bank (the jig) to which a vertical agitation of the water (jigging) can be applied. The jigging motion separates the stream into lighter minerals on the top and denser minerals (the concentrate) on the screen bed. Discharge of the waste and collection of the concentrate is continuous.
Kimberlite	A volcanic rock originating from the earth's mantle composed of olivine, phlogopite, diopside and minor accessory minerals, including the occasional diamond.
Lamproite	A volcanic rock originating from the earth's mantle composed of olivine, diopside, phlogopite, richterite, leucite, sanidine, wadeite and priderite, plus accessory minerals, including the occasional diamond.
Mantle	Intermediate zone of the earth, resting on the earth's core at a depth of about 2,900 kilometres, and surrounded by the earth's crust.
Mill	Industrial equipment used to grind ore finely after being crushed.
Mineral deposit	A mineralised ore body which has been identified by a sufficient number of closely spaced drill holes and/or underground sampling to contain sufficient tonnage and ore grade to warrant further exploration or development. Mineral deposits or mineralised materials do not qualify as commercially mineable ore body reserves, as prescribed under standards generally applied within the mining industry, until a final and comprehensive economic, technical and legal feasibility study based upon the test results has been concluded.
Ore	A deposit of rock containing a mineral or aggregate of minerals from which metals can be mined or extracted.
Ore dressing	The process of cleaning ore and removing waste material.

Overburden	The waste rock overlying and surrounding an ore body which in open-pit mining has to be removed to allow mining of the ore.
Pipe	A tabular or cylindrical rock body, usually vertical.
Placer deposit	A glacial or alluvial deposit of sand or gravel containing eroded particles of valuable minerals.
Probable reserves	That material for which tonnage and grade are computed partly from specific measurements, samples or production data, and partly from projection for a reasonable distance on geological evidence, and for which the sites available for inspection, measurement and sampling are too widely or otherwise inappropriately spaced to outline the material completely or to establish its grade throughout.
Production stockpile	A stockpile of ore which is stored until it can be processed.
Proven reserves	That material for which tonnage is computed from dimensions revealed in outcrops or trenches or underground workings or drill holes and for which (i) the grade is computed from the results of adequate sampling; (ii) the sites for inspection, sampling and measurement are so spaced and the geological character so well-defined that the size, shape and mineral content are established; (iii) the computed tonnage and grade are judged to be accurate within limits which shall be stated; and (iv) it shall be stated whether the tonnage and grade of proven ore or measured ore are "in situ" or extractable.
Radiometric separation	A method of ore sorting which involves the identification of diamonds through the detection of their indicative range of emitted isotopes.
Rock burst	Small earthquakes or other seismic events caused by stress to rock in mining operations.
Rock dump	An area in which overburden is stored.
Sinkhole	A hollow place or depression in which drainage collects.
Tailings	The waste material discarded from an ore treatment plant after the extraction of a valuable concentrate from the ore fed to the plant.
Ultramafic	Rock that is rich in magnesium and iron.
Wet x-ray sorting	A process which allows wet ore emerging from sizing screens to be sorted immediately, without having to be dried.

Summary of Certain Differences Between IFRS and US GAAP

The financial information included herein is prepared and presented in accordance with IFRS. Certain differences exist between IFRS and US GAAP, which might be material to the financial information herein. The matters described below summarise certain differences between IFRS and US GAAP that may be material. We have not prepared a complete reconciliation of our consolidated financial statements and related footnote disclosures between IFRS and US GAAP and have not quantified such differences. Accordingly, no assurance is provided that the following summary of differences between IFRS and US GAAP is complete. Potential investors should consult their own professional advisers for an understanding of the differences between IFRS and US GAAP, and how those differences might affect the financial information herein.

IFRS	US GAAP
Accounting framework	
Historical cost basis, adjusted for inflation by applying the consumer price index, due to Russia being considered highly inflationary (through 31 December 2002). However, certain classes of financial assets and liabilities must be carried at fair value.	Historical cost basis. However, in a highly inflationary environment, local currency statements may be remeasured using another reporting currency as the functional currency.
Property, plant and equipment	
Property, plant and equipment are tangible assets that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Capitalised costs include all costs directly attributable to bringing an asset to the location and working condition necessary for it to operate in a manner consistent with its intended use.	Definition and capitalisation of costs is consistent with IFRS.
IFRS permits the use of historical cost or revalued amounts. Regular valuations of entire classes of assets are required when the revaluation option is chosen.	Revaluations are not permitted.
Borrowing costs may be capitalised for qualifying assets but it is not required. All borrowing costs are expensed in our IFRS consolidated financial statements.	Borrowing costs must be capitalised for qualifying assets.
Depreciation of property, plant and equipment	
The depreciable amount of an item of property, plant and equipment must be allocated on a systematic basis over its useful life, reflecting the pattern in which the asset's benefits are consumed by the entity. Any changes in the depreciation method used are treated as a change in accounting estimate and are reflected in the depreciation charge for the current and prospective periods.	Similar to IFRS, except that US GAAP classifies a change in the depreciation method as a change in accounting policy. The cumulative effect of the change is then reflected in the current year's statement of income.
Property, plant and equipment related to extraction of minerals are depreciated and amortised based on the units-of-production basis for each area of interest over its expected useful life. For assets not directly associated with production, the straight-line method is used.	Like IFRS, US GAAP requires the application of the units-of-production method for depreciation, depletion and amortisation of mining assets. The straight-line method is an acceptable alternative for assets not associated with mining production.

IFRS

US GAAP

Impairment of assets

An entity must assess annually whether there are any indications that an asset may be impaired. If there is any such indication, the assets must be tested for impairment. An impairment loss must be recognised in the statement of income when an asset's carrying amount exceeds its recoverable amount.

The impairment loss is the difference between the asset's carrying amount and its recoverable amount. The recoverable amount is the higher of the asset's net selling price and its value in use. Value in use is the future cash flows to be derived from the particular asset, discounted to present value using a pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the asset.

An impairment loss recognised for an asset should be reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised, in which case, the carrying amount of the asset should be increased to its recoverable amount.

Similar to IFRS except that for assets to be held and used, impairment is first measured by reference to undiscounted cash flows. If impairment exists the entity must measure impairment by comparing the asset's carrying value to its fair value. If there is no impairment by reference to undiscounted cash flows, no further action is required but the useful life of the asset must be reconsidered. Assets classified as held for disposal must be measured at the lower of the carrying amount and fair value less selling costs.

The impairment loss is based on the asset's fair value, being either market value (if an active market for the asset exists) or the sum of discounted future cash flows. The discount rate reflects the risk specific to that asset. For assets to be disposed of, the loss recognised is the excess of the asset's carrying amount over its fair value less cost to sell.

Reversals of impairment losses for assets to be held and used are prohibited. Subsequent revisions, both increases and decreases, to the carrying amount of an asset to be disposed, must be reported as adjustments to the carrying amount of the asset but limited by the carrying amount at the date the decision to dispose of the asset is made.

Comprehensive income

IFRS does not require disclosure of comprehensive income. However, IFRS requires separating the statement of recognised gains and losses either in notes or in statement of changes in shareholders' equity.

US GAAP requires disclosure of comprehensive income, which is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distribution to owners.

Business combinations

Business combinations can be in the form of either an acquisition or a uniting of interest. Acquisitions are the most common and uniting of interests are severely restricted.

The date of acquisition is the date on which the acquirer obtains control over the acquired entity.

All business combinations initiated after 30 June 2001 are acquisitions and accounted for in accordance with the purchase method. Before 30 June 2001, business combinations were accounted for using either the purchase method or the pooling-of-interests method.

The date of acquisition is the date on which assets are received or securities are issued.

IFRS

The purchase method records the assets and liabilities of the acquired entity at fair value. The cost of acquisition is the amount of cash or cash equivalents paid (or the fair value of the other purchase consideration given). Where consideration is in the form of shares, the shares issued as consideration are recorded at their fair value as at the date of acquisition. Where the acquisition occurs in stages, the fair value of the shares issued as consideration is determined at each exchange date. In an active market the published price of a share at the date of exchange is the best evidence of fair value.

US GAAP

Like IFRS, assets and liabilities acquired are recorded at fair value.

Shares issued as consideration are measured at their market price over a reasonable period of time (interpreted to be a few days) before and after the parties reach an agreement on the purchase price and the proposed transaction is announced. The date for measuring the value of marketable securities must not be influenced by the need to obtain shareholder or regulatory approval.

Definition of a subsidiary

Focuses on the concept of the power to control in determining whether a parent/subsidiary relationship exists. Control is the parent's ability to govern the financial and operating policies of a subsidiary to obtain benefits. Subsidiaries are consolidated from the date on which effective control is secured and are no longer consolidated from the date control ceases.

Focuses on a controlling financial interest through ownership of a majority voting interest, coupled with control. Also, variable interest entities ("VIEs") in which a parent does not have voting control but absorbs the majority of losses or returns must also be consolidated.

Inventories

Carried at the lower of cost or net realisable value (being sale proceeds less all further costs to bring the inventories to completion). Reversal of the write-down is required for a subsequent increase in value of inventory previously written down.

Broadly consistent with IFRS, in that the lower of cost and market value is used to value inventories. Market value is defined as being current replacement cost subject to an upper limit of net realisable value and a lower limit of net realisable value less a normal profit margin. Reversal of a write-down is prohibited.

Taxation

Current and deferred taxes are measured based on tax laws and rates that have been enacted or "substantively enacted" as of the balance sheet date. In some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws).

Current and deferred taxes are measured using enacted tax laws and rates. Enactment of a new tax law is viewed as a discrete event of the period of enactment. The enactment date is the date that a tax rate change is signed into law.

IFRS

US GAAP

Revenue recognition

Based on several criteria, which require the recognition of revenue when risks and rewards have been transferred and the revenue and related costs can be reliably remeasured.

Revenue should be recognised only when all four of the following criteria have been met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed and determinable, and collectibility is reasonably assured. Extensive detailed guidance exists for specific transactions.

Restructured liabilities

Liabilities are remeasured (extinguished) and a gain or loss recognised when there is a significant modification of terms.

Liabilities are remeasured and a gain or loss recognised in accordance with EITF 96-19, "Debtors Accounting for a Modification in Exchange of Debt Instruments" which is more restrictive than IFRS concerning what represents a significant modification of terms.

Deferred tax assets

Deferred tax assets are recognised when it is probable that future taxable profits will be available against which the deferred tax asset can be utilised. The carrying amount of the deferred tax asset is reviewed at each reporting date and reduced if appropriate.

Similar to IFRS but recognises all deferred tax assets and provides a valuation allowance if it is more likely than not that some portion, or all, of the deferred tax asset will not be realised. There are a number of specific differences in application.

Segment reporting

Report primary and secondary (business and geographic) segments based on risks and returns.

Report based on internal reporting segments. Operating segments are those business activities for which discrete information is available, and whose operating results are regularly reviewed by the entity's chief operating decision maker in determining resource allocation and assessing performance.

Related parties

There is no specific requirement in IFRS to disclose the name of the related party (other than the ultimate parent entity). Disclosure of "pricing policy" is required along with other elements of transactions necessary for an understanding of the financial statements, which would normally include the volumes of the transactions and the amounts of outstanding items.

Transactions involving related parties are presumed not to be on an arm's-length basis, as the requisite conditions of competitive, free-market dealings may not exist. US GAAP requires the disclosure of any changes in the method of establishing "terms" for related party transactions and the resulting effect on the financial statements. In addition, disclosure of the nature of the relationship, a description of the transaction, the amounts for each period, and the amounts due to or from related parties is required.

Pension costs under defined benefit plans

Defined benefit plans obligate the employer to provide certain defined post-employment benefits to employees. The risks associated with the plan assets rest with the employer. The amount recognised as a defined benefit plan liability is based on the present value of the obligation at the balance sheet date net of the fair value of any plan assets.

Similar to IFRS. However, there are a number of differences in specific treatment of certain items under the plan, including actuarial gains and losses, expected return on plan assets, and gains and losses on curtailment or settlement.

IFRS

Recognition of a minimum pension liability is not required.

US GAAP

Additionally, a minimum liability is required to be recognised when the accumulated benefit obligation exceeds the fair value of the plan assets and the amount of the accrued liability.

Provisions

Provisions are recorded for present obligations arising from past events if an outflow of resources is probable and can be reliably estimated.

Similar to IFRS, with rules for specific situations (employee termination costs, environmental liabilities, loss contingencies, etc).

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AK "ALROSA"

IFRS Consolidated Interim Financial Statements (unaudited)

(in millions of Russian roubles, unless otherwise stated)

IFRS Consolidated Interim Balance Sheet

	Notes	30 June 2004 (unaudited)	31 December 2003
Assets			
Non-current Assets			
Restricted cash	4	374	340
Investments in associated undertakings	3	811	900
Available-for-sale investments	3	931	1,187
Long-term accounts receivable	7	2,814	2,339
Property, plant and equipment	5	108,754	104,443
Total Non-current Assets		113,684	109,209
Current Assets			
Inventories	6	17,100	15,796
Trade and other receivables	7	10,512	7,235
Prepaid profit tax		236	277
Available-for-sale investments		22	505
Cash and cash equivalents	4	10,822	3,347
Total Current Assets		38,692	27,160
Total Assets		152,376	136,369
Shareholders' Equity			
Share capital	8	11,491	11,491
Retained earnings		52,688	49,813
Total Shareholders' Equity		64,179	61,304
Grant	9	9,994	10,498
Minority Interest		3,094	3,035
Liabilities			
Non-current Liabilities			
Long-term debt	10	26,883	24,684
Provision for restoration liability	12	6,116	5,394
Provision for pension obligations	13	1,505	1,963
Other provisions	15	1,145	1,215
Deferred tax liabilities	16	1,503	2,466
Total Non-current Liabilities		37,152	35,722
Current Liabilities			
Short-term loans and current portion of long-term debt ...	11	25,171	13,883
Trade and other payables	14	8,636	9,122
Taxes payable	16	2,945	2,758
Dividends payable		1,205	47
Total Current Liabilities		37,957	25,810
Total Liabilities		75,109	61,532
Total Shareholders' Equity, Grant, Minority Interest and Liabilities		152,376	136,369

Signed by the following members of management:

Vladimir T. Kalitin
President, Chairman of the Board

Olga A. Lyashenko
Chief Accountant

15 October 2004

The accompanying notes form an integral part of these unaudited IFRS consolidated interim financial statements.

AK "ALROSA"

IFRS Consolidated Interim Financial Statements (unaudited)

(in millions of Russian roubles, unless otherwise stated)

IFRS Consolidated Interim Statement of Income

		Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
	Notes		
Sales	17	34,768	28,030
Cost of sales	18	(17,362)	(12,771)
Royalty	9	(4,346)	(4,627)
Gross profit		13,060	10,632
General and administrative expenses	19	(1,460)	(1,482)
Other operating income	20	982	1,024
Other operating expenses	21	(5,539)	(4,501)
Operating Profit		7,043	5,673
Finance cost, net	22	(2,071)	(2,083)
Income from associated undertakings, net	3	240	163
Exchange gains, net		305	1,067
Profit before Profit Tax		5,517	4,820
Profit tax	16	(1,248)	(295)
Profit after Profit Tax		4,269	4,525
Minority interest		(194)	(37)
Net Profit for the Period		4,075	4,488

The accompanying notes form an integral part of these unaudited IFRS consolidated interim financial statements.

AK "ALROSA"

IFRS Consolidated Interim Financial Statements (unaudited)

(in millions of Russian roubles, unless otherwise stated)

IFRS Consolidated Interim Statement of Cash Flows

		Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
	Notes		
Net Cash Inflow from Operating Activities	23	1,896	896
Cash Flows from Investing Activities			
Purchase of property, plant and equipment		(5,991)	(5,750)
Proceeds from sales of fixed assets		72	—
Acquisition of available-for-sale investments		(20)	(18)
Proceeds from sale of available-for-sale investments		35	217
Interest received		93	61
Net Cash Outflow from Investing Activities		(5,811)	(5,490)
Cash Flows from Financing Activities			
Repayment of loans		(34,375)	(30,089)
Loans received		47,652	38,516
Interest paid		(1,811)	(2,226)
Payment to restricted cash account		(34)	(119)
Dividends paid		(42)	(105)
Net Cash Inflow from Financing Activities		11,390	5,977
Net Increase in Cash and Cash Equivalents		7,475	1,383
Cash and cash equivalents at the beginning of the period		3,347	2,998
Cash and Cash Equivalents at the End of the Period		<u>10,822</u>	<u>4,381</u>

Significant non-cash transactions are discussed in note 27.

The accompanying notes form an integral part of these unaudited IFRS consolidated interim financial statements.

AK "ALROSA"

IFRS Consolidated Interim Financial Statements (unaudited)

(in millions of Russian roubles, unless otherwise stated)

IFRS Consolidated Interim Statement of Changes in Shareholders' Equity

	<u>Share capital</u>	<u>Retained earnings</u>	<u>Total</u>
Balance at 31 December 2002	11,491	44,157	55,648
Dividends (note 8)	—	(700)	(700)
Net profit for the six months ended 30 June 2003 (unaudited)	—	4,488	4,488
Balance at 30 June 2003 (unaudited)	11,491	47,945	59,436
Balance at 31 December 2003	11,491	49,813	61,304
Dividends (note 8)	—	(1,200)	(1,200)
Net profit for the six months ended 30 June 2004 (unaudited)	—	4,075	4,075
Balance at 30 June 2004 (unaudited)	11,491	52,688	64,179

The accompanying notes form an integral part of these unaudited IFRS consolidated interim financial statements.

AK "ALROSA"

Notes to the IFRS Consolidated Interim Financial Statements (unaudited)

(in millions of Russian roubles, unless otherwise stated)

1. ACTIVITIES

The core activities of Closed Joint Stock Company AK "ALROSA" (the "Company") and its subsidiaries (the "Group") are the exploration and extraction of diamond reserves and the marketing and distribution of raw and cut diamonds. The Company was registered on 13 August 1992 as a closed joint stock company in the Republic of Sakha (Yakutia), which is located within the Russian Federation. The Group operates mining facilities in Mirny, Udachny, Aikhal, Nyurba and Anabar (located in Eastern Siberia) and had 47,260 employees as at 30 June 2004 (31 December 2003: 46,998 employees). The Company is subject to special legislation issued by the Russian Federation and the Republic of Sakha (Yakutia), which significantly influences the Company's core operating activities. This legislation includes, but is not limited to, the Law on State Secrets of the Russian Federation and requirements to obtain quotas for export of diamonds from the Government of the Russian Federation (note 17).

As at 30 June 2004 the Company's principal shareholders are the Russian Federation (37 per cent. of shares) and the Republic of Sakha (Yakutia) (32 per cent. of shares). The rest of shares are held by administrations of districts of the Republic of Sakha (Yakutia) (8 per cent. of shares) and individuals (23 per cent. of shares).

2. ACCOUNTING POLICIES

(a) Basis of presentation

Group companies incorporated in Russia maintain their statutory accounting records and prepare statutory financial reports in accordance with the Regulations on Accounting and Reporting of the Russian Federation and their measurement currency is the Russian rouble ("RR"). Group companies incorporated in other countries maintain their statutory accounting records in accordance with relevant legislation and in the appropriate measurement currency. The accompanying consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of available-for-sale investment securities and financial assets held-for-trading. The consolidated financial statements are based on the statutory accounting records, with adjustments and reclassifications for the purpose of presentation in accordance with International Financial Reporting Standards ("IFRS"), including International Accounting Standards and Interpretations issued by the International Accounting Standards Board.

Prior to 1 January 2003 the adjustments and reclassifications made to the statutory records for the purpose of presentation in accordance with IFRS included the restatement of balances and transactions for the changes in the general purchasing power of the RR in accordance with IAS 29 (*"Financial Reporting in Hyperinflationary Economies"*). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. Therefore, non-monetary assets and liabilities (those balance sheet items that were not expressed in terms of the monetary unit current as of 31 December 2002) and components of shareholders' equity were restated from their historical cost by applying the change in the general price index from the date the non-monetary item originated to 31 December 2002. As the characteristics of the economic environment of the Russian Federation indicated that hyperinflation ceased, effective from 1 January 2003 the Group no longer applies the provisions of IAS 29. Accordingly, the amounts expressed in the measuring unit current as of 31 December 2002 were treated as the basis for the carrying amounts in subsequent financial statements.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as at the date of the consolidated financial

AK "ALROSA"

Notes to the IFRS Consolidated Interim Financial Statements (unaudited)

(in millions of Russian roubles, unless otherwise stated)

statements, and the reported amount of revenues and operating costs during the reporting period. The most significant estimates relate to realisation of inventories, investments, allowance for bad and doubtful accounts receivable, deferred taxation, reserve estimates used to calculate depreciation, pension and other post-retirement benefit costs and the evaluation of the provision for restoration liability. Actual results could differ from these estimates.

Certain amounts have been reclassified in the comparative financial information for the six months ended 30 June 2003 to conform to the current period presentation. Cost of sales for the six months ended 30 June 2003 has been increased by RR'mln 1,579 as a result of the reclassification of the extraction tax from other operating expenses. This reclassification better reflects the nature of these costs. Other operating expenses for the six months ended 30 June 2003 have also been decreased by an additional RR'mln 4,627, due to presenting the royalty as a separate line in the statement of income. This change has been made in order to present the information about the Group's activity in a format considered to be more useful to the users of the consolidated financial statements.

During the period December 2003 to June 2004, the International Accounting Standards Board ("IASB") revised 17 of its standards and issued four new standards. These standards are effective for accounting periods commencing on or after 1 January 2005, but may be adopted early. The Group has not adopted these revised and new standards early in preparing the consolidated interim financial information.

(b) Principles of consolidation

The Group comprises the Company and its subsidiaries. The effects of transactions between subsidiaries within the Group are eliminated and accounting policies of the subsidiaries and associated undertakings are conformed to those of the Company.

A subsidiary is an entity in which the Group has an interest of more than one half of the voting rights or otherwise has the power to exercise control over the operations.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases.

For subsidiaries that are not wholly owned, the minority interest at the balance sheet date represents the minority shareholders' portion of the pre-acquisition carrying amounts of the identifiable assets and liabilities of the subsidiary at the acquisition date, and the minority shareholders' portion of movements in equity since the date of the combination. Minority interest is presented separately from liabilities and shareholders' equity on the face of the consolidated balance sheet.

Associated undertakings over which the Group has a significant but not a controlling influence are accounted for using the equity method. Significant influence is usually evidenced by the Group owning, directly or indirectly, between 20 per cent. and 50 per cent. of the voting share capital.

Equity accounting is discontinued when the carrying amount of the investment in an associated undertaking reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated undertaking.

(c) Grant

Production assets received from the Republic of Sakha (Yakutia) on 19 January 1993 under the terms of a mineral lease agreement (the "Lease Agreement") to "transfer of rights to use and exploit land, diamond deposits, main production and non-production facilities", are recorded in accordance with IAS 20, "Accounting for Government Grants and Disclosure of Government

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Assistance", at historical amounts adjusted for the effects of inflation, with a corresponding credit reflected as a Grant in the Group's balance sheet. The Grant is amortised in line with the reduction in the carrying value of the underlying assets, with the amortised portion recorded as an increase in income (see note 9).

Social assets received under the aforementioned Lease Agreement have not been included in the accompanying consolidated financial statements, since the majority of these assets have been or will be transferred free of charge to local administrations.

(d) *Property, plant and equipment*

Property, plant and equipment comprise costs incurred in developing areas of interest as well as the costs related to the construction and acquisition of mining assets. Expenditure related to geophysical analysis is expensed until it is determined to be probable that economically recoverable reserves exist.

At each reporting date, management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, the management estimates the recoverable amount, which is determined as the higher of an asset's net selling price and its value in use, the carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) in the statement of income. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

Depreciation and amortisation

Property, plant and equipment are depreciated upon commencement of commercial mining activities at a specific area of interest.

Depreciation and amortisation of buildings, land and improvements and plant and equipment related to extraction of minerals is calculated on a units of production basis for each area of interest over its expected useful life.

Depreciation of assets not directly associated with production is calculated on a straight line basis over its estimated useful life.

Summary of useful lives and alternative basis for depreciation:

	Assets related to extraction of minerals	Other assets
Buildings	Units of production	8-50 years
Land and improvements	Units of production	7-50 years
Plant and equipment	Units of production	4-13 years
Transport	5-13 years	5-13 years
Other	4-17 years	4-17 years

Disposals and retirement

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the balance sheet along with the corresponding accumulated depreciation (if any). Any gain or loss resulting from such retirement or disposal is included in the consolidated statement of income.

Repair and maintenance costs

Maintenance and repairs are expensed as incurred.

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Local infrastructure assets

Local infrastructure assets constructed or purchased by the Group subsequent to 1 January 1993 (the date of privatisation) are included in the financial statements at historical cost adjusted for the effects of inflation and depreciated during their useful lives as set out above. These assets are an integral part of the Group's production activities.

(e) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions are reassessed at each reporting date, and are included in the consolidated financial statements at their expected net present values using discount rates appropriate to the Group in the economic environment in the Russian Federation at each balance sheet date.

The provision for restoration liability is determined based on the terms of the Lease Agreement (see note 9). Under this agreement, in the year 2017 the Company is obliged to transfer property, plant and equipment subject to the Lease Agreement to the Republic of Sakha (Yakutia) or settle its liability by means of a cash payment. The initial provision for restoration liability together with any changes in the estimate of the ultimate restoration liability is recorded on the balance sheet, with a corresponding amount recorded as part of property, plant and equipment in accordance with IAS 16, "*Property, Plant and Equipment*" (revised 1998). This amount is amortised over the shorter of the term of the Lease Agreement and the useful life of the relevant property.

Changes in the provision for restoration liability resulting from the passage of time are reflected in the consolidated statement of income each period under finance costs. Other changes in the provision, relating to a change in the discount rate applied, in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change. The effects of such changes are added to, or deducted from, the cost of the related asset.

(f) Inventories

Inventories of diamonds, extracted ore and concentrates, mining and construction stores and consumable supplies are valued at the lower of the weighted average cost or net realisable value.

Cost of extracted ore and concentrates is calculated using the quantities determined based on the surveyors' measurements of the volumes of ore and concentrates remaining at the period end. Cost of inventories includes those directly attributable to mining the diamonds, extracting the ore and producing concentrates, and those directly attributable to bringing mining and construction stores and consumable supplies to their present location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

(g) Investments

In accordance with IAS 39 "*Financial Instruments: Recognition and Measurement*" investments are classified into the following categories: trading, held-to-maturity or available-for-sale. Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments and are included in current assets. Investments with a fixed maturity that the management has the intention and ability

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to hold to maturity are classified as held-to-maturity and are included in non-current assets. During the period, the Group did not hold any investments classified as trading or held-to-maturity. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets, unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and evaluates such designation on a regular basis.

All purchases and sales of investments are recognised on the settlement date, which is the date that the investment is delivered to or by the Group. Cost of purchase includes transaction costs. Trading and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective yield method. Realised and unrealised gains and losses arising from changes in the fair value of trading investments and of available-for-sale investments are included in the statement of income in the period in which they arise.

Since the majority of the Group's investments are not publicly traded and no reliable method of fair value estimation exists for those investments, these investments are excluded from fair value valuation.

Those financial assets that are excluded from fair valuation and that have a fixed maturity are measured at amortised cost using the effective interest rate method less impairment. Those that do not have a fixed maturity date are measured at cost less impairment.

Unquoted available-for-sale equity investments are reviewed for impairment losses at every balance sheet date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When a review for impairment is conducted, the recoverable amount is assessed by reference to the net present value of expected future cash inflows. The discount rate applied is based upon the Group's weighted average cost of capital with appropriate adjustment for the risks associated with the investment under assessment. When the level of information available to calculate the net present value of expected future cash inflows makes this exercise unworkable, management uses different valuation techniques to estimate whether there is objective evidence of impairment and to determine the likely amount of impairment, if any.

(h) Components of cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks with a maturity at the date of inception of less than three months, which are considered by the Group at the time of deposit to have minimal fair value and default risks.

(i) Deferred taxes

Deferred tax is calculated at rates enacted or substantively enacted at the balance sheet date, using the liability method, for all temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. The principal temporary differences arise from application in previous periods of IAS 29, depreciation on property, plant and equipment and provisions and expenses, which are charged to the consolidated statement of income before they become deductible for tax purposes.

Deferred tax liabilities are recognised in respect of all taxable temporary differences relating to investments in subsidiaries, unless the Group is able to control the timing of the reversal of

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the temporary difference and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax assets attributable to temporary differences, unused tax losses and credits are recognised only to the extent that it is probable that future taxable profit will be available against which they can be utilised.

Deferred tax assets and liabilities are offset when the Group has a legally enforceable right to set off current tax assets against current liabilities, when deferred tax balances relate to the same regulatory body (i.e., federal or republic), and when they relate to the same jurisdiction and taxable entity.

(j) Foreign currencies

Transactions denominated in foreign currencies are recorded, on initial recognition, in the measurement currency, by applying the exchange rate between the measurement currency and the foreign currency at the date of the transaction. Outstanding foreign currency monetary items at the balance sheet date are reported at the closing rate. Non-monetary items which are carried in terms of historical cost denominated in a foreign currency are reported using the exchange rate at the date of the transaction, and non-monetary items which are carried at fair value denominated in a foreign currency are reported using the exchange rates that existed when the values were determined.

Exchange differences arising on the settlement of monetary items or reporting monetary items at rates different from those at which they were initially recorded are recognised in the statement of income in the period in which they arise.

(k) Revenue recognition

Revenues are recognised when goods are shipped to the customer, as this is the date on which the risks and rewards of ownership are transferred to the customer. Sales are shown net of VAT and export duties, and after eliminating sales within the Group.

Revenue from rendering of transport services is recognised in financial statements in the period in which the services are rendered.

Interest income is recognised on a time proportion basis that takes into account the effective yield on the asset.

Dividend income is recognised when the shareholder's right to receive payment is established.

(l) Measurement of trade and other receivables

Trade and other receivables are carried at the original invoice amount including Value Added Tax ("VAT") less provision made for impairment of these receivables. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected future cash flows, discounted at the market rate of interest for similar borrowers.

(m) Value added taxes

In the consolidated balance sheet and the consolidated statement of cash flows, transactions and balances are presented inclusive of the associated VAT applicable under the legislation of the relevant jurisdiction in which the transaction occurred.

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(n) Borrowings

Borrowings are recognised initially at cost, which is the fair value of the proceeds received (which is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price), net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised as interest expense over the period of the borrowings.

Borrowing costs are expensed as incurred.

(o) Pension and other post-retirement benefits

In the normal course of business the Group contributes to the Russian Federation State pension plan on behalf of its employees. Mandatory contributions to the State pension plan, which is a defined contribution plan, are expensed when incurred and are included within wages, salaries and other staff costs in cost of sales.

The Group operates a defined benefit pension plan. Pension costs are recognised using the projected unit credit method. The cost of providing pensions is charged to the cost of sales within the consolidated statement of income so as to spread the regular cost over the service lives of employees. The pension obligation is measured at the present value of the estimated future cash outflows using the interest rates on governmental securities, which have the terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognised over the average remaining service life of employees.

The Group owns and controls the Almaznaya Osen pension fund, which administers the Group's defined benefit plan. The Group contributes funds to the Almaznaya Osen pension fund, which invests them in governmental securities and other financial instruments. These investments are considered the pension fund plan assets. The defined benefit liability is recognised net of the fair value of plan assets at the balance sheet date.

(p) Social obligations

Social costs relating to the maintenance of housing are determined in accordance with agreements with the local authorities and expensed or capitalised as appropriate.

Discretionary and voluntary payments made to fund and support social programmes and related operations are expensed as incurred.

(q) Non-cash transactions

Non-cash transactions are measured at the fair value of the consideration received or receivable. When it is not possible to measure reliably the fair value of the consideration received or receivable, non-cash transactions are measured at the fair value of the consideration given.

Non-cash transactions have been excluded from the operating, investing and financing activities components in the accompanying consolidated statement of cash flows.

(r) Share capital

Share capital consists of ordinary shares, which are classified as equity.

(s) Segment reporting

Business segments (primary segments) provide products or services that are subject to risks and returns that are different from those of other business segments. Geographical segments (secondary segments) provide products or services within a particular economic environment

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that are subject to risks and returns that are different from those of components operating in other economic environments.

3. GROUP STRUCTURE AND INVESTMENTS

The Company's significant consolidated subsidiaries and associated undertaking are as follows:

Name	Country of Incorporation	Percentage of voting interest held	
		30 June 2004 (unaudited)	31 December 2003
Consolidated Subsidiaries			
ALROSA Finance S.A.	Luxembourg	100	100
ZAO Irelyakhneft	Russia	100	100
Pension Fund Almaznaya Osen.....	Russia	97	97
OA0 Severalmaz	Russia	92	92
OOO GRK Aldanzoloto..... (1)	Russia	91	—
OA0 Viluygesstroy	Russia	90	90
OOO MAK-Bank.....	Russia	88	88
OA0 ALROSA-Nyurba	Russia	87	87
OA0 Viluyskaya GES-3.....	Russia	72	72
OA0 ALROSA-Gas	Russia	53	53
OA0 Investment Group ALROSA..... (2)	Russia	50	50
Associated Undertaking			
Catoca Mining Company Ltd	(3) Angola	33	33

(1) In February 2004 OAo Investment Group ALROSA, a subsidiary of the Group, acquired 91 per cent. of the share capital of OOO GRK Aldanzoloto, a gold-mining company located in Republic of Sakha (Yakutia). Total purchase consideration was RR'mln 916, which approximated to the fair value of the acquired net assets of OOO GRK Aldanzoloto, represented mostly by property, plant and equipment. The acquired business contributed revenues of RR'mln 534 (including RR'mln 464 of gold sales, see note 17) and net profit of RR'mln 12 to the Group for the six months ended 30 June 2004, and its assets and liabilities at 30 June 2004 were respectively RR'mln 1,265 and RR'mln 308.

(2) The Group owned 50.01 per cent. of the voting interest in OAo Investment Group ALROSA at 30 June 2004 and 31 December 2003.

(3) Catoca Mining Company Ltd is a diamond-mining company located in Angola. The investment in this associated undertaking was accounted for by the Group using the equity method. An income figure of RR'mln 253 was included in the Group's financial statements for the six months ended 30 June 2004, with a corresponding income of RR'mln 163 included in the financial statements for the six months ended 30 June 2003. In June 2004 Catoca Mining Company Ltd declared dividends for the year ended 31 December 2003; the Group's share of these dividends amounted to RR'mln 403. The Group's share of the net assets of Catoca Mining Company Ltd included in these financial statements is RR'mln 642 and RR'mln 792 as at 30 June 2004 and 31 December 2003, respectively.

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Non-current available-for-sale investments

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Available-for-sale investments at the beginning of the period..	1,187	1,427
Additions	21	64
Disposals	(14)	(234)
Change in provision for impairment of available-for-sale investments (note 21)	(263)	112
Available-for-sale investments at the end of the period	931	1,369

4. CASH AND CASH EQUIVALENTS AND RESTRICTED CASH

Cash and cash equivalents

As at 30 June 2004, the cash and cash equivalents balance mainly represents current accounts of the Group on which the weighted average interest rate is 1 per cent. (31 December 2003: 2 per cent.).

At 30 June 2004 cash and cash equivalents of RR'mln 6,710 were held with OAO "Web-Invest Bank" and OAO "Bank Vozrozhdeniye" on current and deposit accounts.

Restricted cash

Included within the restricted cash are balances of RR'mln 203 and RR'mln 205 as at 30 June 2004 and 31 December 2003, respectively, which represent deposit accounts held with J.P. Morgan Chase Bank and Vneshtorgbank. The Group is required to maintain a balance equal to the amount of its next scheduled principal and interest payment in accordance with its loan agreements with these banks.

The remaining RR'mln 171 as at 30 June 2004 (31 December 2003: RR'mln 135) represents mandatory reserve deposits held with the Central Bank of the Russian Federation by MAK-Bank, a consolidated subsidiary; these balances are not available for use in the Group's day to day operations.

At 30 June 2004 the weighted average interest rate on the restricted cash balance is approximately nil per cent. (31 December 2003: approximately nil per cent.).

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5. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Land and improve- ments	Plant and equipment	Transport	Assets under construction	Other	TOTAL
Cost at 31 December 2003	44,927	35,594	28,362	15,435	29,533	843	154,694
Additions through acquisition of subsidiaries	177	13	562	102	246	42	1,142
Additions	28	96	574	274	6,174	284	7,430
Transfers	454	571	168	8	(1,220)	19	—
Disposals	(470)	(18)	(456)	(328)	(183)	(144)	(1,599)
Change in estimate of provision for restoration liability (see note 12) ...	359	131	24	4	—	1	519
Impairment of property, plant and equipment (see note 21)	—	—	—	—	(667)	—	(667)
Cost at 30 June 2004 (unaudited)	<u>45,475</u>	<u>36,387</u>	<u>29,234</u>	<u>15,495</u>	<u>33,883</u>	<u>1,045</u>	<u>161,519</u>
Accumulated depreciation at 31 December 2003	(13,185)	(14,146)	(13,808)	(8,830)	—	(282)	(50,251)
Charge for the period	(625)	(728)	(1,410)	(745)	—	(61)	(3,569)
Disposals	396	2	342	282	—	33	1,055
Accumulated depreciation at 30 June 2004 (unaudited)	<u>(13,414)</u>	<u>(14,872)</u>	<u>(14,876)</u>	<u>(9,293)</u>	<u>—</u>	<u>(310)</u>	<u>(52,765)</u>
Net book value at 31 December 2003	<u>31,742</u>	<u>21,448</u>	<u>14,554</u>	<u>6,605</u>	<u>29,533</u>	<u>561</u>	<u>104,443</u>
Net book value at 30 June 2004 (unaudited)	<u>32,061</u>	<u>21,515</u>	<u>14,358</u>	<u>6,202</u>	<u>33,883</u>	<u>735</u>	<u>108,754</u>

Refer to note 9 for property, plant and equipment included above which is subject to the Lease Agreement with the Republic of Sakha (Yakutia).

6. INVENTORIES

	30 June 2004 (unaudited)	31 December 2003
Diamonds	6,390	5,245
Ores and concentrates	2,356	2,133
Mining and construction materials	7,143	7,255
Consumable supplies	1,211	1,163
	<u>17,100</u>	<u>15,796</u>

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7. TRADE AND OTHER RECEIVABLES

	30 June 2004 (unaudited)	31 December 2003
Long-term accounts receivable		
Long-term VAT recoverable	1,545	1,214
Receivables from related parties (see note 26)	894	670
Loans issued	299	189
Long-term prepaid royalty	76	144
Other long-term receivables and advances	—	122
	<u>2,814</u>	<u>2,339</u>
Current accounts receivable		
Advances to suppliers.....	2,505	894
Taxes recoverable	1,643	1,859
Notes receivable	860	108
Loans issued	884	352
Prepaid taxes, other than profit tax.....	944	1,055
Receivables from related parties (see note 26)	952	524
Trade receivables for supplied diamonds	525	488
Other receivables.....	2,199	1,955
	<u>10,512</u>	<u>7,235</u>

Taxes recoverable relate to input VAT incurred with respect to purchases. The amount is available for offset against future output VAT following the settlement of outstanding balances payable in relation to the inventories and services purchased.

Long-term VAT recoverable, which relates to the materials and services used for construction of property, plant and equipment, normally becomes available for offset against future output VAT after the respective asset is put into use.

Notes receivable at 30 June 2004 included interest-bearing US Dollar-denominated notes of OAO "Web-Invest Bank" totalling RR'mln 827. The maturity of these notes ranges from 6-12 months and interest rate ranges from 5.8 - 6.4 per cent. per annum.

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The impairment provision offset against individual receivable balances was as follows:

	30 June 2004 (unaudited)	Interest on impaired receivables	Bad debt expense	31 December 2003
Long-term accounts receivable				
Long-term prepaid royalty.....	50	(21)	—	71
	50	(21)	—	71
Current accounts receivable				
Prepaid taxes, other than profit tax	43	(3)	—	46
Receivables from related parties (see note 26).....	301	(2)	(4)	307
Notes receivable	251	—	—	251
Loans issued	96	—	—	96
Other receivables.....	1,668	(4)	191	1,481
	2,359	(9)	187	2,181
Long-term accounts receivable				
Long-term VAT recoverable.....	—	(225)	—	225
Receivables from related parties (see note 26).....	160	—	—	160
Long-term prepaid royalty.....	104	(16)	11	109
	264	(241)	11	494
Current accounts receivable				
Prepaid taxes, other than profit tax	69	(25)	15	79
Receivables from related parties (see note 26).....	364	(5)	20	349
Notes receivable	146	(69)	2	213
Loans issued	161	—	—	161
Other receivables.....	1,179	(25)	379	825
	1,919	(124)	416	1,627

The average effective interest rates at the balance sheet dates were as follows:

	30 June 2004 (unaudited)	31 December 2003
Long-term accounts receivable		
Receivable from related parties.....	22%	30%
Loans issued	14%	17%
Long-term prepaid taxes, other than profit tax.....	10%	10%

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8. SHARE CAPITAL

	30 June 2004 (unaudited)		31 December 2003	
	Shares	Amount	Shares	Amount
Authorised, issued and fully paid ordinary share capital at RR 57,455 per share	200,000	11,491	200,000	11,491

Distributable profits

The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net profit. For the six months ended 30 June 2004 and 30 June 2003, the statutory profit for the Company as reported in the published statutory reporting forms was RR'mln 4,919 and RR'mln 5,431, respectively. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation, and accordingly, management believes that at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements.

Dividends

On 21 June 2003, the Company's shareholders approved dividends for the year ended 31 December 2002 totalling RR'mln 700. Dividends per share amounted to RR 3,500.

On 19 June 2004, the Company's shareholders approved dividends for the year ended 31 December 2003 totalling RR'mln 1,200. Dividends per share amounted to RR 6,000.

9. GRANT AND ASSETS SUBJECT TO MINERAL LEASE AGREEMENT

On 19 January 1993, the Company entered into a Lease Agreement with the Republic of Sakha (Yakutia) for the "transfer of rights to use and exploit land, diamond deposits, main production and non-production facilities". This agreement has a term of 25 years and provides the Company with the right to use certain production and non-production assets for exploring, mining and operating diamond deposits. The agreement requires the Company to return the assets in 2017 and reimburse the Government of the Republic of Sakha (Yakutia) for depreciation of assets. The Government in turn is required to reimburse the Company for qualifying repair and maintenance costs. The precise mechanism for determining the value and nature of the assets to be returned to the Republic of Sakha (Yakutia) under the terms of the mineral Lease Agreement is currently being negotiated between the parties.

Management has estimated the restoration liability based upon its interpretation of the Lease Agreement and, in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", has calculated and recorded the net present value of the restoration liability (see notes 2(e) and 12).

The agreement stipulates that certain of its terms should be renegotiated every five years. The agreement also stipulates that the Company is subject to royalties and other taxes on the right to use the land and logging areas, disposal and burial of waste and contaminated materials and the use of mineral resources and water for industrial purposes. The main subject of the renegotiations relates to the amount and timing of the royalty and other payments.

Royalty payments expensed during the six months ended 30 June 2004 totalled RR'mln 4,346 (six months ended 30 June 2003: RR'mln 4,627). Ecology fund payments expensed during the

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six months ended 30 June 2004 totalled RR'mln 460 (six months ended 30 June 2003: RR'mln 454).

Pursuant to an addendum to the Lease Agreement dated 22 December 2002, the Company and the Republic of Sakha (Yakutia) agreed that the royalty payments, including ecology fund payments and VAT, due in 2003 are fixed at RR'mln 10,680.

Pursuant to an addendum to the Lease Agreement dated 17 September 2003, the Company and the Republic of Sakha (Yakutia) agreed that the royalty payments, including ecology fund payments and VAT, due in 2004 are fixed at RR'mln 10,500.

Recoverable VAT related to royalty and ecology fund payments depends on the percentage of export diamond sales to the total diamond sales of the Company. The amount of such VAT for the six months ended 30 June 2004 was RR'mln 444.

The carrying values of Company owned and granted assets subject to the Lease Agreement with the Republic of Sakha (Yakutia) and Grant are as follows:

	30 June 2004 (unaudited)	31 December 2003
Assets subject to the agreement with the Republic of Sakha (Yakutia)		
Net book value of granted assets received in 1993	9,994	10,498
Net book value of Company owned assets subsequently transferred to the lease	5,600	4,939
Net book value at the end of the period	15,594	15,437

10. LONG-TERM DEBT

	30 June 2004 (unaudited)	31 December 2003
Banks:		
US\$-denominated floating rate	3,914	2,843
US\$-denominated fixed rate	5,741	4,665
RR-denominated fixed rate	2,930	4,963
	12,585	12,471
Eurobonds	14,289	14,463
RR-denominated non-convertible bonds	4,151	4,870
Commercial paper	193	235
Other US\$-denominated fixed rate loans	528	—
Other RR-denominated fixed rate loans	372	375
	32,118	32,414
Less: current portion of long-term debt (see note 11)	(5,235)	(7,730)
	26,883	24,684

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In May 2003 ALROSA Finance S.A., a wholly owned subsidiary of the Group, issued Eurobonds in the amount of US\$'mln 500 due for repayment on 6 May 2008 with an interest rate of 8.125 per cent. per annum.

US\$-denominated fixed rate debt as at 30 June 2004 includes a loan totalling RR'mln 4,316 received by OAO Severalmaz, a subsidiary of the Group, from ING Bank in March and April 2004. The loan is due for repayment in March 2006 with an interest rate of 8.875 per cent. per annum.

The long-term commercial paper has defined maturity dates ranging between one and 10 years, and is carried at amortised cost.

The average effective interest rates at the balance sheet dates were as follows:

	30 June 2004 (unaudited)	31 December 2003
Banks:		
US\$-denominated floating rate.....	5.2%	5.1%
US\$-denominated fixed rate.....	9.6%	10.1%
RR-denominated fixed rate.....	14.6%	16.8%
Eurobonds.....	8.7%	8.7%
RR-denominated non-convertible bonds.....	14.5%	14.0%
Commercial paper.....	44.9%	35.3%
Other US\$-denominated fixed rate loans.....	9.0%	—
Other RR-denominated fixed rate loans.....	11.7%	11.4%

The exchange rate for the US Dollar at 30 June 2004 was RR 29.03 to US\$ 1 (31 December 2003: RR 29.45 to US\$ 1).

At 30 June 2004 long-term loans had the following maturity profile:

	Within 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 years and thereafter	Total
Banks:						
US\$-denominated floating rate.....	1,009	2,250	219	218	218	3,914
US\$-denominated fixed rate.....	623	5,084	—	—	34	5,741
RR-denominated fixed rate..	2,530	400	—	—	—	2,930
Eurobonds.....	—	—	—	14,289	—	14,289
RR-denominated non- convertible bonds.....	1,000	3,151	—	—	—	4,151
Commercial paper.....	—	54	41	40	58	193
Other US\$-denominated fixed rate loans.....	73	93	85	78	199	528
Other RR-denominated fixed rate loans.....	—	187	45	—	140	372
	5,235	11,219	390	14,625	649	32,118

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At 31 December 2003 long-term loans had the following maturity profile:

	Within 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 years and thereafter	Total
Banks:						
US\$-denominated floating rate	971	835	261	479	297	2,843
US\$-denominated fixed rate	3,275	1,372	18	—	—	4,665
RR-denominated fixed rate..	2,433	2,000	—	—	530	4,963
Eurobonds	—	—	—	—	14,463	14,463
RR-denominated non- convertible bonds	1,051	3,819	—	—	—	4,870
Commercial paper	—	106	30	38	61	235
Other RR-denominated fixed rate loans	—	163	52	20	140	375
	<u>7,730</u>	<u>8,295</u>	<u>361</u>	<u>537</u>	<u>15,491</u>	<u>32,414</u>

The Group has not entered into any derivative contracts in respect of its foreign currency obligations or interest rate exposure.

The carrying amounts and fair values of long-term debt were as follows:

	30 June 2004 (unaudited)		31 December 2003	
	Carrying amounts	Fair values	Carrying amounts	Fair values
Banks	12,585	12,913	12,471	12,855
Eurobonds	14,289	14,223	14,463	14,759
Non-convertible bonds	4,151	4,424	4,870	4,917
Commercial paper	193	922	235	545
Other	900	905	375	390

The fair value of long-term debt is estimated by discounting the future contractual cash outflows at the market interest rate available to the Group at the balance sheet date.

As at 30 June 2004, long-term debt totalling RR'mln 102 (31 December 2003: RR'mln 1,283) included above was secured with the assets of the Group. As separate loan agreements do not specify individual pledged assets, the carrying amount of pledged assets is not disclosed.

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RR-denominated non-convertible bonds

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Balance at the beginning of the period	4,870	6,720
Issuance (par value RR 1 thousand).....	63	30
Amortisation of discount	19	19
Repayment (par value RR 1 thousand)	(801)	(851)
Balance at the end of the period	4,151	5,918

Non-convertible bonds of the Company of the 19th series totalling RR'mln 2,948 at 30 June 2004 (31 December 2003: RR'mln 2,929) have fixed coupon rates of 16 per cent. Other non-convertible bonds cannot be classified with certainty as fixed or floating rate. The first coupon on these bonds is determined by the Supervisory Council of the Company and the following coupons are linked to certain indicators, such as the Central Bank of the Russian Federation refinancing rate or the yields on government bonds.

11. SHORT-TERM LOANS AND CURRENT PORTION OF LONG-TERM DEBT

	30 June 2004 (unaudited)	31 December 2003
Banks:		
US\$-denominated floating rate	2,076	148
US\$-denominated fixed rate	15,515	4,227
RR-denominated fixed rate	258	207
	17,849	4,582
Commercial paper	384	450
Other US\$-denominated fixed rate loans	221	171
Other RR-denominated fixed rate loans	1,482	950
	19,936	6,153
Add: current portion of long-term debt (note 10)	5,235	7,730
	25,171	13,883

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The average effective interest rates at the balance sheet dates were as follows:

	30 June 2004 (unaudited)	31 December 2003
Banks:		
US\$-denominated floating rate	5.8%	6.2%
US\$-denominated fixed rate	8.4%	9.5%
RR-denominated fixed rate	8.5%	8.8%
Commercial paper	18.1%	22.5%
Other US\$-denominated fixed rate loans	5.9%	6.5%
Other RR-denominated fixed rate loans	2.9%	2.9%

As at 30 June 2004, short-term loans totalling RR'mln 1,180 (31 December 2003: RR'mln 6,825) included above were secured with the assets of the Group. As separate loan agreements do not specify individual pledged assets, the carrying amount of pledged assets is not disclosed.

Commercial paper

Commercial paper comprises unsecured notes, denominated in RR, issued by the Group to provide short- and medium-term working capital facilities. The short-term commercial paper is typically a discounted non-interest bearing instrument, with defined maturity dates ranging from one month to one year and is carried at amortised cost.

12. PROVISION FOR RESTORATION LIABILITY

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
At the beginning of the period	5,394	2,743
Change in estimate of provision for restoration liability	519	2,266
Increase in the discounted amount during the period	203	193
At the end of the period	6,116	5,202

The provision for restoration liability represents the net present value of the estimated future obligation, upon termination of the lease, to return certain property, plant and equipment received from the Republic of Sakha (Yakutia) under the terms of the Lease Agreement (see notes 2(e) and 9). The discount rate used to calculate the net present value of the restoration liability at 30 June 2004 was 7.3 per cent. (31 December 2003: 8.2 per cent.), which is pre-tax real rate and is considered appropriate for the Group in the economic environment in the Russian Federation at the balance sheet date.

Under the Lease Agreement the Company is obliged to reimburse to the Republic of Sakha (Yakutia) the amount of accumulated depreciation on property, plant and equipment subject to this agreement (leased property, plant and equipment) and the Republic of Sakha (Yakutia) is obliged to reimburse to the Company the amount of qualified repair and maintenance expenses incurred by the Company in relation to the leased property, plant and equipment. The Company and the Republic of Sakha (Yakutia) determined the amount to be reimbursed

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by the Company on a net basis as the difference between the amount of depreciation on leased assets and the amount of repair and maintenance expense in relation to the leased property, plant and equipment. Reimbursement is effected by means of the transfer of title of certain of the Company's own items of property, plant and equipment to the Republic of Sakha (Yakutia) and these assets are, subsequent to their transfer, treated as leased property, plant and equipment (see note 9).

Prior to 1 January 2003 Republic of Sakha (Yakutia) was obliged to reimburse to the Company the actual amount of qualified repair and maintenance expense incurred by the Company in relation to the leased property, plant and equipment. Pursuant to an addendum to the Lease Agreement dated 17 September 2003, starting from 1 January 2003 the Republic of Sakha (Yakutia) is obliged to reimburse qualified repair and maintenance expense incurred by the Company, subject to such expense being limited to 30 per cent. of the depreciation on leased property, plant and equipment. This new limitation, in combination with the decrease of discount rate from 10.5 to 8.2 per cent., resulted in a change in the estimate of the amount of provision for restoration liability in the six months ended 30 June 2003 totalling RR'mln 2,266, which was added to the cost of the related assets.

In the six months ended 30 June 2004 a further decrease of the discount rate from 8.2 to 7.3 per cent. resulted in a change in the estimate of provision for restoration liability totalling RR'mln 519, which was added to the cost of the related asset (see note 5).

13. PROVISION FOR PENSION OBLIGATIONS

The amounts recognised in the consolidated balance sheet are as follows:

	30 June 2004 (unaudited)	31 December 2003
Present value of obligations	6,401	5,387
Fair value of plan assets	(1,116)	—
Unrecognised actuarial losses	(3,780)	(3,424)
Net liability.....	1,505	1,963

Due to changes in pension legislation, Pension Fund Almaznaya Osen reinvested the major part of its funds into financial instruments issued by third parties (mostly government bonds). These financial instruments are considered the Pension Fund plan assets.

The amounts recognised in the consolidated statement of income are as follows:

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Current service cost.....	118	53
Interest cost.....	431	521
Net actuarial losses	289	122
Net expense recognised in the statement of income.....	838	696

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Total expenses associated with pension obligations are included within wages, salaries and other staff costs within cost of sales in the consolidated statement of income.

Movements in the net liability recognised in the balance sheet were as follows:

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Net liability at the beginning of the period.....	1,963	1,268
Net expense recognised in the statement of income during the reporting period	838	696
Contributions made	(1,116)	—
Benefits paid	(180)	(119)
Net liability at the end of the period.....	1,505	1,845

Principal actuarial assumptions used:

	30 June 2004 (unaudited)	31 December 2003
Discount rate (nominal).....	9%	9%
Future pension increases (nominal).....	8%	9%
Employees' average remaining working life (years)	10	11

14. TRADE AND OTHER PAYABLES

	30 June 2004 (unaudited)	31 December 2003
Accrual for employee flights and holidays	2,946	3,053
Trade.....	2,392	2,757
Wages and salaries	1,032	1,051
Advances from customers.....	637	1,251
Interest payable	494	397
Payables to related parties.....	116	85
Other payables and accruals	1,019	528
	8,636	9,122

In accordance with Russian legislation, the Group entities are required to pay for the holiday entitlement and the cost of travel for employees and their family members to an agreed-upon destination and back, or a pre-determined allowance.

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15. OTHER PROVISIONS

	30 June 2004 (unaudited)	31 December 2003
Provision for guarantee given	905	972
Provision for legal claim.....	240	243
	<u>1,145</u>	<u>1,215</u>
<i>Provision for guarantee given</i>		
Provision at 31 December 2003.....		972
Interest accrued.....		45
Interest paid		(101)
Exchange gain.....		(11)
Provision at 30 June 2004.....		<u>905</u>

In April 2003 the Company guaranteed a US Dollar-denominated fixed rate loan issued by OAO "Investment Bank Trust" to ZAO "Nazymyskaya Oil and Gas Research Expedition", which is due for repayment in 2006. The Company management expects the Group to incur an outflow of economic resources in connection with this guarantee and therefore the Group has recognised a provision for the principal amount of the loan and accrued interest in the financial statements at 31 December 2003 and 30 June 2004. In June 2004, ZAO "Nazymyskaya Oil and Gas Research Expedition" failed to pay the first interest installment to the bank. The Company as guarantor paid the interest installment to the bank totalling RR'mln 101.

Provision for legal claim

Bateman Projects Limited, a South African company, and its Dutch subsidiary, Bateman International B.V. (collectively "Bateman"), outside construction firms which were involved in the development of the Nyurba processing plant, filed an arbitration claim against the Company claiming damages for alleged loss of profit under the contracts concluded between the Company and Bateman and damages allegedly resulting from use of Bateman's intellectual property rights. As the Company management expects the Group to incur an outflow of economic resources in connection with this US Dollar-denominated legal claim, the Group has recognised a provision in the financial statements at 31 December 2003 and 30 June 2004. The Company management does not expect any additional material outflows of economic resources in relation to this claim.

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16. PROFIT AND OTHER TAX ASSETS AND LIABILITIES

Taxes payable comprise the following:

	30 June 2004 (unaudited)	31 December 2003
Unified social tax	1,016	869
Extraction tax	578	506
Property tax	314	385
Personal income tax (employees)	251	242
Royalty payable to Republic of Sakha (Yakutia)	239	118
Value added tax	224	243
Tax penalties	148	154
Profit tax	22	202
Other taxes and accruals	153	39
	<u>2,945</u>	<u>2,758</u>

Taxes other than profit tax and extraction tax included in other operating expenses comprise the following:

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Property tax	495	518
Ecology fund	460	454
Tax penalties	11	18
Other taxes and accruals	230	54
	<u>1,196</u>	<u>1,044</u>

In accordance with Resolution No. 1364 of the Government of the Russian Federation dated 9 December 1999, in addition to the taxes noted above the Company is obliged to pay 6.5 per cent. on the value of diamonds sold for export in the form of an export duty (see note 17).

According to legislation which became substantively enacted in the year ended 31 December 2001, profit tax payable by companies in the Russian Federation with effect from 1 January 2002 ranges from 20 per cent. to 24 per cent., depending on the decision each year of regional and local tax authorities, which can agree jointly on a supplementary amount of up to 4 per cent. above that set by the federal tax authorities. The rate used to compute the deferred profit tax assets and liabilities of the Group at 30 June 2004 and 31 December 2003 was 24 per cent., which reflects the fact that, based on their decisions in respect of tax rates, substantially all regional and local tax authorities in the regions in which the Group operates assessed the maximum supplementary amount in respect of the six months ended 30 June 2004 and year ended 31 December 2003.

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Profit tax expense comprises the following:

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Current tax expense	2,211	1,634
Deferred tax benefit.....	(963)	(1,339)
	<u>1,248</u>	<u>295</u>

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

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Profit before profit tax and minority interest.....	5,517	4,820
Theoretical tax charge at statutory rate of 24 per cent. thereon.....	1,324	1,157
Income not assessable for profit tax purposes	(440)	(890)
Expenses and losses not deductible for profit tax purposes	364	28
	<u>1,248</u>	<u>295</u>

Differences between IFRS and Russian statutory tax accounting give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profit tax purposes. The tax effect of the movement in these temporary differences is recorded at the rate of 24 per cent. (2003: 24 per cent.).

	30 June 2004 (unaudited)	Tax effect of movement in temporary differences	31 December 2003
Deferred tax liabilities			
Property, plant and equipment	3,723	17	3,706
Inventories.....	541	(443)	984
Long-term investments	18	(101)	119
Deferred tax assets			
Accrual for employee benefits	(919)	68	(987)
Exploration costs written off.....	(250)	(76)	(174)
Impairment of accounts receivable.....	(329)	191	(520)
Provision for pension obligations	(215)	(60)	(155)
Write-down of inventories	(707)	(327)	(380)
Other deductible temporary differences.....	(359)	(232)	(127)
Net deferred tax liability	<u>1,503</u>	<u>(963)</u>	<u>2,466</u>

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	30 June 2003 (unaudited)	Tax effect of movement in temporary differences	31 December 2002
Deferred tax liabilities			
Property, plant and equipment	4,402	(385)	4,787
Inventories	559	(262)	821
Long-term investments	153	(108)	261
Deferred tax assets			
Accrual for employee benefits	(716)	131	(847)
Exploration costs written off	(299)	(71)	(228)
Impairment of accounts receivable	(480)	(98)	(382)
Provision for pension obligations	(377)	(289)	(88)
Write-down of inventories	(163)	(54)	(109)
Other deductible temporary differences	(232)	(203)	(29)
Net deferred tax liability	<u>2,847</u>	<u>(1,339)</u>	<u>4,186</u>

17. SALES

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Revenue from diamond sales:		
Export (predominantly one customer)	15,333	12,380
Domestic	15,895	13,331
	<u>31,228</u>	<u>25,711</u>
Other revenue:		
Transport	913	753
Gold	464	—
Trading	419	423
Social infrastructure	447	381
Construction	247	253
Other	1,050	509
	<u>34,768</u>	<u>28,030</u>

Export duties totalling RR'mln 927 for the six months ended 30 June 2004 (six months ended 30 June 2003: RR'mln 719) were netted against revenues from export of diamonds.

Sales of gold were performed by OOO GRK Aldanzoloto, a subsidiary of the Group, acquired during the six months ended 30 June 2004 (see note 3).

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	Six months ended 30 June 2004 US\$'mln (unaudited)	Six months ended 30 June 2003 US\$'mln (unaudited)
Hard currency revenue from export diamond sales including export duties (predominantly one customer).....	566	421
US\$-denominated domestic diamond sales settled in RR.....	551	426
	<u>1,117</u>	<u>847</u>

During the six months ended 30 June 2004 and 30 June 2003 sales to De Beers occurred on the basis of separate agreements for each individual shipment of diamonds. Contingencies related to the trade agreement with De Beers, covering the period from 1 January 2002 to 31 December 2006 are disclosed in note 25(i).

Pursuant to existing federal legislation, the Government of the Russian Federation issued, on an annual basis, an export quota for rough diamonds. The quota stipulated the maximum amount of diamonds that might be exported in a given year. The physical volume in carats provided in any quota constituted a State secret.

In November 2002, the President of the Russian Federation signed a decree liberalising the Russian diamond market. The decree authorised the Government of the Russian Federation to grant multi-year quotas, not to exceed five years, and in February 2003 the Company was granted a five-year quota to export up to US\$'mln 1,300 of diamonds each year, based on current market prices. The physical volume in carats provided in any quota constitutes a State secret.

18. COST OF SALES

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Wages, salaries and other staff costs	6,080	4,509
Depreciation.....	3,000	2,699
Fuel and energy	2,960	2,260
Materials.....	2,646	1,709
Extraction tax.....	2,404	1,579
Services	899	815
Transport.....	365	680
Write down of inventory	177	157
Other	199	230
Movement in inventories	(1,368)	(1,867)
	<u>17,362</u>	<u>12,771</u>

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Depreciation totalling RR'mln 569 (six months ended 30 June 2003: RR'mln 464) and staff costs totalling RR'mln 1,254 (six months ended 30 June 2003: RR'mln 1,027) were incurred by the Group's construction division and were capitalised in the period.

19. GENERAL AND ADMINISTRATIVE EXPENSES

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Administrative expenses.....	1,273	1,055
Bad debt expense	187	427
	<u>1,460</u>	<u>1,482</u>

Wages, salaries and other staff costs totalling RR'mln 366 (six months ended 30 June 2003: RR'mln 294) were included in administrative expenses.

20. OTHER OPERATING INCOME

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Amortisation of Grant (see note 9)	504	490
Other	478	534
	<u>982</u>	<u>1,024</u>

21. OTHER OPERATING EXPENSES

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Social costs	1,118	1,247
Taxes other than profit tax and extraction tax (see note 16)	1,196	1,044
Exploration expenses.....	843	551
Selling and marketing expenses	568	515
Impairment of property, plant and equipment	667	—
Loss on disposal of property, plant and equipment	335	48
Provision for (reversal of provision for) impairment of available-for-sale investments, net.....	263	(112)
Provision for guarantee given (see note 15)	45	927
Other	504	281
	<u>5,539</u>	<u>4,501</u>

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Wages, salaries and other staff costs totalling RR'mln 297 (six months ended 30 June 2003: RR'mln 243) were included in selling and marketing expenses.

Social costs

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Maintenance of local infrastructure.....	593	536
Charity	169	488
Hospital expenses	90	55
Education	102	40
Other	164	128
	<u>1,118</u>	<u>1,247</u>

22. FINANCE COSTS, NET

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Interest expense:		
Bank loans.....	942	1,396
Commercial paper	47	70
Non-convertible bonds.....	343	505
Eurobonds	622	195
Provision for restoration liability (see note 12)	203	193
Other	7	62
	<u>2,164</u>	<u>2,421</u>
Interest income	(93)	(338)
	<u>2,071</u>	<u>2,083</u>

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23. CASH GENERATED FROM OPERATIONS

Reconciliation of profit before tax to cash generated from operations:

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Profit before profit tax	5,517	4,820
Adjustments for:		
Income from associated undertakings, net (note 3)	(240)	(163)
Interest income (note 22)	(93)	(338)
Interest expense (note 22)	2,164	2,421
Provision for (reversal of provision for) impairment of available-for-sale investments, net (note 21)	263	(112)
Impairment of property, plant and equipment (note 21)	667	—
Provision for guarantee given (note 21)	—	927
Loss on disposal of property, plant and equipment (note 21)	335	48
Amortisation of Grant (note 20)	(504)	(490)
Depreciation (note 18)	3,000	2,699
Adjustments for non-cash investing activity (note 27)	(1,141)	(1,318)
Adjustments for non-cash financing activity (note 27)	(121)	(608)
Unrealised foreign exchange effect on non-operating items	(204)	(1,260)
Net operating cash flow before changes in working capital	9,643	6,626
Net increase in inventories	(1,304)	(1,929)
Net increase in trade and other receivables, excluding dividends receivable	(3,349)	(2,823)
Net (decrease) increase in provisions, trade and other payables, excluding interest payable	(1,111)	61
Net increase in taxes payable other than profit tax	367	273
Cash generated from operations	4,246	2,208
Profit tax paid	(2,350)	(1,312)
Net cash flows from operating activities	1,896	896

24. FINANCIAL RISKS MANAGEMENT

(a) Credit risk

Financial assets, which potentially subject Group entities to credit risk, consist primarily of accounts receivable and cash and cash equivalents.

The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable represents the maximum amount exposed to credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision already recorded.

At 30 June 2004, the Group had significant cash balances in two banks (see Note 4). Cash is placed in financial institutions, which are considered at the time of the deposit to have minimal risk of default.

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(b) Foreign exchange risk

The Group exports production to European and other countries and attracts a substantial amount of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated liabilities (see notes 10 and 11) give rise to foreign exchange exposure.

The Group does not have arrangements to mitigate the foreign exchange risks of the Group's operations.

(c) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest bearing long-term borrowings. The majority of interest rates on long-term borrowings are fixed, and are disclosed in note 10. The Group's principal interest bearing assets are current accounts opened with a number of banks (see note 4), loans issued and notes receivable (see note 7).

(d) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, and ensuring the availability of additional funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in its funding requirements by keeping committed credit lines available.

(e) Fair value estimation

The fair value of publicly traded trading and available-for-sale securities is based on quoted market prices at the balance sheet date.

The estimated fair value of financial assets carried at amortised cost is determined by discounting estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates available to the Group for similar financial instruments. Fair value of these financial assets did not materially differ from their carrying amount at 30 June 2004 and 31 December 2003. At 30 June 2004 and 31 December 2003, the fair value of financial liabilities which is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments with the same remaining maturity, did not materially differ from the carrying amount of these financial liabilities (note 10).

The carrying amounts of financial assets and liabilities with maturity of less than one year are assumed to approximate their fair values.

25. CONTINGENCIES, COMMITMENTS AND OTHER RISKS

(a) Operating environment

The Russian Federation continues to display some 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.

Whilst there have been improvements in the economic trends, the future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial

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and monetary measures undertaken by the government, together with tax, legal, regulatory, and political developments.

(b) Taxes

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. 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 30 June 2004 management 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.

In December 2002, based on results of a tax audit, the tax authorities filed certain claims against the Company for tax penalties totalling RR'mln 657. The Company disputed the total amount of the tax authorities' claims, as management believes the Company is in compliance with the tax legislation. In March 2004 the case was heard in the Arbitration Court of the Republic of Sakha (Yakutia). The court decided in favour of the Company. In June 2004 the appeals instance of the Arbitration Court of the Republic of Sakha (Yakutia) upheld the decision. The tax authorities disputed this decision in a higher court. The Company has not recognised these tax penalties as a liability in its financial statements because management does not anticipate that any material cash outflows will arise from this contingency liability. The status of these tax claims has not changed as of the date of these financial statements.

(c) Legal proceedings

The Group is a party to certain legal proceedings 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 adverse effect on the results of operations or financial position of the Group as at 30 June 2004, other than amounts that have been accrued in the consolidated financial statements.

(d) Insurance

The Group is assessing its policies for insuring assets and operations. At present, apart from the full insurance of movements of diamond inventory from the production location to the customers, very few assets and operations of the Group are insured and, in the instances where assets are insured, the amounts generally are not sufficient to cover all costs associated with replacing the assets.

(e) Social obligations

The Group makes contributions to mandatory and voluntary local social programmes. The Group's local infrastructure assets as well as local social programmes benefit the local communities at large and are not normally restricted to the Group's employees. The Group is negotiating the transfer of certain social assets to the local authorities; however, the Group expects to continue funding these social programmes for the foreseeable future.

AK "ALROSA"

Notes to the IFRS Consolidated Interim Financial Statements (unaudited)

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(f) Capital commitments

At 30 June 2004, the Group has contractual commitments for capital expenditures of approximately RR'mln 1,408 (31 December 2003: RR'mln 1,364).

(g) Restoration, rehabilitation and environmental costs

Under its licence agreements, the Group is not responsible for any significant restoration, rehabilitation and environmental expenditures that may be incurred subsequent to the cessation of production at each mine, apart from the obligation to return assets received under the Lease Agreement (see note 9). However, the Group is obliged to restore riverbeds and the surrounding areas. These expenses are not expected to be material to the Group and are expensed in the period incurred.

(h) Guarantees

As at 30 June 2004, the Group has guaranteed a US Dollar-denominated loan issued by the National Bank of Republic of Belarus to AKB "Rosbank", totalling RR'mln 726. Management of the Company does not expect the Group to incur any outflow of economic resources or economic benefits in connection with this guarantee.

(i) Trade agreement with De Beers

On 17 December 2001, a trade agreement between the Company and De Beers was signed, covering the period from 1 January 2002 to 31 December 2006. Pursuant to this agreement, the Company agreed to sell and De Beers agreed to buy up to US\$m 800 in value of the Company's annual diamond production at the current market prices. To be legally enforceable, this agreement requires the regulatory permission of the European Commission. Currently, the Company is in the process of negotiating the resolution of certain objections raised by the European Commission. Management of the Company believes that the result of these negotiations will be favourable for the Group.

In addition, the European Commission could seek to impose fines of up to 10 per cent. of the Company's sales in respect of the Company's previous trade agreements with De Beers, which were not notified to the European Commission. Management of the Company does not anticipate that any material liabilities will arise from this contingent liability.

26. RELATED PARTY TRANSACTIONS

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions, which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The Company's principal shareholders are the Russian Federation and the Republic of Sakha (Yakutia). IAS 24 specifically excludes government departments and agencies in the course of their normal dealings with enterprise and government controlled entities from the definition of related parties, and therefore transactions under those exemptions between, and balances due to or from entities, under government or other state control and government departments and agencies in the course of their normal dealings and the Group's companies are not detailed in this note.

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Information related to the Lease Agreement with the Republic of Sakha (Yakutia) is disclosed in notes 9 and 12.

Remuneration to the members of Supervisory Council and Management Board of the Company incurred during six months ended 30 June 2004 totalled RR'mln 92 (six months ended 30 June 2003: RR'mln 94).

Significant related party transactions are summarised as follows:

Long-term accounts receivable	30 June 2004 (unaudited)	31 December 2003
OAo "Sobinbank" and its affiliates, receivable secured by the loan payable.....	670	670
OAo "Yuzhno-Verkhoyanskaya Gornaya Company", an associated undertaking	224	—
	<u>894</u>	<u>670</u>

Current accounts receivable	30 June 2004 (unaudited)	31 December 2003
Catoca Mining Company Ltd., an associated undertaking (see note 3)	403	2
OAo "Yuzhno-Verkhoyanskaya Gornaya Company", an associated undertaking	354	391
OAo "Tuymaada Diamond"	171	174
ZAO PIC "Orel Almaz", an associated undertaking	164	167
Other	161	97
Less: provision for bad debt	(301)	(307)
	<u>952</u>	<u>524</u>

Loans provided by related parties:

Name of bank	Interest rate	30 June 2004 (unaudited)	31 December 2003
OAo "Sobinbank" (RR-denominated)	20-25 per cent.	670	675
		<u>670</u>	<u>675</u>

The Group owns a 6 per cent. interest in OAo "Sobinbank" at 30 June 2004 (at 31 December 2003 — 15 per cent.) and a 13 per cent. interest in OAo "Tuymaada — Diamond" at 30 June 2004 (at 31 December 2003 — 13 per cent.). The Group's management are members of the Board of Directors of these companies.

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27. SIGNIFICANT NON-CASH TRANSACTIONS

	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Non-cash investing activities:		
Inventory used in construction	(990)	(1,113)
Purchase of property, plant and equipment	—	(337)
Other	(151)	132
	<u>(1,141)</u>	<u>(1,318)</u>
Non-cash financing activities:		
Commercial paper issuance	233	259
Commercial paper and loans redemption	(354)	(867)
	<u>(121)</u>	<u>(608)</u>

28. SEGMENT INFORMATION

The Group has one reportable business segment, which is the production and sale of diamonds. The Group evaluates performance and makes investment and strategic decisions based upon the review of profitability for the Group as a whole. The performance measurement systems employed by the Group to review overall profitability are based on the results of the Group determined using Russian statutory accounting books and records. Russian statutory accounting differs in many significant respects from IFRS.

An analysis of revenue by type is disclosed in note 17. Revenue from sales by geographical location of the customer, and assets and capital expenditures by geographical location of the asset are as follows:

	Sales		Total assets		Capital expenditures	
	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)	30 June 2004 (unaudited)	31 December 2003	Six months ended 30 June 2004 (unaudited)	Six months ended 30 June 2003 (unaudited)
Russian Federation	19,435	15,650	151,148	135,009	7,303	8,685
Western Europe	8,157	9,254	—	—	—	—
Other countries	7,176	3,126	181	183	127	—
	<u>34,768</u>	<u>28,030</u>	<u>151,329</u>	<u>135,192</u>	<u>7,430</u>	<u>8,685</u>
Associated undertakings.....	—	—	811	900	—	—
Unallocated assets	—	—	236	277	—	—
Total	<u>34,768</u>	<u>28,030</u>	<u>152,376</u>	<u>136,369</u>	<u>7,430</u>	<u>8,685</u>

Sales to De Beers are included in the Western Europe geographical segment.

The Group has one individual customer, De Beers, that accounted for 22 per cent. of its sales during the six months ended 30 June 2004 (six months ended 30 June 2003: 31 per cent.).

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Notes to the IFRS Consolidated Interim Financial Statements (unaudited)

(in millions of Russian roubles, unless otherwise stated)

29. POST BALANCE SHEET EVENTS

Contingencies

In July 2004, the Constitutional Court of the Russian Federation made publicly available a recently issued interpretation of existing VAT legislation that has the possible effect of denying the recovery of input VAT or deferring the point at which the Company is able to offset input VAT to the extent the arising of such VAT is deemed to be attributable to the utilisation of funds other than own funds (e.g., borrowings or funds received free of charge). In the event that local taxation authorities would follow this decision and are successful in any challenge, the result, which is not practicable to determine, could have a material adverse impact on the Company's financial condition. Management is unable to predict the outcome of this uncertainty as of the date of issuing these financial statements.

Borrowings

In September 2004 the Group received RR'mln 2,903 as the first tranche of an unsecured syndicated loan from Citibank and *Société Generale* totalling US\$m 300 due for repayment in 2007, with an interest rate of LIBOR plus 3.25 per cent. per annum.

AUDITORS' REPORT
to the Shareholders and Supervisory Council of
Closed Joint Stock Company AK "ALROSA"

1. We have audited the accompanying consolidated balance sheets of Closed Joint Stock Company AK "ALROSA" (the "Company") and its subsidiaries (the "Group") as of 31 December 2003 and 2002, and the related consolidated statements of income, of cash flows and of changes in shareholders' equity for the years then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.
2. We conducted our audit in accordance with International Standards on Auditing. 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 consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
3. In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial positions of the Group as of 31 December 2003 and 2002, and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Moscow, Russian Federation

23 July 2004

AK "ALROSA"

IFRS Consolidated Financial Statements

(in millions of Russian roubles, unless otherwise stated)

IFRS Consolidated Balance Sheet

	Notes	31 December 2003	31 December 2002	31 December 2001
Assets				
Non-current Assets				
Restricted cash	4	340	194	394
Investments in associated undertakings.....	3	900	901	606
Available-for-sale investments.....	3	1,187	1,427	2,282
Long-term accounts receivable.....	7	2,339	1,682	1,873
Property, plant and equipment.....	5	104,443	96,440	84,072
Total Non-current Assets		109,209	100,644	89,227
Current Assets				
Restricted cash	4	—	214	—
Inventories	6	15,796	13,639	13,582
Trade and other receivables	7	7,235	8,524	8,909
Prepaid profit tax		277	210	755
Available-for-sale investments.....		505	383	—
Cash and cash equivalents	4	3,347	2,997	1,721
Total Current Assets.....		27,160	25,967	24,967
Total Assets.....		136,369	126,611	114,194
Shareholders' Equity				
Share capital	8	11,491	11,491	11,491
Retained earnings.....		49,813	44,157	42,304
Total Shareholders' Equity		61,304	55,648	53,795
Grant	9	10,498	11,560	12,798
Minority Interest		3,035	2,974	2,563
Liabilities				
Non-current Liabilities				
Long-term debt.....	10	24,684	15,903	7,651
Provision for restoration liability.....	12	5,394	2,743	3,047
Provision for pension obligations.....	13	1,963	1,268	554
Other provisions	15	1,215	—	—
Deferred tax liabilities.....	16	2,466	4,186	2,562
Total Non-current Liabilities		35,722	24,100	13,814
Current Liabilities				
Short-term loans and current portion of long-term debt	11	13,883	19,970	19,295
Trade and other payables	14	9,122	8,912	6,868
Taxes payable.....	16	2,758	3,321	4,812
Dividends payable		47	126	249
Total Current Liabilities.....		25,810	32,329	31,224
Total Liabilities		61,532	56,429	45,038
Total Shareholders' Equity, Grant, Minority Interest and Liabilities.....		136,369	126,611	114,194

Signed by the following members of management:

Vladimir T. Kalitin
President, Chairman of the Board

Olga A. Lyashenko
Chief Accountant

23 July 2004

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

AK "ALROSA"

IFRS Consolidated Financial Statements

(in millions of Russian roubles, unless otherwise stated)

IFRS Consolidated Statement of Income

	Notes	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Sales	17	60,004	59,119	67,048
Cost of sales.....	18	(29,818)	(31,106)	(31,879)
Royalty	9	(9,096)	(8,166)	(10,504)
Gross profit		21,090	19,847	24,665
General and administrative expenses	19	(2,881)	(3,101)	(2,519)
Other operating income	20	2,238	1,953	1,716
Other operating expenses	21	(10,294)	(10,079)	(9,033)
Operating Profit		10,153	8,620	14,829
Finance costs, net	22	(4,103)	(4,914)	(5,004)
Income from associated undertakings	3	400	497	289
Monetary gain	2(a)	—	3,702	3,792
Exchange gains (losses), net		1,910	(813)	(856)
Profit before Profit Tax		8,360	7,092	13,050
Profit tax	16	(1,718)	(4,274)	(1,804)
Profit after Profit Tax		6,642	2,818	11,246
Minority interest		(286)	(327)	(293)
Net Profit for the Year		6,356	2,491	10,953

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

AK "ALROSA"

IFRS Consolidated Financial Statements

(in millions of Russian roubles, unless otherwise stated)

IFRS Consolidated Statement of Cash Flows

	Notes	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Net Cash Inflow from Operating Activities	23	9,997	11,584	10,520
Cash Flows from Investing Activities				
Purchase of property, plant and equipment		(11,919)	(16,726)	(12,200)
Proceeds from sales of fixed assets		815	49	—
Acquisition of available-for-sale investments		(191)	(392)	(23)
Proceeds from sale of available-for-sale investments		238	—	433
Interest received		348	147	114
Dividends received from associated undertakings		392	385	306
Net Cash Outflow from Investing Activities		(10,317)	(16,537)	(11,370)
Cash Flows From Financing Activities				
Repayment of loans		(56,373)	(49,558)	(35,213)
Loans received		61,853	61,685	40,914
Interest paid		(4,100)	(4,783)	(3,867)
Receipt from (payment to) restricted cash account		68	(14)	(30)
Dividends paid		(778)	(761)	(266)
Net Cash Inflow from Financing Activities		670	6,569	1,538
Effects of inflation on cash and cash equivalents		—	(340)	(264)
Net Increase in Cash and Cash Equivalents		350	1,276	424
Cash and cash equivalents at the beginning of the year		2,997	1,721	1,297
Cash and Cash Equivalents at the End of the Year		3,347	2,997	1,721

Significant non-cash transactions are discussed in note 27.

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

AK "ALROSA"

IFRS Consolidated Financial Statements

(in millions of Russian roubles, unless otherwise stated)

IFRS Consolidated Statement of Changes in Shareholders' Equity

	Share capital	Retained earnings	Total
Balance at 1 January 2001 as previously reported	11,491	31,447	42,938
Effect of adopting IAS 39, net of profit tax (note 2(a)).....	—	399	399
Balance at 1 January 2001 as restated	11,491	31,846	43,337
Dividends (note 8)	—	(495)	(495)
Net profit for the year ended 31 December 2001	—	10,953	10,953
Balance at 31 December 2001	11,491	42,304	53,795
Dividends (note 8)	—	(638)	(638)
Net profit for the year ended 31 December 2002	—	2,491	2,491
Balance at 31 December 2002	11,491	44,157	55,648
Dividends (note 8)	—	(700)	(700)
Net profit for the year ended 31 December 2003	—	6,356	6,356
Balance at 31 December 2003	11,491	49,813	61,304

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

AK "ALROSA"

Notes to the IFRS Consolidated Financial Statements

(in millions of Russian roubles, unless otherwise stated)

1. ACTIVITIES

The core activities of Closed Joint Stock Company AK "ALROSA" (the "Company") and its subsidiaries (the "Group") are the exploration and extraction of diamond reserves and the marketing and distribution of raw and cut diamonds. The Company was registered on 13 August 1992 as a closed joint stock company in the Republic of Sakha (Yakutia), which is located within the Russian Federation. The Group operates mining facilities in Mirny, Udachny, Aikhal, Nyurba and Anabar (located in Eastern Siberia) and had 46,998 employees as at 31 December 2003 (31 December 2002: 48,757 employees, 31 December 2001: 47,680). The Company is subject to special legislation issued by the Russian Federation and the Republic of Sakha (Yakutia), which significantly influences the Company's core operating activities. This legislation includes, but is not limited to, the Law on State Secrets of the Russian Federation and requirements to obtain quotas for export of diamonds from the Government of the Russian Federation (note 17).

As at 31 December 2003 the Company's principal shareholders are the Russian Federation (37 per cent. of shares) and the Republic of Sakha (Yakutia) (32 per cent. of shares). The rest of the shares are held by administrations of districts of the Republic of Sakha (Yakutia) (8 per cent. of shares) and individuals (23 per cent. of shares).

2. ACCOUNTING POLICIES

(a) Basis of presentation

Group companies incorporated in Russia maintain their statutory accounting records and prepare statutory financial reports in accordance with the Regulations on Accounting and Reporting of the Russian Federation and their measurement currency is the Russian rouble ("RR"). Group companies incorporated in other countries maintain their statutory accounting records in accordance with relevant legislation and in the appropriate measurement currency. The accompanying consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of available-for-sale investment securities and financial assets held-for-trading. The consolidated financial statements are based on the statutory accounting records, with adjustments and reclassifications for the purpose of presentation in accordance with International Financial Reporting Standards ("IFRS"), including International Accounting Standards and Interpretations issued by the International Accounting Standards Board.

Prior to 1 January 2003 the adjustments and reclassifications made to the statutory records for the purpose of IFRS presentation included the restatement of balances and transactions for the changes in the general purchasing power of the RR in accordance with IAS 29 *"Financial Reporting in Hyperinflationary Economies"* ("IAS 29"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation has ceased, effective from 1 January 2003 the Group no longer restates its financial statements in accordance with IAS 29. Accordingly, the amounts expressed in the measuring unit current at 31 December 2002 are treated as the basis for the carrying amounts in these financial statements.

Corresponding figures, for the years ended 31 December 2002 and 31 December 2001 were restated for the changes in the general purchasing power of the RR at 31 December 2002. The restatement was calculated using the conversion factors derived from the Russian Federation Consumer Price Index, published by the Russian State Committee on Statistics, and from indices obtained from other sources for years prior to 1992. The indices used to restate corresponding figures, based on 1988 prices (1988 = 100), and the respective conversion factors for the five years ended 31 December 2002, are:

AK "ALROSA"

Notes to the IFRS Consolidated Financial Statements

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Year	Index	Conversion factors
1998	1,216,400	2.24
1999	1,661,481	1.64
2000	1,995,937	1.37
2001	2,371,572	1.15
2002	2,730,154	1.00

The significant guidelines followed in restating the corresponding figures were:

- all corresponding amounts were stated in terms of the measuring unit current at 31 December 2002;
- monetary assets and liabilities held at 31 December 2002 were not restated because they were already expressed in terms of the monetary unit current at 31 December 2002;
- non-monetary assets and liabilities (those balance sheet items that were not expressed in terms of the monetary unit current at 31 December 2002) and components of shareholders' equity were restated from their historical cost by applying the change in the general price index from the date the non-monetary item originated to 31 December 2002;
- all items in the consolidated statements of income and cash flows were restated by applying the change in the general price index from the dates when the items were initially transacted to 31 December 2002;
- gains or losses that arose as a result of holding monetary assets and liabilities for the reporting year ended 31 December 2002 were included in the consolidated statement of income as a monetary gain or loss.

The Group has adopted IAS 39, *"Financial Instruments: Recognition and Measurement"* ("IAS 39"), which is effective for accounting periods beginning on or after 1 January 2001. The financial impact of adopting this standard was reported in the consolidated statement of changes in shareholders' equity as an adjustment to opening equity as at 1 January 2001.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as at the date of the consolidated financial statements, and the reported amount of revenues and operating costs during the reporting period. The most significant estimates relate to realisation of inventories, investments, allowance for bad and doubtful accounts receivable, deferred taxation, reserve estimates used to calculate depreciation, pension and other post-retirement benefit costs and the evaluation of the provision for restoration liability. Actual results could differ from these estimates.

In 2003, the Group adopted the IFRIC Interpretation 1, *"Changes in Existing Decommissioning, Restoration and Similar Liabilities"* ("IFRIC 1") early. Adoption of IFRIC 1 had no impact on opening retained earnings at 31 December 2002 and has not resulted in a change in the accounting policy relating to changes in the provision for restoration liability as the Group was applying an accounting policy which is consistent with the one prescribed by IFRIC 1.

Certain amounts have been reclassified in the comparative financial information for the years ended 31 December 2002 and 2001 to conform to the current year presentation. Cost of sales for the years ended 31 December 2002 and 2001 have been increased by RR'mln 4,460 and RR'mln 6,312, respectively, as a result of reclassification of the extraction tax from other operating expenses. This reclassification better reflects the nature of these costs. Other operating expenses for the years ended 31 December 2002 and 2001 have also been decreased by RR'mln 8,166 and RR'mln 10,504, respectively, due to presenting the royalty as a separate line in the statement of income. This change has been made in order to present the

AK "ALROSA"

Notes to the IFRS Consolidated Financial Statements

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information about the Group's activity in a format considered to be more useful to the users of the consolidated financial statements.

(b) Principles of consolidation

The Group comprises the Company and its subsidiaries. The effects of transactions between subsidiaries within the Group are eliminated and accounting policies of the subsidiaries and associated undertakings are conformed to those of the Company.

A subsidiary is an entity in which the Group has an interest of more than one half of the voting rights or otherwise has the power to exercise control over the operations.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases.

For subsidiaries that are not wholly owned, the minority interest at the balance sheet date represents the minority shareholders' portion of the pre-acquisition carrying amounts of the identifiable assets and liabilities of the subsidiary at the acquisition date, and the minority shareholders' portion of movements in equity since the date of the combination. Minority interest is presented separately from liabilities and shareholders' equity on the face of the consolidated balance sheet.

Associated undertakings over which the Group has a significant but not a controlling influence, are accounted for using the equity method. Significant influence is usually evidenced by the Group owning, directly or indirectly, between 20 per cent. and 50 per cent. of the voting share capital.

Equity accounting is discontinued when the carrying amount of the investment in an associated undertaking reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated undertaking.

(c) Grant

Production assets received from the Republic of Sakha (Yakutia) on 19 January 1993 under the terms of a mineral lease agreement (the "Lease Agreement") to "transfer of rights to use and exploit land, diamond deposits, main production and non-production facilities", are recorded in accordance with IAS 20, "Accounting for Government Grants and Disclosure of Government Assistance", at historical amounts adjusted for the effects of inflation, with a corresponding credit reflected as a Grant in the Group's balance sheet. The Grant is amortised in line with the reduction in the carrying value of the underlying assets, with the amortised portion recorded as an increase in income (see note 9).

Social assets received under the aforementioned Lease Agreement have not been included in the accompanying consolidated financial statements, since the majority of these assets have been or will be transferred free of charge to local administrations.

(d) Property, plant and equipment

Property, plant and equipment comprise costs incurred in developing areas of interest as well as the costs related to the construction and acquisition of mining assets. Expenditure related to geophysical analysis is expensed until it is determined to be probable that economically recoverable reserves exist.

At each reporting date, management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's net selling price and its value in use, the carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) in the statement of income. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

AK "ALROSA"

Notes to the IFRS Consolidated Financial Statements

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Depreciation and amortisation

Property, plant and equipment are depreciated upon commencement of commercial mining activities at a specific area of interest.

Depreciation and amortisation of buildings, land and improvements and plant and equipment related to extraction of minerals is calculated on a units of production basis for each area of interest over its expected useful life.

Depreciation of assets not directly associated with production is calculated on a straight line basis over its estimated useful life.

Summary of useful lives and alternative basis for depreciation:

	Assets related to extraction of minerals	Other assets
Buildings.....	Units of production	8-50 years
Land and improvements.....	Units of production	7-50 years
Plant and equipment.....	Units of production	4-13 years
Transport	5-13 years	5-13 years
Other	4-17 years	4-17 years

Disposals and retirement

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the balance sheet along with the corresponding accumulated depreciation (if any). Any gain or loss resulting from such retirement or disposal is included in the consolidated statement of income.

Repair and maintenance costs

Maintenance and repairs are expensed as incurred.

Local infrastructure assets

Local infrastructure assets constructed or purchased by the Group subsequent to 1 January 1993 (the date of privatisation) are included in the financial statements at historical cost adjusted for the effects of inflation and depreciated during their useful lives as set out above. These assets are an integral part of the Group's production activities.

(e) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions are reassessed at each reporting date, and are included in the consolidated financial statements at their expected net present values using discount rates appropriate to the Group in the economic environment in the Russian Federation at each balance sheet date.

The provision for restoration liability is determined based on the terms of the Lease Agreement (see note 9). Under this agreement, in the year 2017 the Company is obliged to transfer property, plant and equipment subject to the Lease Agreement to the Republic of Sakha (Yakutia) or settle its liability by means of a cash payment. The initial provision for restoration liability together with any changes in estimation of the ultimate restoration liability is recorded on the balance sheet, with a corresponding amount recorded as part of property, plant and equipment in accordance with IAS 16, "Property, Plant and Equipment" (revised 1998). This amount is amortised over the shorter of the term of the Lease Agreement and the useful life of the relevant property.

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Changes in the provision for restoration liability resulting from the passage of time are reflected in the consolidated statement of income each period under finance costs. Other changes in the provision, relating to a change in the discount rate applied, in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change. The effects of such changes are added to, or deducted from, the cost of the related asset.

(f) Inventories

Inventories of diamonds, extracted ore and concentrates, mining and construction stores and consumable supplies are valued at the lower of the weighted average cost or net realisable value.

Cost of extracted ore and concentrates is calculated using the quantities determined based on surveyors' measurements of the volumes of ore and concentrates remaining at the period end. Cost of inventories include those directly attributable to mining the diamonds, extracting the ore and producing concentrates, and those directly attributable to bringing mining and construction stores and consumable supplies to their present location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

(g) Investments

In accordance with IAS 39 *"Financial Instruments: Recognition and Measurement"* investments are classified into the following categories: trading, held-to-maturity or available-for-sale. Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments and included in current assets. Investments with a fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets. During the period, the Group did not hold any investments classified as trading or held-to-maturity. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and evaluates such designation on a regular basis.

All purchases and sales of investments are recognised on the settlement date, which is the date that the investment is delivered to or by the Group. Cost of purchase includes transaction costs. Trading and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective yield method. Realised and unrealised gains and losses arising from changes in the fair value of trading investments and of available-for-sale investments are included in the statement of income in the period in which they arise.

Since the majority of the Group's investments are not publicly traded and no reliable method of fair value estimation exists for those investments, these investments are excluded from fair value valuation.

Those financial assets that are excluded from fair valuation and that have a fixed maturity are measured at amortised cost using the effective interest rate method less impairment. Those that do not have a fixed maturity date are measured at cost less impairment.

Unquoted available-for-sale equity investments are reviewed for impairment losses at every balance sheet date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When a review for impairment is conducted, the recoverable amount is assessed by reference to the net present value of expected future cash

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inflows. The discount rate applied is based upon the Group's weighted average cost of capital with appropriate adjustment for the risks associated with the investment under assessment. When the level of information available to calculate the net present value of expected future cash inflows makes this exercise unworkable, management uses different valuation techniques to estimate whether there is objective evidence of impairment and to determine the likely amount of impairment, if any.

(h) Components of cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks with a maturity at the date of inception of less than three months, which are considered by the Group at the time of deposit to have minimal fair value and default risks.

(i) Deferred taxes

Deferred tax is calculated at rates enacted or substantively enacted at the balance sheet date, using the liability method, for all temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. The principal temporary differences arise from application in previous periods of IAS 29, depreciation on property, plant and equipment and provisions and expenses, which are charged to the consolidated statement of income before they become deductible for tax purposes.

Deferred tax liabilities are recognised in respect of all taxable temporary differences relating to investments in subsidiaries, unless the Group is able to control the timing of the reversal of the temporary difference and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax assets attributable to temporary differences, unused tax losses and credits are recognised only to the extent that it is probable that future taxable profit will be available against which they can be utilised.

Deferred tax assets and liabilities are offset when the Group has a legally enforceable right to set off current tax assets against current liabilities, when deferred tax balances relate to the same regulatory body (i.e., federal or republic), and when they relate to the same jurisdiction and taxable entity.

(j) Foreign currencies

Transactions denominated in foreign currencies are recorded, on initial recognition, in the measurement currency, by applying the exchange rate between the measurement currency and the foreign currency at the date of the transaction. Outstanding foreign currency monetary items at the balance sheet date are reported at the closing rate. Non-monetary items which are carried in terms of historical cost denominated in a foreign currency are reported using the exchange rate at the date of the transaction, and non-monetary items which are carried at fair value denominated in a foreign currency are reported using the exchange rates that existed when the values were determined.

Exchange differences arising on the settlement of monetary items or reporting monetary items at rates different from those at which they were initially recorded are recognised in the statement of income in the period in which they arise.

(k) Revenue recognition

Revenues are recognised when goods are shipped to the customer, as this is the date on which the risks and rewards of ownership are transferred to the customer. Sales are shown net of VAT and export duties, and after eliminating sales within the Group.

Revenue from rendering of transport services is recognised in financial statements in the period when the services are rendered.

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Interest income is recognised on a time proportion basis that takes into account the effective yield on the asset.

Dividend income is recognised when the shareholder's right to receive payment is established.

(l) Measurement of trade and other receivables

Trade and other receivables are carried at original invoice amount including VAT less provision made for impairment of these receivables. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected future cash flows, discounted at the market rate of interest for similar borrowers.

(m) Value added taxes

In the consolidated balance sheet and the consolidated statement of cash flows, transactions and balances are presented inclusive of the associated VAT applicable under the legislation of the relevant jurisdiction in which the transaction occurred.

(n) Borrowings

Borrowings are recognised initially at cost, which is the fair value of the proceeds received (which is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price), net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised as interest expense over the period of the borrowings.

Borrowing costs are expensed as incurred.

(o) Pension and other post-retirement benefits

In the normal course of business the Group contributes to the Russian Federation State pension plan on behalf of its employees. Mandatory contributions to the State pension plan, which is a defined contribution plan, are expensed when incurred and are included within wages, salaries and other staff costs in cost of sales.

The Group operates a defined benefit pension plan. Pension costs are recognised using the projected unit credit method. The cost of providing pensions is charged to cost of sales within the consolidated statement of income so as to spread the regular cost over the service lives of employees. The pension obligation is measured at the present value of the estimated future cash outflows using the interest rates on governmental securities, which have the terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognised over the average remaining service life of employees.

The Group owns and controls Pension Fund Almaznaya Osen, which administers the Group's defined benefit plan. The assets of Pension Fund Almaznaya Osen primarily consist of commercial paper and non-convertible bonds of the Company and its subsidiaries and other accounts receivable due from the Company. The parent/subsidiary relationship between the Group and Pension fund Almaznaya Osen means that the assets held by pension fund Almaznaya Osen do not meet the definition of plan assets and are eliminated in the consolidated balance sheet as intercompany balances.

(p) Social obligations

Social costs relating to the maintenance of housing are determined in accordance with agreements with the local authorities and expensed or capitalised as appropriate.

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Discretionary and voluntary payments made to fund and support social programmes and related operations are expensed as incurred.

(q) Non-cash transactions

Non-cash transactions are measured at the fair value of the consideration received or receivable. When it is not possible to measure reliably the fair value of the consideration received or receivable, non-cash transactions are measured at the fair value of the consideration given.

Non-cash transactions have been excluded from the operating, investing and financing activities components in the accompanying consolidated statement of cash flows.

(r) Share capital

Share capital consists of ordinary shares, which are classified as equity.

(s) Segment reporting

Business segments (primary segments) provide products or services that are subject to risks and returns that are different from those of other business segments. Geographical segments (secondary segments) provide products or services within a particular economic environment that is subject to risks and returns that are different from those of components operating in other economic environments.

3. GROUP STRUCTURE AND INVESTMENTS

The Company's significant consolidated subsidiaries and associated undertaking are as follows:

Name	Country of Incorporation	Percentage of voting interest held		
		31 December 2003	31 December 2002	31 December 2001
Consolidated Subsidiaries				
ALROSA Finance S.A.....	(1) Luxembourg	100	—	—
ZAO Irelyakhneft	Russia	100	100	100
Pension Fund Almaznaya Osen	Russia	97	97	97
OAO Severalmaz.....	(2) Russia	92	72	72
OAO Viluygesstroy	Russia	90	90	90
OOO MAK-Bank	Russia	88	85	85
OAO ALROSA-Nyurba	Russia	87	87	88
OAO Viluyskaya GES-3	(3) Russia	72	66	66
OAO ALROSA-Gas.....	(4) Russia	53	53	48
OAO Investment Group ALROSA....	(5) Russia	50	50	50
Associated Undertaking				
Catoca Mining Company Ltd	(6) Angola	33	33	33

(1) In April 2003 the Group established the special purpose entity ALROSA Finance S.A., which is registered in Luxembourg, for the purpose of making Eurobond offering.

(2) In June and November 2003 the Group increased its shareholding in OAO Severalmaz to 92 per cent. through additional cash contributions of RR'mln 410.

(3) In July and December 2003 the Group increased its shareholding in OAO Viluyskaya GES-3 to 72 per cent. through additional cash contributions of RR'mln 844.

(4) The effective holding of the Group in OAO ALROSA-Gaz did not exceed 50 per cent. at 31 December 2001; however, it was considered a subsidiary as the Group exercised control over its operations through majority membership in the Board of Directors.

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- (5) The Group owned 50.01 per cent. of voting interest in OAO Investment Group ALROSA at 31 December 2003, 2002 and 2001.
- (6) Catoca Mining Company Ltd is a diamond-mining company located in Angola. The investment in this associated undertaking was accounted for by the Group using the equity method. Income of RR'mln 400 was included in the Group's financial statements for the year ended 31 December 2003 (2002: RR'mln 497; 2001: RR'mln 289). In April 2003 Catoca Mining Company Ltd declared dividends for the year ended 31 December 2002; the Group's share of these dividends amounted to RR'mln 392. The Group's share of the net assets of Catoca Mining Company Ltd included in these financial statements is RR'mln 792 as at 31 December 2003 (2002: RR'mln 784; 2001: RR'mln 489).

Non-current available-for-sale investments

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Available-for-sale investments at the beginning of the year	1,427	2,282	2,371
Additions	69	12	166
Disposals	(339)	(324)	(753)
Change in provision for impairment of available-for-sale investments (note 21)	30	(543)	498
Available-for-sale investments at the end of the year	<u>1,187</u>	<u>1,427</u>	<u>2,282</u>

4. CASH AND CASH EQUIVALENTS AND RESTRICTED CASH

Cash and cash equivalents

As at 31 December 2003, the cash and cash equivalents balance mainly represents current accounts of the Group on which the weighted average interest rate is 2 per cent. (31 December 2002: nil per cent.; 31 December 2001: nil per cent.).

Restricted cash

Included within the non-current portion of restricted cash are balances of RR'mln 205, RR'mln 82 and RR'mln 303 as at 31 December 2003, 31 December 2002 and 31 December 2001, respectively, which represent deposit accounts held with J.P. Morgan Chase Bank, Vneshtorgbank and the Bank of New York. The Group is required to maintain a balance equal to the amount of its next scheduled principal and interest payment in accordance with its loan agreements with these banks.

The remaining RR'mln 135 as at 31 December 2003 (31 December 2002: RR'mln 112; 31 December 2001: RR'mln 91) represents mandatory reserve deposits held with the Central Bank of the Russian Federation by MAK-Bank, a consolidated subsidiary; these balances are not available for use in the Group's day to day operations.

The current portion of restricted cash of RR'mln 214 as at 31 December 2002 represented a deposit account held with the Bank of New York. The Group was required to maintain a balance equal to the amount of its next scheduled principal and interest payment in accordance with a loan agreement with that bank. The loan was fully repaid by the Group in October 2003, and the deposit account was closed.

At 31 December 2003, 2002 and 2001 the weighted average interest rate on the restricted cash balance is approximately nil per cent.

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5. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Land improve- ment	Plant and equipment	Transport	Assets under construction	Other	TOTAL
Cost at 31 December 2000	34,026	31,208	19,033	13,532	14,763	508	113,070
Additions through acquisition of subsidiaries	—	109	98	42	2,523	43	2,815
Additions	358	302	2,571	1,283	13,013	199	17,726
Transfers	1,309	559	366	7	(2,293)	52	—
Disposals	(553)	(3,269)	(555)	(592)	(610)	(193)	(5,772)
Change in estimate of provision for restoration liability (see note 12)	(419)	(170)	(40)	(4)	—	(1)	(634)
Cost at 31 December 2001	<u>34,721</u>	<u>28,739</u>	<u>21,473</u>	<u>14,268</u>	<u>27,396</u>	<u>608</u>	<u>127,205</u>
Additions through acquisition of subsidiaries	24	5	10	—	7	3	49
Additions	783	106	1,348	1,327	16,399	153	20,116
Transfers	3,527	3,024	1,737	4	(8,307)	15	—
Disposals	(684)	(431)	(432)	(882)	(830)	(116)	(3,375)
Change in estimate of provision for restoration liability (see note 12)	(414)	(150)	(28)	(5)	—	(2)	(599)
Impairment of property, plant and equipment	—	—	—	—	(627)	—	(627)
Cost at 31 December 2002	<u>37,957</u>	<u>31,293</u>	<u>24,108</u>	<u>14,712</u>	<u>34,038</u>	<u>661</u>	<u>142,769</u>
Additions through acquisition of subsidiaries	45	1	39	2	3	4	94
Additions	273	194	1,872	1,401	11,345	490	15,575
Transfers	6,528	3,999	3,288	292	(14,183)	76	—
Disposals	(1,446)	(463)	(1,052)	(989)	(1,744)	(390)	(6,084)
Change in estimate of provision for restoration liability (see note 12)	1,570	570	107	17	—	2	2,266
Reversal of impairment of property, plant and equipment	—	—	—	—	74	—	74
Cost at 31 December 2003	<u>44,927</u>	<u>35,594</u>	<u>28,362</u>	<u>15,435</u>	<u>29,533</u>	<u>843</u>	<u>154,694</u>
Accumulated Depreciation at 31 December 2000	(12,116)	(14,718)	(8,492)	(7,046)	—	(103)	(42,475)
Charge for the year	(854)	(1,148)	(2,008)	(1,237)	—	(24)	(5,271)
Disposals	413	3,217	488	487	—	8	4,613
Accumulated depreciation at 31 December 2001	(12,557)	(12,649)	(10,012)	(7,796)	—	(119)	(43,133)
Charge for the year	(882)	(894)	(2,348)	(1,215)	—	(99)	(5,438)
Disposals	626	422	334	836	—	24	2,242
Accumulated depreciation at 31 December 2002	(12,813)	(13,121)	(12,026)	(8,175)	—	(194)	(46,329)
Charge for the year	(1,149)	(1,265)	(2,571)	(1,417)	—	(118)	(6,520)
Disposals	777	240	789	762	—	30	2,598
Accumulated depreciation at 31 December 2003	<u>(13,185)</u>	<u>(14,146)</u>	<u>(13,808)</u>	<u>(8,830)</u>	<u>—</u>	<u>(282)</u>	<u>(50,251)</u>
Net book value at 31 December 2000	<u>21,910</u>	<u>16,490</u>	<u>10,541</u>	<u>6,486</u>	<u>14,763</u>	<u>405</u>	<u>70,595</u>
Net book value at 31 December 2001	<u>22,164</u>	<u>16,090</u>	<u>11,461</u>	<u>6,472</u>	<u>27,396</u>	<u>489</u>	<u>84,072</u>
Net book value at 31 December 2002	<u>25,144</u>	<u>18,172</u>	<u>12,082</u>	<u>6,537</u>	<u>34,038</u>	<u>467</u>	<u>96,440</u>
Net book value at 31 December 2003	<u>31,742</u>	<u>21,448</u>	<u>14,554</u>	<u>6,605</u>	<u>29,533</u>	<u>561</u>	<u>104,443</u>

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Refer to note 9 for property, plant and equipment included above which is subject to the Lease Agreement with the Republic of Sakha (Yakutia).

6. INVENTORIES

	31 December 2003	31 December 2002	31 December 2001
Diamonds.....	5,245	2,554	2,796
Ores and concentrates.....	2,133	2,032	1,540
Mining and construction materials.....	7,255	7,989	8,292
Consumable supplies.....	1,163	1,064	954
	<u>15,796</u>	<u>13,639</u>	<u>13,582</u>

7. TRADE AND OTHER RECEIVABLES

	31 December 2003	31 December 2002	31 December 2001
Long-term accounts receivable			
Long-term VAT recoverable	1,214	295	608
Receivables from related parties (see note 26).....	670	721	968
Loans issued.....	189	125	160
Long-term prepaid royalty	144	174	137
Other long-term receivables and advances.....	122	367	—
	<u>2,339</u>	<u>1,682</u>	<u>1,873</u>

	31 December 2003	31 December 2002	31 December 2001
Current accounts receivable			
Taxes recoverable.....	1,859	1,901	891
Prepaid taxes, other than profit tax.....	1,055	1,454	611
Advances to suppliers	894	915	1,414
Receivables from related parties (see note 26).....	524	891	1,896
Trade receivables for supplied diamonds.....	488	490	1,629
Loans issued.....	352	353	321
Notes receivable	108	468	222
Prepayment for commercial paper redemption.....	—	273	—
Other receivables	1,955	1,779	1,925
	<u>7,235</u>	<u>8,524</u>	<u>8,909</u>

Taxes recoverable relate to input VAT incurred with respect to purchases. The amount is available for offset against future output VAT following the settlement of outstanding balances payable in relation to the inventories and services purchased.

Long-term VAT recoverable, which relates to the materials and services used for construction of property, plant and equipment, becomes available for offset against future output VAT after the respective asset is put into use.

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The prepayment for commercial paper redemption relates to receivables from a broker, which the Group intended to realise by receiving from the broker the Group's commercial paper purchased by broker from third parties.

The impairment provision offset against individual receivable balances was as follows:

	31 December 2003	Interest on impaired receivables	Bad debt written-off	Bad debt expense	31 December 2002	
Long-term accounts receivable						
Long-term VAT recoverable	—	(278)	—	—	278	
Receivables from related parties (see note 26).....	—	—	(160)	—	160	
Long-term prepaid royalty.	71	(31)	—	14	88	
	71	(309)	(160)	14	526	
Current accounts receivable						
Prepaid taxes, other than profit tax.....	46	(16)	—	(17)	79	
Receivables from related parties (see note 26).....	307	—	—	(42)	349	
Loans issued	96	—	—	—	96	
Notes receivable	251	(12)	—	47	216	
Other receivables.....	1,481	(10)	(23)	691	823	
	2,181	(38)	(23)	679	1,563	
	31 December 2002	Monetary effect	Interest on impaired receivables	Bad debt written- off	Bad debt expense	31 December 2001
Long-term accounts receivable						
Long-term VAT recoverable .	278	(24)	(58)	—	155	205
Receivables from related parties (see note 26).....	160	(28)	—	—	—	188
Long-term prepaid royalty ...	88	(11)	(31)	—	66	64
	526	(63)	(89)	—	221	457
Current accounts receivable						
Prepaid taxes, other than profit tax.....	79	(2)	—	—	67	14
Receivables from related parties (see note 26).....	349	(4)	—	—	325	28
Loans issued	96	(9)	(20)	—	125	—
Notes receivable.....	216	(37)	—	(66)	35	284
Other receivables.....	823	(38)	—	(24)	598	287
	1,563	(90)	(20)	(90)	1,150	613

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	31 December 2001	Monetary effect	Bad debt written- off	Bad debt expense	31 December 2000
Long-term accounts receivable					
Long-term VAT recoverable.....	205	—	—	205	—
Receivable from related parties (see note 26).....	188	—	—	188	—
Long-term prepaid royalty	64	—	—	64	—
	<u>457</u>	<u>—</u>	<u>—</u>	<u>457</u>	<u>—</u>
Current accounts receivable					
Prepaid taxes, other than profit tax	14	—	—	14	—
Receivables from related parties (see note 26).....	28	—	—	—	28
Notes receivable	284	—	—	284	—
Advances to suppliers	—	(2)	—	(12)	14
Other receivables.....	287	(70)	(78)	24	411
	<u>613</u>	<u>(72)</u>	<u>(78)</u>	<u>310</u>	<u>453</u>

The effective interest rates at the balance sheet dates were as follows:

	31 December 2003	31 December 2002	31 December 2001
Long-term accounts receivable			
Receivable from related parties	30%	30%	30%
Loans issued.....	17%	19%	24%
Long-term prepaid royalty	10%	18%	22%
Other long-term receivables and advances.....	—	16%	—

8. SHARE CAPITAL

	31 December 2003		31 December 2002		31 December 2001	
	Shares	Amount	Shares	Amount	Shares	Amount
Authorised, issued and fully paid ordinary share capital at RR 57,455 per share	200,000	11,491	200,000	11,491	200,000	11,491

Distributable profits

The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net profit. For the year ended 31 December 2003, 31 December 2002 and 31 December 2001, the statutory profit for the Company as reported in the published statutory reporting forms was RR'mln 9,663, RR'mln 6,474 and RR'mln 9,066, respectively. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal

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interpretation, and accordingly, management believes that at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements.

Dividends

On 30 June 2001, the Company's shareholders approved dividends for the year ended 31 December 2000 totalling RR'mln 495 (RR'mln 400 in nominal terms). Dividends per share amounted to RR 2,475 (RR 2,000 in nominal terms).

On 29 June 2002, the Company's shareholders approved dividends for the year ended 31 December 2001 totalling RR'mln 638 (RR'mln 600 in nominal terms). Dividends per share amounted to RR 3,190 (RR 3,000 in nominal terms).

On 21 June 2003, the Company's shareholders approved dividends for the year ended 31 December 2002 totalling RR'mln 700. Dividends per share amounted to RR 3,500.

9. GRANT AND ASSETS SUBJECT TO MINERAL LEASE AGREEMENT

On 19 January 1993, the Company entered into a Lease Agreement with the Republic of Sakha (Yakutia) for the "transfer of rights to use and exploit land, diamond deposits, main production and non-production facilities". This agreement has a term of 25 years and provides the Company with the right to use certain production and non-production assets for exploring, mining and operating diamond deposits. The agreement requires the Company to return the assets in 2017 and reimburse the Government of Republic of Sakha (Yakutia) for depreciation of assets. The Government in turn is required to reimburse the Company for qualifying repair and maintenance costs. The precise mechanism for determining the value and nature of the assets to be returned to the Republic of Sakha (Yakutia) under the terms of the mineral Lease Agreement is currently being negotiated between the parties.

Management has estimated the restoration liability based upon its interpretation of the Lease Agreement and, in accordance with IAS 37 "*Provisions, Contingent Liabilities and Contingent Assets*", has calculated and recorded the net present value of the restoration liability (see notes 2 (e) and 12).

The agreement stipulates that certain of its terms should be renegotiated every five years. The agreement also stipulates that the Company is subject to royalties and other taxes on the right to use the land and logging areas, disposal and burial of waste and contaminated materials and the use of mineral resources and water for industrial purposes. The main subject of the renegotiations relates to the amount and timing of royalty and other payments.

Royalty payments expensed during the year ended 31 December 2003 totalled RR'mln 9,096 (year ended 31 December 2002: RR'mln 8,166, year ended 31 December 2001: RR'mln 10,504). Ecology fund payments expensed during the year ended 31 December 2003 totalled RR'mln 856 (year ended 31 December 2002: RR'mln 734, year ended 31 December 2001: RR'mln 983).

Pursuant to an addendum to the Lease Agreement dated 22 December 2002, the Company and the Republic of Sakha (Yakutia) agreed that the royalty payments including ecology fund payments and VAT due in 2003 are fixed at RR'mln 10,680.

Pursuant to an addendum to the Lease Agreement dated 17 September 2003, the Company and the Republic of Sakha (Yakutia) agreed that the royalty payments including ecology fund payments and VAT due in 2004 are fixed at RR'mln 10,500.

Recoverable VAT related to royalty and ecology fund payments depends on the percentage of export diamond sales to the total diamond sales of the Company. The amount of such VAT for the year ended 31 December 2003 was RR'mln 728.

The carrying values of Company owned and granted assets subject to the Lease Agreement with the Republic of Sakha (Yakutia) and Grant are as follows:

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	31 December 2003	31 December 2002	31 December 2001
Assets subject to the agreement with the Republic of Sakha (Yakutia)			
Net book value of granted assets received in 1993..	10,498	11,560	12,798
Net book value of Company owned assets subsequently transferred to the lease.....	4,939	5,142	3,942
Net book value at the end of the year	15,437	16,702	16,740

10. LONG-TERM DEBT

	31 December 2003	31 December 2002	31 December 2001
Banks:			
US\$-denominated floating rate	2,843	3,496	1,321
US\$-denominated fixed rate	4,665	7,726	1,642
RR-denominated fixed rate	4,963	3,633	2,069
	12,471	14,855	5,032
Eurobonds.....	14,463	—	—
RR-denominated non-convertible bonds.....	4,870	6,720	1,957
Commercial paper	235	602	432
Other RR-denominated fixed rate loans	375	341	1,723
	32,414	22,518	9,144
Less: current portion of long-term debt (see note 11)	(7,730)	(6,615)	(1,493)
	24,684	15,903	7,651

In May 2003 "Alrosa Finance S.A.", a wholly owned subsidiary of the Group, issued Eurobonds in the amount of US\$m 500 due for repayment on 6 May 2008 with an interest rate of 8.125 per cent. per annum.

The long-term commercial paper has defined maturity dates ranging between one and 10 years, and is carried at amortised cost.

The average effective interest rates at the balance sheet dates were as follows:

	31 December 2003	31 December 2002	31 December 2001
Banks:			
US\$-denominated floating rate	5.1%	6.8%	6.9%
US\$-denominated fixed rate	10.1%	10.8%	14.8%
RR-denominated fixed rate	16.8%	18.1%	20.1%
Eurobonds.....	8.7%	—	—
RR-denominated non-convertible bonds.....	14.0%	19.3%	23.3%
Commercial paper	35.3%	30.2%	36.0%
Other RR-denominated fixed rate loans	11.4%	14.8%	16.0%

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At 31 December 2003 long-term loans had the following maturity profile:

	Within 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 years and thereafter	Total
Banks:						
US\$-denominated floating rate	971	835	261	479	297	2,843
US\$-denominated fixed rate	3,275	1,372	18	—	—	4,665
RR-denominated fixed rate..	2,433	2,000	—	—	530	4,963
Eurobonds	—	—	—	—	14,463	14,463
RR-denominated non- convertible bonds.....	1,051	3,819	—	—	—	4,870
Commercial paper.....	—	106	30	38	61	235
Other RR-denominated fixed rate loans.....	—	163	52	20	140	375
	<u>7,730</u>	<u>8,295</u>	<u>361</u>	<u>537</u>	<u>15,491</u>	<u>32,414</u>

At 31 December 2002 long-term loans had the following maturity profile:

	Within 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 years and thereafter	Total
Banks:						
US\$-denominated floating rate	902	2,208	95	47	244	3,496
US\$-denominated fixed rate	3,476	3,399	832	19	—	7,726
RR-denominated fixed rate..	671	2,702	—	—	260	3,633
RR-denominated non- convertible bonds.....	1,404	1,550	3,766	—	—	6,720
Commercial paper.....	162	74	34	2	330	602
Other RR-denominated fixed rate loans.....	—	90	—	—	251	341
	<u>6,615</u>	<u>10,023</u>	<u>4,727</u>	<u>68</u>	<u>1,085</u>	<u>22,518</u>

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At 31 December 2001 long-term loans had the following maturity profile:

	Within 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 years and thereafter	Total
Banks:						
US\$-denominated floating rate	573	383	146	146	73	1,321
US\$-denominated fixed rate	107	666	129	740	—	1,642
RR-denominated fixed rate..	687	720	—	—	662	2,069
RR-denominated non- convertible bonds.....	—	1,957	—	—	—	1,957
Commercial paper.....	—	293	37	40	62	432
Other RR-denominated fixed rate loans.....	126	390	620	391	196	1,723
	1,493	4,409	932	1,317	993	9,144

The Group has not entered into any derivative contracts in respect of its foreign currency obligations or interest rate exposure.

The carrying amounts and fair values of long-term debt were as follows:

	31 December 2003		31 December 2002		31 December 2001	
	Carrying amounts	Fair values	Carrying amounts	Fair values	Carrying amounts	Fair values
Banks	12,471	12,855	14,855	14,920	5,032	4,978
Eurobonds	14,463	14,759	—	—	—	—
Non-convertible bonds.....	4,870	4,917	6,720	6,274	1,957	2,161
Commercial paper.....	235	545	602	722	432	642
Other	375	390	341	263	1,723	1,564

Fair value of long-term debt is estimated by discounting the future contractual cash outflows at the market interest rate available to the Group at the balance sheet date.

As at 31 December 2003, long-term debt totalling RR'mln 1,283 (31 December 2002: RR'mln 7,196; 31 December 2001: RR'mln 1,755) included above was secured with the assets of the Group. As separate loan agreements do not specify individual pledged assets, the carrying amount of pledged assets is not disclosed.

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RR-denominated non-convertible bonds

	Long-term	Short-term	Total
Balance at 31 December 2000.....	—	969	969
Issuance	2,102	618	2,720
Repayment	—	(933)	(933)
Amortisation of discount	—	46	46
Monetary effect	(145)	(124)	(269)
Balance at 31 December 2001.....	1,957	576	2,533
Issuance	5,788	—	5,788
Repayment	(448)	(532)	(980)
Amortisation of discount	—	—	—
Monetary effect	(577)	(44)	(621)
Balance at 31 December 2002.....	6,720	—	6,720
Issuance	30	—	30
Repayment	(1,919)	—	(1,919)
Amortisation of discount	39	—	39
Balance at 31 December 2003.....	4,870	—	4,870

Non-convertible bonds of the Company of the 19th series totalling RR'mln 2,929 at 31 December 2003 (31 December 2002: RR'mln 2,862; 31 December 2001: RR'mln nil) and non-convertible bonds of OAO Vilyuiskaya GES-3 totalling RR'mln 1 at 31 December 2003 (31 December 2002: RR'mln 500; 31 December 2001: RR'mln nil) have fixed coupon rates of 16 per cent. and 19 per cent., respectively. Other non-convertible bonds cannot be classified with certainty as fixed or floating rate. The first coupon on these bonds is determined by the Supervisory Council of the Company and the following coupons are linked to certain indicators, such as the Central Bank of the Russian Federation refinancing rate or the yields on government bonds.

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11. SHORT-TERM LOANS AND CURRENT PORTION OF LONG-TERM DEBT

	31 December 2003	31 December 2002	31 December 2001
Banks:			
US\$-denominated floating rate	148	782	693
US\$-denominated fixed rate	4,227	8,181	9,394
RR-denominated fixed rate	207	978	700
	4,582	9,941	10,787
RR-denominated non-convertible bonds (see note 10)	—	—	576
Commercial paper	450	1,513	4,904
Other US\$-denominated fixed rate	171	974	809
Other RR-denominated fixed rate loans	950	927	726
	6,153	13,355	17,802
Add: current portion of long-term debt (see note 10)	7,730	6,615	1,493
	13,883	19,970	19,295

The average effective interest rates at the balance sheet dates were as follows:

	31 December 2003	31 December 2002	31 December 2001
Banks:			
US\$-denominated floating rate	6.2%	6.4%	10.9%
US\$-denominated fixed rate	9.5%	11.5%	13.4%
RR-denominated fixed rate	8.8%	19.4%	23.5%
RR-denominated non-convertible bonds	—	—	24.6%
Commercial paper	22.5%	29.3%	38.0%
Other US\$-denominated fixed rate	6.5%	10.3%	9.1%
Other RR-denominated fixed rate loans	2.9%	8.9%	1.0%

Exchange rate for US Dollar (US\$) effective at 31 December 2003 was RR 29.45 to US\$ 1 (31 December 2002: RR 31.78 to US\$ 1; 31 December 2001: RR 30.14 to US\$ 1).

As at 31 December 2003, short-term loans totalling RR'mln 6,825 (31 December 2002: RR'mln 11,180; 31 December 2001: RR'mln 7,492) included above were secured with the assets of the Group. As separate loan agreements do not specify individual pledged assets, the carrying amount of pledged assets is not disclosed.

Commercial paper

Commercial paper comprises unsecured notes, denominated in RR, issued by the Group to provide short- and medium-term working capital facilities. The short-term commercial paper is typically discounted non-interest bearing instrument, with defined maturity dates ranging from one month to one year and is carried at amortised cost.

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12. PROVISION FOR RESTORATION LIABILITY

	31 December 2003	31 December 2002	31 December 2001
At the beginning of the year	2,743	3,047	3,542
Change in the estimate of provision for restoration liability	2,266	(599)	(634)
Increase in the discounted amount during the year	385	295	139
At the end of the year	5,394	2,743	3,047

The provision for restoration liability represents the net present value of the estimated future obligation, upon termination of the lease, to return certain property, plant and equipment received from the Republic of Sakha (Yakutia) under the terms of the Lease Agreement (see notes 2(e) and 9). The discount rate used to calculate the net present value of the restoration liability at 31 December 2003 was 8.2 per cent. (31 December 2002: 10.5 per cent.; 31 December 2001: 12.1 per cent.), which is a pre-tax real rate and is considered appropriate to the Group in the economic environment in the Russian Federation at the balance sheet date.

Under the Lease Agreement the Company is obliged to reimburse to the Republic of Sakha (Yakutia) the amount of accumulated depreciation on property, plant and equipment subject to this agreement (leased property, plant and equipment) and the Republic of Sakha (Yakutia) is obliged to reimburse to the Company the amount of qualified repair and maintenance expense incurred by the Company in relation to the leased property, plant and equipment. The Company and the Republic of Sakha (Yakutia) determined the amount to be reimbursed by the Company on a net basis as the difference between the amount of depreciation on leased assets and the amount of repair and maintenance expense in relation to the leased property, plant and equipment. Reimbursement is effected by means of the transfer of title of certain of the Company's own items of property, plant and equipment to the Republic of Sakha (Yakutia) and these assets are, subsequent to their transfer, treated as leased property, plant and equipment (see note 9).

Prior to 1 January 2003 Republic of Sakha (Yakutia) was obliged to reimburse to the Company the actual amount of qualified repair and maintenance expense incurred by the Company in relation to the leased property, plant and equipment. Pursuant to an addendum to the Lease Agreement dated 17 September 2003, starting from 1 January 2003 the Republic of Sakha (Yakutia) is obliged to reimburse qualified repair and maintenance expense incurred by the Company, subject to such expense being limited to 30 per cent. of the depreciation on leased property, plant and equipment. This new limitation, in combination with the decrease in the discount rate, resulted in a change in the estimate of the amount of provision for restoration liability totalling RR'mln 2,266, which was added to the cost of the related assets (see note 5).

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13. PROVISION FOR PENSION OBLIGATIONS

The amounts recognised in the consolidated balance sheet are as follows:

	31 December 2003	31 December 2002	31 December 2001
Present value of obligations (unfunded).....	5,387	4,391	2,609
Unrecognised actuarial losses.....	(3,424)	(3,123)	(2,055)
Net liability	1,963	1,268	554

The amounts recognised in the statement of income are as follows:

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Current service cost.....	110	53	16
Interest cost	641	526	336
Net actuarial losses	244	337	5
Net expense recognised in the statement of income	995	916	357

Total expenses associated with pension obligations are included within wages, salaries and other staff costs within cost of sales in the consolidated statement of income.

Movements in the net liability recognised in the balance sheet were as follows:

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Net liability at the beginning of the year.....	1,268	554	466
Net expense recognised in the statement of income	995	916	357
Benefits paid	(300)	(202)	(269)
Net liability at the end of the year.....	1,963	1,268	554

Principal actuarial assumptions used:

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Discount rate (nominal).....	9%	11%	13%
Future pension increases (nominal)	9%	9%	9%
Employees' average remaining working life (years).....	11	11	11

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14. TRADE AND OTHER PAYABLES

	31 December 2003	31 December 2002	31 December 2001
Accrual for employee flights and holidays.....	3,053	2,495	1,607
Trade.....	2,757	3,885	2,626
Advances from customers.....	1,251	231	302
Wages and salaries.....	1,051	1,037	1,014
Interest payable.....	397	526	358
Payables to related parties.....	85	88	166
Other payables and accruals	528	650	795
	<u>9,122</u>	<u>8,912</u>	<u>6,868</u>

In accordance with Russian legislation, the Group entities are required to pay for the holiday entitlement and the cost of travel for employees and their family members to an agreed-upon destination and back, or a pre-determined allowance.

15. OTHER PROVISIONS

	31 December 2003	31 December 2002	31 December 2001
Provision for guarantee given.....	972	—	—
Provision for legal claim	243	—	—
	<u>1,215</u>	<u>—</u>	<u>—</u>

In April 2003 the Company guaranteed a US Dollar-denominated fixed rate loan issued by OAO "Investment Bank Trust" to ZAO "Nazymyskaya Oil and Gas Research Expedition", which is due for repayment in 2006. The Company management expects the Group to incur an outflow of economic resources in connection with this guarantee and therefore the Group has recognised a provision for the principal amount of the loan and accrued interest in the financial statements at 31 December 2003. In June 2004, ZAO "Nazymyskaya Oil and Gas Research Expedition" failed to pay the first interest installment to the bank. The Company as guarantor paid the interest installment to the bank.

Bateman Projects Limited, a South African company, and its Dutch subsidiary, Bateman International B.V. (collectively "Bateman"), outside construction firms, which were involved in the development of the Nyurba processing plant, filed an arbitration claim against the Company claiming damages for alleged loss of profit under the contracts concluded between the Company and Bateman and damages allegedly resulting from use of Bateman's intellectual property rights. As the Company management expects the Group to incur an outflow of economic resources in connection with this US Dollar-denominated legal claim, the Group has recognised a provision in the financial statements at 31 December 2003. The Company management does not expect any additional material outflows of economic resources in relation to this claim.

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16. PROFIT AND OTHER TAX ASSETS AND LIABILITIES

Taxes payable comprise the following:

	31 December 2003	31 December 2002	31 December 2001
Unified social tax	869	893	664
Extraction tax	506	108	560
Property tax.....	385	310	264
Value added tax.....	243	162	485
Personal income tax (employees).....	242	175	89
Profit tax.....	202	298	32
Tax penalties	154	867	448
Royalty payable to Republic of Sakha (Yakutia)	118	335	1,842
Road users tax	—	93	159
Other taxes and accruals	39	80	269
Taxes payable	2,758	3,321	4,812

Taxes other than profit tax and extraction tax included in other operating expenses comprise the following:

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Property tax.....	1,125	946	881
Ecology fund	856	734	983
Road users tax	—	613	655
Tax penalties	128	1,128	187
Other taxes and accruals	131	196	35
Taxes other than profit tax and extraction tax	2,240	3,617	2,741

Road users tax has been abolished in accordance with legislation effective since 1 January 2003.

In accordance with legislation effective 1 January 2002, non-recoverable resource tax and resource recovery tax were replaced with an extraction tax. Accordingly, in these consolidated financial statements non-recoverable resource tax and resource recovery tax were reclassified and presented as extraction tax.

As a result of a tax dispute, at 31 December 2002, the Company recorded liability for tax penalties totalling RR'mln 1,195, relating to 1999, 2000 and 2001.

In accordance with Resolution No. 1364 of the Government of the Russian Federation dated 9 December 1999, in addition to the taxes noted above the Company is obliged to pay 6.5 per cent. on the value of diamonds sold for export in the form of an export duty (see note 17).

During 2001, the Group accrued profit tax at the rate of 35 per cent. According to legislation which became substantively enacted in the year ended 31 December 2001, profit tax payable by companies in the Russian Federation with effect from 1 January 2002 ranges from 20 per cent. to 24 per cent., depending on the decision each year of regional and local tax authorities, which can agree jointly on a supplementary amount of up to 4 per cent. above that set by the federal tax authorities. The rate used to compute the deferred profit tax assets and liabilities of the Group at 31 December 2003 and 31 December 2002 was 24 per cent.,

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which reflects the fact that, based on their decisions in respect of tax rates, substantially all regional and local tax authorities in the regions in which the Group operates assessed the maximum supplementary amount in respect of the year ended 31 December 2003 and year ended 31 December 2002.

Profit tax expense comprises the following:

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Current tax expense	3,438	2,650	4,069
Deferred tax (benefit) expense	(1,720)	1,624	(1,090)
Effect of decrease in tax rate	—	—	(1,175)
Profit tax	<u>1,718</u>	<u>4,274</u>	<u>1,804</u>

Net profit before taxation for financial statement reporting purposes is reconciled to tax expense as follows:

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Profit before profit tax and minority interest	<u>8,360</u>	<u>7,092</u>	<u>13,050</u>
Theoretical tax charge at statutory rate of 24 per cent. (year ended 31 December 2002: 24 per cent.; year ended 31 December 2001: 35 per cent.) thereon	2,006	1,702	4,568
Profit tax concessions	—	—	(3,652)
Income not assessable for profit tax purposes	(1,007)	(297)	(615)
Expenses and losses not deductible for profit tax purposes	719	1,146	2,727
Tax penalties	—	287	66
Non-temporary elements of monetary gain	—	1,773	2,643
Inflation effect on deferred tax balance at the beginning of the year	—	(337)	(752)
Statutory revaluation of property, plant and equipment	—	—	(2,006)
Effect of decrease in tax rate on net deferred tax liability	—	—	(1,175)
Profit tax	<u>1,718</u>	<u>4,274</u>	<u>1,804</u>

The non-temporary impact of monetary gains and losses reflects the effect on the theoretical tax charge of inflation with respect to non-monetary items of a non-temporary nature (primarily equity and net deferred tax liability).

Differences between IFRS and Russian statutory tax accounting give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profits tax purposes. The tax effect of the movement on these temporary differences is recorded at the rate of 24 per cent. (2002: 24 per cent., 2001: 24 per cent.).

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	31 December 2003	Movement in temporary differences	31 December 2002	Movement in temporary differences	31 December 2001
Deferred tax liabilities					
Property, plant and equipment	3,706	(1,081)	4,787	1,799	2,988
Inventories	984	163	821	623	198
Long-term investments.....	119	(142)	261	133	128
Accounts receivable.....	—	—	—	(215)	215
Commercial paper	—	—	—	(31)	31
Deferred tax assets					
Accrual for employee benefits	(987)	(140)	(847)	(253)	(594)
Research and development costs written-off	(174)	54	(228)	(228)	—
Impairment of accounts receivable.....	(520)	(138)	(382)	(382)	—
Provision for pension obligations.....	(155)	(46)	(109)	(109)	—
Write-down of inventories.	(380)	(292)	(88)	278	(366)
Other deductible temporary differences....	(127)	(98)	(29)	9	(38)
Net deferred tax liability....	2,466	(1,720)	4,186	1,624	2,562

	31 December 2001	Effect of applying IAS 39	Movement in temporary differences	Change in tax rate	31 December 2000
Deferred tax liabilities					
Property, plant and equipment	2,988	—	(1,369)	(973)	5,330
Inventories	198	—	(91)	(113)	402
Long-term investments.....	128	—	(58)	(175)	361
Accounts receivable.....	215	—	(99)	21	293
Commercial paper	31	77	(14)	(32)	—
Deferred tax assets					
Accrual for employee benefits	(594)	—	273	(68)	(799)
Write-down of inventories.	(366)	—	168	93	(627)
Other deductible temporary differences....	(38)	—	15	157	(210)
Net deferred tax liability....	2,562	77	(1,175)	(1,090)	4,750

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17. SALES

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Revenue from diamond sales			
Export (predominantly one customer).....	27,196	26,684	36,433
Domestic	27,595	27,184	24,551
	54,791	53,868	60,984
Other revenue			
Transport	1,584	1,409	1,680
Trading	1,379	1,094	1,030
Social infrastructure	714	710	761
Construction	539	1,144	1,000
Other.....	997	894	1,593
	60,004	59,119	67,048

Export duties totalling RR'mln 1,641 for the year ended 31 December 2003 (year ended 31 December 2002: RR'mln 1,522; year ended 31 December 2001: RR'mln 2,134) were netted against revenues from export of diamonds.

	Year ended 31 December 2003 US\$m	Year ended 31 December 2002 US\$m	Year ended 31 December 2001 US\$m
Hard currency revenue from export diamond sales including export duties (predominantly one customer).....	943	851	1,069
US\$-denominated domestic diamond sales settled in Russian roubles	901	817	678
	1,844	1,668	1,747

During the year ended 31 December 2003 and 31 December 2002 sales to De Beers occurred on the basis of separate agreements for each individual shipment of diamonds. Contingencies related to the trade agreement with De Beers, covering the period from 1 January 2002 to 31 December 2006 are disclosed in note 25 (i).

Pursuant to existing federal legislation, the Government of the Russian Federation issued, on an annual basis, an export quota for rough diamonds. The quota stipulated the maximum amount of diamonds that might be exported in a given year. The physical volume in carats provided in any quota constituted a State secret.

In November 2002, the President of the Russian Federation signed a decree liberalising the Russian diamond market. The decree authorised the Government of the Russian Federation to grant multi-year export quotas, not to exceed five years, and in February 2003 the Company was granted a five-year export quota. The physical volume in carats provided in any quota constitutes a State secret.

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18. COST OF SALES

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Wages, salaries and other staff costs.....	10,809	10,869	9,489
Depreciation	5,487	4,642	4,945
Materials	4,861	4,655	5,421
Fuel and energy	4,626	4,262	4,484
Extraction tax	3,878	4,460	6,312
Services.....	1,207	795	401
Transport	1,066	1,027	977
Other.....	441	505	289
Write-down (reversal of provision for) of inventory	235	141	(326)
Movement in inventories	(2,792)	(250)	(113)
	<u>29,818</u>	<u>31,106</u>	<u>31,879</u>

Depreciation totalling RR'mln 1,033 (year ended 31 December 2002: RR'mln 796; year ended 31 December 2001: RR'mln 326) and staff costs totalling RR'mln 1,911 (year ended 31 December 2002: RR'mln 1,804; year ended 31 December 2001: RR'mln 1,150) were incurred by the Group's construction division and were capitalised in the year.

19. GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Administrative expenses	2,188	1,730	1,752
Bad debt expense.....	693	1,371	767
	<u>2,881</u>	<u>3,101</u>	<u>2,519</u>

Wages, salaries and other staff costs totalling RR'mln 781 (2002: RR'mln 477; 2001: RR'mln 551) were included in administrative expenses.

20. OTHER OPERATING INCOME

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Amortisation of Grant (see note 9)	1,062	1,238	1,142
Gain on restructuring of tax debt	—	—	243
Other.....	1,176	715	331
	<u>2,238</u>	<u>1,953</u>	<u>1,716</u>

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21. OTHER OPERATING EXPENSES

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Social costs.....	2,695	1,758	2,010
Taxes other than profit tax and extraction tax (see note 16)	2,240	3,617	2,741
Exploration expenses	1,308	1,105	966
Selling and marketing expenses	1,199	1,207	1,270
Loss on disposal of property, plant and equipment.....	1,044	744	2
Provision for guarantee given (see note 15).....	972	—	—
Provision for legal claim (see note 15)	243	—	—
(Reversal of provision) provision for impairment of available-for-sale investments, net	(30)	543	(498)
(Reversal of impairment) impairment of property, plant and equipment	(74)	627	—
Loss from flooding in Lensk	—	—	2,194
Other.....	697	478	348
	<u>10,294</u>	<u>10,079</u>	<u>9,033</u>

Wages, salaries and other staff costs totalling RR'mln 521 (2002: RR'mln 414; 2001: RR'mln 456) were included in selling and marketing expenses.

Loss from flooding in Lensk

In May 2001, certain of the Group's commodities in warehouse facilities, together with certain other Group's assets, were damaged or destroyed by severe flooding in the town of Lensk, located within the Republic of Sakha (Yakutia). The expenses related to damaged inventories, compensating the flood victims for their property and repairing damaged assets are disclosed as other operating expense. Loss from flooding in Lensk includes loss on disposed assets in the amount totalling RR'mln 309.

Social costs

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Maintenance of local infrastructure	1,194	967	853
Charity	871	279	723
Education.....	200	121	105
Hospital expenses.....	138	108	173
Other.....	292	283	156
	<u>2,695</u>	<u>1,758</u>	<u>2,010</u>

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22. FINANCE COSTS, NET

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Interest expense:			
Bank loans	2,244	2,329	1,979
Commercial paper	258	1,249	2,305
Non-convertible bonds	912	875	457
Eurobonds.....	835	—	
Provision for restoration liability (see note 12)	385	295	139
Other.....	94	500	350
	4,728	5,248	5,230
Interest income	(625)	(334)	(226)
	4,103	4,914	5,004

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23. CASH GENERATED FROM OPERATIONS

Reconciliation of profit before tax to cash generated from operations:

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Profit before profit tax	8,360	7,092	13,050
Adjustments for:			
Income from associated undertakings (note 3)	(400)	(497)	(289)
Interest income (note 22)	(625)	(334)	(226)
Interest expense (note 22)	4,728	5,248	5,230
(Reversal of provision) provision for impairment of available-for-sale investments, net (note 21)	(30)	543	(498)
(Reversal of impairment) impairment of property, plant and equipment (note 21)	(74)	627	—
Provision for legal claim (note 21)	243	—	—
Provision for guarantee given (note 21)	972	—	—
Adjustments for non-cash investing activity (note 27)	(1,738)	(2,301)	(5,967)
Adjustments for non-cash financing activity (note 27)	(296)	(228)	1,726
Depreciation (note 18)	5,487	4,642	4,945
Gain on restructuring of tax debt (note 20)	—	—	(243)
Amortisation of Grant (note 20)	(1,062)	(1,238)	(1,142)
Loss on disposal of property, plant and equipment (note 21)	1,044	744	2
Unrealised foreign exchange effect on non- operating items	(2,053)	825	879
Monetary effect on non-operating balances	—	(3,606)	(4,049)
Net operating cash flow before changes in working capital	14,556	11,517	13,418
Net increase in inventories	(2,157)	(57)	(1,347)
Net decrease (increase) in trade and other receivables, excluding dividends receivable and prepayment for own commercial paper redemption	632	1,127	3,619
Net increase (decrease) in trade and other payables, excluding interest payable	1,034	2,590	425
Net (decrease) increase in taxes payable other than profit tax	(467)	(1,757)	228
Net decrease in deferred royalty payable	—	—	(1,742)
Cash generated from operations	13,598	13,420	14,601
Profit tax paid	(3,601)	(1,836)	(4,081)
Net cash flows from operating activities	9,997	11,584	10,520

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24. FINANCIAL RISK MANAGEMENT

(a) Credit risk

Financial assets, which potentially subject Group entities to credit risk, consist principally of accounts receivable. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable represents the maximum amount exposed to credit risk. The Group has no other significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision already recorded.

Cash is placed in financial institutions, which are considered at the time of the deposit to have minimal risk of default.

(b) Foreign exchange risk

The Group exports production to European and other countries and attracts a substantial amount of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated liabilities (see notes 10 and 11) give rise to foreign exchange exposure.

The Group does not have arrangements to mitigate the foreign exchange risks of the Group's operations.

(c) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest bearing long-term borrowings. The majority of interest rates on long-term borrowings are fixed, and are disclosed in note 10. The Group has no significant interest bearing assets.

(d) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, and ensuring the availability of additional funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in its funding requirements by keeping committed credit lines available.

(e) Fair value estimation

The fair value of publicly traded trading and available-for-sale securities is based on quoted market prices at the balance sheet date.

The estimated fair value of financial assets carried at amortised cost is determined by discounting estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates available to the Group for similar financial instruments. Fair value of these financial assets did not materially differ from their carrying amount at 31 December 2003, 31 December 2002 and 31 December 2001. At 31 December 2003, 31 December 2002 and 31 December 2001 the fair value of financial liabilities which is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments with the same remaining maturity, did not materially differ from the carrying amount of these financial liabilities (note 10).

The carrying amounts of financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values.

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25. CONTINGENCIES, COMMITMENTS AND OTHER RISKS

(a) Operating environment

The Russian Federation continues to display some 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.

Whilst there have been improvements in the economic trends, 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.

(b) Taxes

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. 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 2003 management 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.

In December 2002, based on results of a tax audit, the tax authorities filed certain claims against the Company for tax penalties totalling RR'mln 657. The Company disputed the total amount of the tax authorities' claims, as management believes the Company is in compliance with the tax legislation. In March 2004 the case was heard in the Arbitration Court of the Republic of Sakha (Yakutia). The court decided in favour of the Company. In June 2004 the appeals instance of the Arbitration Court of the Republic of Sakha (Yakutia) upheld the decision. The tax authorities are preparing to dispute this decision in a higher court. The Company did not recognise these tax penalties as liability in its financial statements because management does not anticipate that any material cash outflows will arise from this contingent liability. The status of these tax claims has not changed as of the date of these financial statements.

(c) Legal proceedings

The Group is a party to certain legal proceedings 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 adverse effect on the results of operations or financial position of the Group as at 31 December 2003, other than amounts that have been accrued in the consolidated financial statements.

(d) Insurance

The Group is assessing its policies for insuring assets and operations. At present, apart from the full insurance of movements of diamond inventory from the production location to the customers, very few assets and operations of the Group are insured and, in the instances where assets are insured, the amounts generally are not sufficient to cover all costs associated with replacing the assets.

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(e) *Social obligations*

The Group makes contributions to mandatory and voluntary local social programmes. The Group's local infrastructure assets as well as local social programmes benefit the local communities at large and are not normally restricted to the Group's employees. The Group is negotiating the transfer of certain social assets to the local authorities; however, the Group expects to continue funding these social programmes for the foreseeable future.

(f) *Capital commitments*

At 31 December 2003, the Group has contractual commitments for capital expenditures of approximately RR'mln 1,364 (31 December 2002: RR'mln 2,823; 31 December 2001: RR'mln 2,551).

(g) *Restoration, rehabilitation and environmental costs*

Under its licence agreements, the Group is not responsible for any significant restoration, rehabilitation and environmental expenditures that may be incurred subsequent to the cessation of production at each mine, apart from the obligation to return assets received under the Lease Agreement (see note 9). However, the Group is obliged to restore riverbeds and the surrounding areas. These expenses are not expected to be material to the Group and are expensed in the period incurred.

(h) *Guarantees*

As at 31 December 2003, the Group has guaranteed US Dollar-denominated loan issued by the National Bank of Republic of Belarus to AKB "Rosbank" totalling RR'mln 736. The Company management does not expect the Group to incur any outflow of economic resources or economic benefits in connection with this guarantee.

(i) *Trade agreement with De Beers*

On 17 December 2001, a trade agreement between the Company and De Beers was signed, covering the period from 1 January 2002 to 31 December 2006. Pursuant to this agreement, the Company agreed to sell and De Beers agreed to buy up to US\$m 800 in value of the Company's annual diamond production at the current market prices. To be legally enforceable, this agreement requires the regulatory permission of the European Commission. Currently, the Company is in the process of negotiating the resolution of certain objections raised by the European Commission. Management of the Company believes that the result of these negotiations will be favourable for the Group.

In addition, the European Commission could seek to impose fines of up to 10 per cent. of the Company's sales in respect of the Company's previous trade agreements with De Beers, which were not notified to the European Commission. Management of the Company does not anticipate that any material liabilities will arise from this contingent liability.

26. RELATED PARTY TRANSACTIONS

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions, which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The Company's principal shareholders are the Russian Federation and the Republic of Sakha (Yakutia).

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IAS 24, "Related Party Disclosures", specifically excludes government departments and agencies in the course of their normal dealings with enterprise and government controlled entities from the definition of related parties, and therefore transactions under those exemptions between, and balances due to or from entities, under government or other state control and government departments and agencies in the course of their normal dealings and the Group's companies are not detailed in this note.

Information related to the Lease Agreement with the Republic of Sakha (Yakutia) is disclosed in notes 9 and 12.

Remuneration to the members of the Supervisory Council and Management Board of the Company incurred during year ended 31 December 2003 totalled RR'mln 134 (year ended 31 December 2002: RR'mln 69; year ended 31 December 2001: RR'mln 67).

Significant related party transactions are summarised as follows:

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Long-term accounts receivable			
OAo "Sobinbank" and its affiliates, receivable			
secured by the loan payable.....	670	848	1,156
ZAO PIC "Orel-Almaz", an associated undertaking..	—	33	—
Less: provision for bad debt.....	—	(160)	(188)
	<u>670</u>	<u>721</u>	<u>968</u>
Current accounts receivable			
OAo "Yuzhno-Verkhoyanskaya Gornaya Company", an associated undertaking	391	—	—
OAo "Tuymaada – Diamond".....	174	260	642
ZAO PIC "Orel-Almaz", an associated undertaking..	167	105	177
OAo "Sobinbank" and its affiliates, receivable			
secured by the loan payable.....	—	679	538
Catoca Mining Ltd., an associated undertaking			
(see note 3)	2	2	213
Other.....	97	194	326
Less: provision for bad debt.....	(307)	(349)	—
	<u>524</u>	<u>891</u>	<u>1,896</u>

Loans provided by related parties:

Name of bank	Interest Rate	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
OAo "Sobinbank"				
(US\$-denominated).....	7-16 per cent.	—	636	847
OAo "Sobinbank"				
(RR-denominated).....	15-35 per cent.	675	1,341	2,018
		<u>675</u>	<u>1,977</u>	<u>2,865</u>

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The Group owns a 15 per cent. interest in OAO "Sobinbank" and 13 per cent. interest in OAO "Tuymaada – Diamond" at 31 December 2003, 2002 and 2001. The Group's management are members of the Board of Directors of these companies.

27. SIGNIFICANT NON-CASH TRANSACTIONS

	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Non-cash investing activities:			
Inventory used in construction	(1,470)	(1,349)	(1,498)
Purchase of property, plant and equipment.....	(337)	(491)	(3,425)
Other.....	69	(461)	(1,044)
	<u>(1,738)</u>	<u>(2,301)</u>	<u>(5,967)</u>
Non-cash financing activities:			
Commercial paper issuance	662	4,042	9,915
Commercial paper and loans redemption.....	(958)	(4,270)	(8,189)
	<u>(296)</u>	<u>(228)</u>	<u>1,726</u>

28. SEGMENT INFORMATION

The Group has one reportable business segment, which is the production and sale of diamonds. The Group evaluates performance and makes investment and strategic decisions based upon a review of profitability for the Group as a whole. The performance measurement systems employed by the Group to review overall profitability are based on the results of the Group determined using Russian statutory accounting books and records. Russian statutory accounting differs in many significant respects from IFRS.

An analysis of revenue by type is disclosed in note 17. Revenue from sales by geographical location of the customer, and assets and capital expenditures by geographical location of the asset are as follows:

	Sales			Total assets			Capital expenditures		
	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001	Year ended 31 December 2003	Year ended 31 December 2002	Year ended 31 December 2001
Russian Federation	32,808	32,435	30,615	135,009	125,227	111,468	15,519	20,116	17,726
Western Europe	19,564	21,374	29,580	—	—	1,062	—	—	—
Other countries.....	7,632	5,310	6,853	183	273	303	56	—	—
	<u>60,004</u>	<u>59,119</u>	<u>67,048</u>	<u>135,192</u>	<u>125,500</u>	<u>112,833</u>	<u>15,575</u>	<u>20,116</u>	<u>17,726</u>
Associated undertakings.....	—	—	—	900	901	606	—	—	—
Unallocated assets	—	—	—	277	210	755	—	—	—
Total	<u>60,004</u>	<u>59,119</u>	<u>67,048</u>	<u>136,369</u>	<u>126,611</u>	<u>114,194</u>	<u>15,575</u>	<u>20,116</u>	<u>17,726</u>

Sales to De Beers are included in the Western Europe geographical segment.

The Group has one individual customer, De Beers, that accounted for 30 per cent. of its sales during the year ended 31 December 2003 (year ended 31 December 2002: 36 per cent.; year ended 31 December 2001: 44 per cent.).

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29. POST BALANCE SHEET EVENTS

Borrowings

In March and April 2004 OAO Severalmaz, a subsidiary of the Group, received US\$'mln 150 as a loan from ING Bank, which is due for repayment in March 2006. The interest rate on the loan is 8.875 per cent. per annum.

Dividends

On 19 June 2004, the Company's shareholders approved dividends for the year ended 31 December 2003 totalling RR'mln 1,200. Dividends per share amounted to RR 6,000.

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