

WIMM BILL DANN FOODS OJSC
Form 20-F
June 16, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 20-F

- o Registration Statement pursuant to Section 12(b) or (g) of the Securities Exchange Act of 1934
or
- x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2005
or
- o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
or
- o Shell company report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number: 1-31232

WIMM-BILL-DANN FOODS OJSC

(Exact name of Registrant as specified in its charter)

RUSSIAN FEDERATION

(Jurisdiction of incorporation or organization)

16 Yauzsky Boulevard, Moscow 109028, Russian Federation

(Address of principal executive offices)

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

| Title of Each Class | Name of Each Exchange on Which Registered |
|--|---|
| AMERICAN DEPOSITARY SHARES, EACH REPRESENTING ONE SHARE OF COMMON STOCK COMMON STOCK, PAR VALUE 20 RUSSIAN RUBLES PER SHARE | NEW YORK STOCK EXCHANGE NEW YORK STOCK EXCHANGE(1) |

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

NONE

(Title of Class)

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

NONE

(Title of Class)

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

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44,000,000 shares of common stock, par value 20 Russian rubles each, as of December 31, 2005.

14,405,337 American Depositary Shares, each representing one share of common stock, as of December 31, 2005.

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

Yes:

No:

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

Yes:

No:

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

Yes:

No:

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

Large accelerated filer:

Accelerated filer:

Non-accelerated filer:

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

Item 17

Item 18

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

Yes:

No:

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

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

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

We desire to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and are including this cautionary statement in connection with this safe harbor legislation and other relevant laws. This document and any other written or oral statements made by us or on our behalf may include forward-looking statements, which reflect our current views with respect to future events and financial performance. The words believe, expect, anticipate, intend, estimate, forecast, project and similar expressions identify forward-looking statements. Forward-looking statements appear in a number of places including, without limitation, Item 3. Key Information D. Risk Factors, Item 4. Information on Our Company and Item 5. Operating and Financial Review and Prospects, and include statements regarding: strategies, outlook and growth prospects; future plans and potential for future growth; liquidity, capital resources and capital expenditures; growth in demand for our services; economic outlook and industry trends; developments of our markets; the impact of regulatory initiatives; and the strength of our competitors.

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

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

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

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

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

The selected consolidated and combined financial data set forth below at December 31, 2005, 2004, 2003, 2002 and 2001 and for the years then ended have been derived from our audited financial statements prepared in accordance with U.S. GAAP. The selected consolidated and combined financial data should be read in conjunction with our Consolidated Financial Statements as of December 31, 2005 and 2004 and for the years ended December 31, 2005, 2004, and 2003 included under Item 18. Financial Statements and Item 5. Operating and Financial Review and Prospects.

| | For the years ended December 31, | | | | |
|--|--|-------------|-------------|-------------|-------------|
| | 2005 | 2004 | 2003 | 2002 | 2001 |
| | (Dollar amounts in thousands, except share, dividends per share and earnings per share) | | | | |
| Statement of Operations Data: | | | | | |
| Sales | 1,399,289 | 1,189,291 | 938,459 | 824,734 | 674,616 |
| Cost of sales | (1,002,246) | (861,661) | (665,104) | (579,707) | (492,990) |
| Gross profit | 397,043 | 327,630 | 273,355 | 245,027 | 181,626 |
| Selling and distribution expenses | (191,990) | (173,433) | (140,746) | (109,527) | (62,213) |
| General and administrative expenses | (109,642) | (92,816) | (75,973) | (62,955) | (54,461) |
| Other operating expenses | (7,916) | (8,458) | (7,481) | (6,497) | (4,498) |
| Operating income | 87,495 | 52,923 | 49,155 | 66,048 | 60,454 |
| Financial income and expenses, net | (22,868) | (14,618) | (15,273) | (14,131) | (10,581) |
| Income before provision for income taxes and minority interest | 64,627 | 38,305 | 33,882 | 51,917 | 49,873 |
| Provision for income taxes(1) | 30,712 | (12,170) | (10,717) | (14,249) | (14,166) |
| Minority interest | (3,649) | (3,161) | (2,012) | (1,922) | (3,962) |
| Income from continuing operations | 30,266 | 22,974 | 21,153 | 35,746 | 31,745 |
| Income from discontinued operations(2) | | | | | 103 |
| Net income | 30,266 | 22,974 | 21,153 | 35,746 | 31,848 |
| Earnings per share basic and diluted: | | | | | |
| Income from continuing operations | 0.69 | 0.52 | 0.48 | 0.83 | 0.91 |
| Income from discontinued operations | | | | | |
| Net income | 0.69 | 0.52 | 0.48 | 0.83 | 0.91 |
| Dividends per share | | | | | |
| Weighted average number of shares outstanding | 44,000,000 | 44,000,000 | 44,000,000 | 43,063,014 | 34,888,000 |
| Other Data from Continuing Operations: | | | | | |
| Capital expenditures | 75,110 | 72,639 | 107,186 | 136,100 | 57,653 |
| Cash provided by (used in) operating activities | 113,937 | 71,720 | 29,940 | (6,863) | 12,591 |
| Cash used in investing activities | (125,157) | (73,808) | (95,142) | (122,677) | (55,486) |
| Cash (used in) provided by financing activities | (82,619) | (16,159) | 73,399 | 152,600 | 44,613 |

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

(2) Discontinued operations consist of banking and brewery businesses, which were disposed of in April 2001.

| | At December 31, | | | | |
|--|-----------------|---------|---------|---------|---------|
| | 2005 | 2004 | 2003 | 2002 | 2001 |
| Balance Sheet Data: | | | | | |
| Total assets | 920,557 | 796,088 | 743,885 | 589,093 | 352,717 |
| Total net assets | 387,043 | 370,916 | 324,618 | 282,884 | 85,011 |
| Total debt(1) | 371,625 | 283,168 | 283,442 | 186,039 | 122,022 |
| Total liabilities | 508,895 | 407,845 | 398,099 | 284,660 | 244,330 |
| Total liabilities and shareholders' equity | 920,557 | 796,088 | 743,885 | 589,093 | 352,717 |

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

Exchange Rates and Inflation

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

| Year ended December 31, | Rubles per U.S. dollar | | | Period End |
|-------------------------|------------------------|-------|------------|------------|
| | High | Low | Average(1) | |
| 2005 | 29.00 | 27.46 | 28.31 | 28.78 |
| 2004 | 29.45 | 27.75 | 28.73 | 27.75 |
| 2003 | 31.88 | 29.25 | 30.61 | 29.45 |
| 2002 | 31.86 | 30.14 | 31.39 | 31.78 |
| 2001 | 30.30 | 28.16 | 29.22 | 30.14 |

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

| | Rubles per U.S. dollar | |
|---------------|------------------------|-------|
| | High | Low |
| May 2006 | 27.24 | 26.92 |
| April 2006 | 27.77 | 27.27 |
| March 2006 | 28.12 | 27.66 |
| February 2006 | 28.26 | 28.10 |
| January 2006 | 28.48 | 28.02 |
| December 2005 | 29.00 | 28.64 |

On June 14, 2006, the exchange rate between the ruble and the U.S. dollar was 27.09 rubles per \$1.00.

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

| Year ended December 31, | Inflation rate |
|-------------------------|----------------|
| 2005 | 10.9 % |
| 2004 | 11.7 % |
| 2003 | 12.0 % |
| 2002 | 15.1 % |
| 2001 | 18.6 % |

Source: Rosstat.

Effective from January 1, 2003, Russia no longer met the criteria for a highly inflationary economy. Therefore, commencing January 1, 2003, our Russian subsidiaries changed their functional currency from the U.S. dollar to the ruble. See Note 3 to our Consolidated Financial Statements included under Item 18. Financial Statements.

Our results of operations are affected by the relationship between the rate of inflation and the nominal rate of devaluation/appreciation of the ruble against the U.S. dollar (*i.e.*, by the real appreciation or depreciation of the ruble against the U.S. dollar). In 2005, 2004 and 2003, the ruble appreciated in real terms against the U.S. dollar.

| | 2005 | 2004 | 2003 |
|--|--------|--------|--------|
| Inflation(1) | 10.9 % | 11.7 % | 12.0 % |
| Nominal appreciation/(depreciation) of the ruble relative to the U.S. dollar(2)(3) | 1.9 % | 6.5 % | 2.2 % |
| Real appreciation of the ruble relative to the U.S. dollar(2) | 10.8 % | 15.1 % | 13.6 % |

(1) Source: Rosstat.

(2) Source: Central Bank of Russia.

(3) For purposes of calculating the interest rate of our U.S. dollar-denominated notes, we used the Russian ruble/U.S. dollar exchange rates at December 31, 2005, 2004 and 2003, which appreciated/(depreciated) at the rates of (3.7)%, 6.1% and 7.9%, respectively.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

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

We have described the risks and uncertainties that our management believes are material, but these risks and uncertainties may not be the only ones we face. Additional risks and uncertainties, including those we currently are not aware of or deem immaterial, may also result in decreased operating revenues, increased operating expenses or other events that could result in a decline in the value of our ADSs.

Risks Relating to Business Operations in Emerging Markets

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

Investors in emerging markets such as the Russian Federation should be aware that these markets are subject to greater risks than more developed markets, including in some cases significant legal, economic and political risks. Investors should also note that emerging economies, such as the economy of the Russian Federation, are subject to rapid change and that the information set out herein may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment is appropriate.

Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved and investors are urged to consult their own legal and financial advisors before making an investment in our securities.

Risks Relating to Our Business and Industry

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

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

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

Our expansion strategy depends, in part, on funding growth in additional markets, on our ability to identify attractive opportunities in markets that will grow and on our ability to manage the operations of acquired or newly established businesses. Should growth decline in our existing markets, not increase as anticipated in markets in which we have recently acquired or established businesses, or not increase in markets into which we subsequently expand, our geographic expansion strategy may not be successful and our business and profitability may suffer. We describe our geographic expansion strategy under Item 4. Information on Our Company B. Business Overview Business Strategy.

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

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

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

Our strategy depends on us being a large manufacturer in the dairy and juice sectors so that we can benefit from economies of scale, better satisfy customer needs and compete effectively against other producers. Our growth will suffer if we are unable to implement our acquisition strategy, whether because we fail to identify suitable targets, outbid competing bidders or finance acquisitions on acceptable terms or for any other reason. Furthermore, any acquisitions or similar arrangements may harm our business if we are unsuccessful in our integration process or fail to achieve the synergies and savings we expect. We describe our acquisition strategy under Item 4. Information on Our Company B. Business Overview Business Strategy.

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

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

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

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

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

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

- the ability to integrate new acquisitions into our operations;
- continued development of financial and management controls and IT systems and their implementation in newly acquired businesses;
- increased marketing activities;
- hiring and training of new personnel; and
- the ability to adapt to changes in the markets in which we operate, including increased competition and demand for our services.

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

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

In connection with the audit of our consolidated financial statements for the year ended December 31, 2005, management and our independent registered public accounting firm have identified material

weaknesses in our internal control over financial reporting as defined in the standards established by the Public Company Accounting Oversight Board's Auditing Standard No. 2 that affected our financial statements for the year ended December 31, 2005. The material weaknesses in our internal control over financial reporting are summarized below:

- Our financial statement closing process and the transformation of our statutory financial statements into U.S. GAAP consolidated financial statements has not reduced to an acceptably low level the risk that material errors may occur and may not be detected on a timely basis by management in the normal course of business;
- Inadequate accounting resources and expertise in respect of the preparation of consolidated financial statements in accordance with U.S. GAAP; and
- Inadequate interpretation and implementation of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*.

Notwithstanding the steps we have taken and continue to take that are designed to remediate each material weakness identified above, we may not be successful in remediating these material weaknesses in the near or long term and we may not be able to prevent other material weaknesses in the future. Any failure to maintain or implement required new or improved internal control over financial reporting, or any difficulties we encounter in their implementation, could result in significant deficiencies or material weaknesses, cause us to fail to meet our periodic reporting obligations or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding the effectiveness of our internal control over financial reporting that will be required when the SEC's rules under Section 404 of the Sarbanes-Oxley Act of 2002 become applicable to us beginning with our annual report for the year ending December 31, 2006, to be filed in 2007. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in the price of our shares and ADSs. See Item 15. Controls and Procedures for additional information.

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

Section 404 of the Sarbanes-Oxley Act and the SEC's and the PCAOB's regulations thereunder will become applicable to us for the fiscal year ending December 31, 2006. These regulations include a requirement that our management evaluate the effectiveness of our internal control over financial reporting on an annual basis and disclose any material weaknesses in our internal control over financial reporting. Our independent registered public accounting firm will be required to audit management's evaluation as well as our internal control over financial reporting. We have already incurred and will continue to incur costs and resources, including time of senior management, to design, maintain and evaluate internal control over financial reporting under these rules. Senior management time will necessarily be diverted from running our business. These costs are especially high for us primarily due to the diversity and geographic location of our businesses. For these reasons, the costs involved in attempting to achieve Section 404 compliance could have a material adverse effect on our business, financial condition, results of operation and prospects.

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

financial reporting. Since 2003, we have hired 4 accounting personnel who are in the process of receiving or have received ACCA-qualification with experience at other NYSE-listed Russian companies and at Big Four accounting firms in order to improve our U.S. GAAP capabilities. In addition, in 2004, we established a new department devoted to developing our systems of internal control over financial reporting in an effort to comply with Section 404 of the Sarbanes-Oxley Act of 2002. The department is comprised of four full-time employees who are tasked with identifying and evaluating our business processes and implementing, where necessary, new or modified internal control procedures over financial reporting. We engaged external consultants to help us correct the material weaknesses and improve our internal control over financial reporting. These consultants are providing assistance in preparation by us of documentation of certain specific internal controls that are currently in place over financial reporting.

Increased competition among juice producers in Russia has caused our sales volumes in our beverage segment to decline, which has adversely affected and may continue to adversely affect our results of operations.

Although juice consumption in Russia continues to increase, our juice product sales volume decreased in 2004 and 2005 due to vigorous market competition from other domestic producers and increased activity by foreign producers. Continued and/or increased competition among juice producers in Russia may cause a continued decline in the sales volumes of our juice products, as well as affect our juice prices and profit margins and, consequently, may materially adversely affect our results of operations. See Item 4. Information on Our Company B. Business Overview Beverage products and brands Market trends and competition for additional information regarding our competitors.

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

Consumer preference for low-price juice products, primarily in the regions outside of Moscow and St. Petersburg where per capita household incomes are generally lower, put pressure on juice prices in 2003, 2004 and 2005. In addition, raw materials required for juice production, such as juice concentrate and sugar, are international commodities and are subject to international price fluctuations, and we have experienced significant increases in the cost of these commodities in 2005. The cost of sugar has not stabilized thus far in 2006 and the price for juice concentrate, especially orange, has increased significantly in 2006 and we expect it to continue to increase for the foreseeable future. A continuation of these trends may cause a decline in our juice product profit margins and, consequently, materially adversely affect our results of operations.

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

Railway transportation is one of our principal means of transporting supplies and juice and water products to our facilities and customers, accounting for approximately 62% of our juice transportation expenses in 2005. Currently, the Russian government sets rail tariffs and may further increase these tariffs as it did in 2003, 2004 and 2005. Railroad tariffs increased by approximately 40%, 32% and 18% in ruble terms in 2003, 2004 and 2005.

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

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

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

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

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

Our success depends, in part, on our continued ability to be an efficient producer in a highly competitive industry. If we cannot continue to control costs through productivity gains or by eliminating redundant costs resulting from acquisitions, our results of operations will suffer. In particular, price increases and shortages of packaging and raw materials could have a material adverse effect on our results of operations. For example, our results of operations may be affected by the availability and pricing of packaging materials, principally cardboard and plastic containers, and raw materials, principally raw milk and juice concentrate. We are substantially dependent upon one supplier of packaging materials, Tetra Pak, which may make us more vulnerable to changes in global supply and demand and their effect on price and availability of these materials. Additionally, weather conditions and other factors beyond our control significantly influence the price and availability of our raw materials. A number of our raw materials, such as juice concentrate and sugar, are international commodities and are subject to international price fluctuations, and we experienced significant increases in raw milk prices during 2003, 2004 and 2005.

Our success also depends on our continued ability to be an effective advertiser in a market where media inflation on leading national television channels exceeded 25% in 2005. A substantial increase in the prices of any of the foregoing, which we may not be able to pass on to customers through price increases, or a protracted interruption in supply with respect to packaging or raw materials, could have a material adverse effect on our financial condition and results of operations. See Item 4. Information on Our Company B. Business Overview.

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

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

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

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

In addition, the average weighted raw milk purchase price increased for us in ruble terms by approximately 11% in 2003, 17% in 2004 and 14% in 2005. The price increases are due, in part, to the raw milk shortages caused by the ongoing decline of dairy cattle in Russia. These increases adversely affected our dairy product profit margins in 2003, 2004 and 2005, and continued increases in raw milk prices could further reduce our profitability. The shortage of high quality raw milk, coupled with the raw milk price increases, may also limit our ability to expand our production of high margin value-added dairy products. See Item 5. Operating and Financial Review and Prospects D. Trend Information for additional information.

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

In 2005, the Moscow City Government purchased approximately 56% of the volume of baby food products we produced, and the proceeds of the baby food products sold to the Moscow City Government comprised approximately 31% of the total sales of our baby food segment and approximately 2% of the total sales of our group. We supply these products to the Moscow City Government pursuant to a tender held on a yearly basis. In the event that we were to lose a tender, or the Moscow City Government was to reduce significantly the prices or the amount of products it purchases from our baby food business, and we were unable to find alternative purchasers, then our revenues and profits from this business could be reduced, which could have a material adverse effect on our financial condition and results of operations. We discuss the sale and distribution of products produced at the Moscow Baby Food Plant in Item 4. Information on Our Company B. Business Overview Current Operations Sales and Distribution Distribution.

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

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

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

Independent distributors may export our products to countries where such products do not meet the requirements of applicable legislation. The consequent recalls of our products and the associated negative publicity may adversely affect our reputation in the Russian Federation, the CIS and abroad, and materially adversely affect our results of operations.

In exporting our products, we attempt to meet the standards and requirements of applicable legislation governing the import of food products into the importing country. Independent distributors have, in some cases, attempted to export our products to countries where such products did not meet the requirements of applicable legislation.

For instance, one of our independent dairy distributors exported our Darling Mila milk to the United States in January 2003. This milk was subsequently recalled from stores in February 2003, when food inspectors discovered that the milk contained sulfonamide. Whereas Russian legislation does not explicitly prohibit sulfonamide in milk, United States legislation does prohibit it. The recall, which was publicized in the Russian press, and any similar events that may occur in the future could negatively affect our reputation in the Russian Federation, the CIS and abroad, and materially adversely affect our results of operations.

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

We maintain insurance against some, but not all, potential risks and losses affecting our operations. We cannot assure you that our insurance will be adequate to cover all of our losses or liabilities. We also can provide no assurance that insurance will continue to be available to us on commercially reasonable

terms. In the event that a significant event were to affect one of our facilities, we could experience substantial property loss and significant disruptions in production, for which we would not be compensated. Additionally, depending on the severity of the property damage, we may not be able to rebuild damaged property in a timely manner or at all. We do not maintain separate funds or otherwise set aside reserves for these types of events. Any such loss or third party claim for damages may have a material adverse effect on our business, results of operations and financial condition.

We are also exposed to product liability claims in the event that consumption of our products results in illness, injury or death, and we cannot assure you that we will not experience any material product liability losses in the future. Although we maintain insurance coverage for product liability, such coverage may be insufficient in the event of a claim. Moreover, certain of our production facilities are currently not covered by product liability insurance. In addition, if any of the products we have produced are determined to be unsuitable for consumption, we may be required to participate in a recall involving such products. For a more detailed discussion of our insurance coverage see Item 4. Information on Our Company B. Business Overview Insurance.

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

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

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

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

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

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

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

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

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

As of June 1, 2006, we had 72 pending trademark applications in Russia and 7 pending trademark applications abroad. We are also in the process of contesting the rejections of a number of our trademarks in countries outside of Russia. If our pending applications are not granted trademark status, we will have limited ability to defend these brand names or images from use by others, significantly reducing the value of any advertising using these brand names or images. This will negatively affect our marketing plans for the products that utilize these brand names or images, and may require us to develop a different marketing approach for these products, resulting in increased advertising expenses and adversely affecting our financial results. We further discuss our patents and trademarks under Item 4. Information on Our Company B. Business Overview Current Operations Trademarks and Patents.

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

We continue to make significant capital expenditures, particularly in connection with the expansion of our existing operations, upgrades of existing facilities, enhancing our infrastructure, including building new warehouses and acquisitions of new companies. For the fulfillment of our capital spending plans, excluding expenditures for acquisitions, we spent approximately \$107.2 million in 2003, \$72.6 million in 2004 and \$75.1 million in 2005. We spent approximately \$9.9 million in 2003, \$5.3 million in 2004 and \$24.3 million in 2005 for acquisitions. However, we may not be able to meet our planned capital spending needs in the future in the event of the following potential developments:

- a lack of external financing sources;
- changes in the terms of existing financing arrangements;
- pursuit of new business opportunities or investment in existing businesses that require significant investment;
- slower than anticipated growth in demand for our products;
- slower than anticipated revenue growth;
- regulatory developments; or
- a deterioration in the Russian economy.

To meet our financing requirements, we may need to attract additional equity or debt financing. Russian companies are limited in their ability to issue shares in the form of ADSs or other depositary receipts due to Russian securities regulations, which, until 2005, generally provided that no more than 40%

of a Russian company's shares may be circulated abroad through depositary receipt programs. This limitation was subsequently decreased to 35%. Our ADS and GDS programs together account for 40% of our outstanding shares (which amount was approved by the Russian securities regulator based on the prior limit and is not required to be reduced to 35%). As a result, we are currently unable to raise additional equity financing through the issuance of depositary receipts. The Russian government or its agencies may also impose other restrictions on international securities offerings by Russian issuers. Any of the foregoing factors may limit the amount of capital available to meet our operating requirements. If we cannot obtain adequate funds to satisfy our capital requirements, we may need to limit our operations significantly, which could have a material adverse effect on our business, results of operations and prospects.

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

As of May 15, 2006, to our knowledge, approximately 58.38% of our outstanding common stock is owned by the group of shareholders that owned us prior to our IPO. This group has acted in concert since our establishment and, since 1997, pursuant to a Partnership and Cooperation Agreement, amended and restated January 16, 2002, which requires the parties to vote the same way. This group continues and will continue to be bound by this agreement to vote as a block until any member of the group elects to withdraw from the agreement. This agreement gives them control over us and the ability to elect a majority of the directors, appoint management and approve certain actions requiring the approval of a majority of our shareholders.

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

Members of our controlling group of shareholders also have interests in other companies, some of which conduct business with us. Related party transactions with these companies may potentially result in the conclusion of transactions on terms less favorable than could be obtained in arm's-length transactions.

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

Russian law currently limits the amount of time that a broadcaster may devote to advertising to 20% of total broadcasting time per day, although within that overall limit, it does not restrict the amount of advertising in any given hour. A newly-adopted law will further limit the permitted amount of advertising time to 15% of daily broadcasting time, as well as limit advertising to no more than 20% in any hour from July 1, 2006 through December 31, 2007. From January 1, 2008, advertising will be further limited to no more than 15% per hour of broadcasting time.

As a result of this new law, the amount of available advertising time will decrease. In turn, the reduction in available advertising time will likely lead to increased costs to advertisers for purchasing advertising time due to an increased demand for available time slots and a drive by media outlets to recover their losses from the decreased volume of advertising time they are permitted to sell. We expect the greatest price increases to affect television advertising, particularly during primetime.

The new law also imposes certain restrictions on advertising that may require us to adjust some of our advertising campaigns.

We are among the largest advertisers in Russia. According to Gallup, we were the second largest advertiser in Russia in 2003, the third largest advertiser in 2004 and the ninth largest advertiser in 2005. In 2005, over 50% of our advertising expenditures related to television advertisements. At the same time, media inflation in Russia has been significant in recent years, exceeding 34% in 2004 and 28% in 2005. Imposition of the new law, coupled with overall media inflation in Russia, will likely increase our advertising expenses. The increased cost of advertising, along with the decreased availability of advertising time slots, may also lead to a decrease in our television advertising which, consequently, may have a material adverse effect on our sales and results of operations.

In the event that our equipment rental arrangements were deemed to be subject to licensing requirements, our subsidiaries engaging in these arrangements could be subject to liquidation or face the invalidation of the rental contracts.

A number of our subsidiaries purchase equipment which they then, in turn, lease to raw milk producers. Prior to February 11, 2002, when the new Federal Law on Licensing of Certain Types of Activities became effective, Russian legislation required a license for financial leasing activities, but it is unclear whether this requirement extended to our leasing activities. Although leasing activities are no longer subject to licensing, in the event that the relevant governmental authorities were to successfully claim that a license was required for our past leasing activities, we would be subject to significant adverse consequences such as the potential liquidation of the leasing entity and invalidation of the relevant contracts.

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

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

Twenty-two of our subsidiaries have negative net assets. These subsidiaries, taken together, are material to our operations. We believe that, as long as these subsidiaries continue to fulfill their obligations, the risk of their liquidation is minimal. However, we have taken and continue to take certain steps to remedy this situation and reduce the number of subsidiaries with negative net assets. We are also in the process of integrating the newly acquired businesses and restructuring our subsidiaries, which we expect will reduce the number of subsidiaries with negative net assets. While we understand that a Moscow court liquidated a company with negative net assets in 2002, we are not aware of any situation where a Russian company has been liquidated pursuant to this legislation if it has met all of its obligations, as each of these subsidiaries has. Therefore, we believe that this risk is remote and have not included it as a contingency in the notes to our financial statements which appear elsewhere in this document. However, weaknesses in the Russian legal system create an uncertain legal environment, which makes the decisions

of a Russian court or a governmental authority difficult, if not impossible, to predict. If involuntary liquidation were to occur, then we may be forced to reorganize the operations we currently conduct through the affected subsidiaries. Any such liquidation could lead to additional costs, which could materially adversely affect our business, financial condition, results of operations and prospects.

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

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

Additionally, of the 98.02% of the Lianozovo Dairy Plant and 98.91% of the Tsaritsino Dairy Plant which we own, 15% of each were acquired in separate investment tenders held by the Department of State and Municipal Property of the Moscow City Government. Under the legislation governing such tenders, a tender is not valid unless at least two participants submit bids. In the investment tenders for the Lianozovo Dairy Plant and the Tsaritsino Dairy Plant, the only two participants were entities which were under common control, an arguable violation of this requirement. In the event that the Russian government authorities were successfully to maintain that these tenders were not duly held since the participants were under common control, we could lose 15% of our stakes in the Lianozovo Dairy Plant and the Tsaritsino Dairy Plant, materially adversely affecting our results of operations.

In addition, under Russian law, transactions in shares may be invalidated on many grounds, including a sale of shares by a person without the right to dispose of such shares, breach of interested party and/or major transactions rules and failure to register the share transfer in the securities register. As a result, defects in earlier transactions in shares of our subsidiaries (where such shares were acquired from third parties) may cause our title to such shares to be subject to challenge.

In the event that companies which, as a result of our corporate reorganization for our initial public offering, were transferred by us but continue to be associated in the public mind with the Wimm-Bill-Dann name give rise to shareholder liability or reputational issues, our results of operations or reputation could suffer.

As part of our corporate reorganization for our initial public offering, we transferred our interests in a bank, Expobank, and four breweries to certain of our shareholders. These shareholders, in turn, have disposed of their interests in the bank and the breweries. In the event that these companies, which are no longer owned by us but may continue to be associated with the Wimm-Bill-Dann name in the public mind, are subject to negative publicity, our reputation could be affected. For example, there have been

press reports about a dispute regarding the exclusion, in the fall of 2000, of minority shareholders from a shareholders' meeting of a beer company previously owned by us and our current shareholders, some of whom are also members of our Board of Directors. These press reports repeated allegations made by the excluded minority shareholders as to the illegality of their exclusion, although their exclusion was upheld in court. Press speculation of a similar nature could raise concerns about how the holders of our securities and minority shareholders in our company will be treated, negatively affecting the price of our securities. Additionally, we could be held responsible for any shareholder liability which arises in connection with these companies and their operations during the time which they were owned by our subsidiaries.

We have engaged and may continue to engage in transactions with related parties that may present conflicts of interest, potentially resulting in the conclusion of transactions on less favorable terms than could be obtained in arm's-length transactions.

We have engaged in transactions with affiliated parties and may continue to do so. For example, we have engaged in transactions with certain of our shareholders, directors and executive officers and companies controlled by them, including equity purchases, supply contracts, loan arrangements, indemnification agreements and real property acquisitions. Conflicts of interest may arise between our affiliates and us, potentially resulting in the conclusion of transactions on terms not determined by market forces.

Allegations about certain of our shareholders or directors could adversely affect our reputation.

Certain of our shareholders and directors, including the Chairman of our Board of Directors, are together controlling shareholders in a group of related companies sometimes referred to as Trinity. The Trinity group engages in agro business, security services, casinos and construction. We purchased Municipal Guard Agency, a security services company, from the Trinity group in 2001. Prior to and in the beginning of 2002, we obtained security services from Trinity-Negus, and we currently purchase milk from certain milk supply companies in the Trinity group. See Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions for a description of these transactions. The Trinity group has been the subject of speculation in the Russian press, including with respect to possible links with organized crime. However, no charges have been brought by governmental authorities against any of our shareholders or directors and, to the best of our knowledge, none has been threatened. In addition, our largest shareholder, who has been a member of our Board of Directors since June 14, 2005, was convicted of a violent crime in 1980 under the Soviet system and served nine years in a labor camp. Press speculation about these or other matters relating to our shareholders or directors could adversely affect our reputation and the value of our securities.

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

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

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

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

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

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

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

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

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

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

Under Russian legislation, the Federal Antimonopoly Service may categorize a company as a dominant force in a market. Our baby food business is categorized as a monopoly in Moscow and the Moscow region, placing restrictions on our ability to increase our profit margins for that business. Any

ruling that any of our other businesses is a monopoly could result in the regulation of our prices and restrictions on our commercial activities. The imposition of government-determined prices could, in turn, result in competitive disadvantages and a significant decline in revenues. Additionally, restrictions on expansion or government-mandated withdrawal from regions or markets would adversely affect our plans for expansion and could reduce our market share.

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

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

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

Over the past several years, we have sought and continue to seek to purchase minority stakes in our subsidiaries with the aim of acquiring 100% interests in each of our key subsidiaries. For example, in January 2005, we acquired a 10% stake in our subsidiary Siberian Dairy Plant from minority shareholders for a cash consideration of \$1.1 million increasing our beneficial ownership to 87.1%. In March and April 2004, we acquired a total of an additional 6.2% of our subsidiary Tsaritsino Dairy Plant from our minority shareholders for a cash consideration of \$3.4 million increasing our beneficial ownership to 97.6%. In addition, we acquired a 47.7% interest in our subsidiary Ufa Dairy Plant in September 2003 from minority shareholders for a cash consideration of \$3.1 million increasing our beneficial ownership to 96.5%. In the future, minority shareholders may elect not to sell their shares to us, and thereby impede our efforts in acquiring 100% ownership interests in our subsidiaries.

Risks Relating to Our Financial Condition

Inflation could increase our costs and decrease our operating margins.

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

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

We have a substantial amount of outstanding indebtedness, primarily consisting of the liabilities we have in connection with our \$150 million loan participation notes due 2008, our ruble bonds, bank loans and obligations under equipment financing. As at December 31, 2005, our consolidated total debt was approximately \$371.6 million, of which \$37.9 million was secured by equipment or inventory.

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

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

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

Our short-term and long-term debt agreements, including the loan agreement relating to our \$150 million loan participation notes due 2008, contain covenants that impose operating and financial restrictions on us and our subsidiaries. These restrictions significantly limit, and in some cases prohibit, among other things, our and certain of our subsidiaries' ability to incur additional debt, provide guarantees, create liens on assets or enter into business combinations. See Item 10. Additional Information C. Material Contracts Loan Agreement relating to the Loan Participation Notes and Guarantee. Failure to comply with these restrictions would constitute a default under our debt agreements, including the loan agreement relating to our \$150 million loan participation notes due 2008, and any of our other senior debt containing cross-default provisions could become immediately due and payable, which would materially adversely affect our business, financial conditions and results of operations. In addition, some of our debt agreements contain provisions which permit our lenders to require us to repay our debt to them in the event of a deterioration in our financial condition.

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

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

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

Our inability to effect certain mergers within our group of companies may prevent us from optimizing our tax rate and result in increased taxes.

As Russian tax regulations do not allow Russian companies to pay taxes on a consolidated basis, *i.e.*, to offset the losses of one subsidiary against the profits of another subsidiary, we are seeking to merge certain companies within each of our segments in an effort to optimize the tax rates applicable to us. Our ability to effect such mergers depends, in each instance, upon our receipt of certain governmental and corporate approvals. Our inability or failure to consummate the mergers may prevent us from optimizing our tax rates and our effective tax rate may increase as our operations continue to expand.

Devaluation of the ruble against the U.S. dollar could increase our costs and reduce our operating revenues.

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

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

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

Currency regulations established by the Central Bank of Russia restrict investments by Russian companies outside Russia and in most hard-currency-denominated instruments in Russia, and there are only a limited number of ruble-denominated instruments in which we may invest our excess cash. Additionally, subject to certain exceptions, Russian companies must repatriate 100% of their offshore foreign currency earnings to Russia. In 2005, Russian companies were required to convert 10% of those

earnings into rubles within seven days of receipt. While this conversion requirement was abolished by legislation that came into effect in May 2006, Russian legislation allows the Central Bank of Russia to reinstate the conversion requirement in any amount up to 30%. Any balances maintained in rubles will give rise to losses if the ruble devalues against the U.S. dollar.

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

The Central Bank of Russia has from time to time imposed various currency control regulations, and may take further actions in the future. Furthermore, the government and the Central Bank of Russia may impose additional requirements on cash inflows and outflows into and out of Russia or on the use of foreign currency in Russia, which could prevent us from carrying on necessary business transactions, or from successfully implementing our business strategy.

A framework law on exchange controls which took effect in June 2004 empowers the government and the Central Bank of Russia to further regulate and restrict currency control matters, including operations involving foreign securities and foreign currency borrowings by Russian companies. While the new regulatory regime continues to be restrictive, the law contemplates that most restrictions on currency operations will be removed effective January 1, 2007.

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

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

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

Limitations on the conversion of rubles to foreign currencies in Russia could increase our costs when making payments in foreign currencies to suppliers and creditors and could cause us to default on our obligations to them.

Many of our major capital expenditures are denominated and payable in various foreign currencies, including the U.S. dollar and euro. Russian legislation currently permits the conversion of ruble revenues into foreign currency. Any delay or other difficulty in converting rubles into a foreign currency to make a payment or delay in or restriction on the transfer of foreign currency could limit our ability to meet our payment and debt obligations, which could result in the loss of suppliers, acceleration of debt obligations and cross-defaults and, consequently, have a material adverse effect on our business, financial condition and results of operations.

If the various initiatives we have used to reduce our tax burden and/or our calculation of our VAT and profit tax liabilities are successfully challenged by the Russian tax authorities, we will face significant losses associated with the assessed amount of tax underpaid and related interest and penalties, which would have a material impact on our financial condition and results of operations.

We have used various initiatives to reduce our tax burden. As described below, several of our tax initiatives have recently been challenged by the Russian tax authorities. There have also been press reports of instances in which the Russian tax authorities have successfully challenged structures similar to those we have used. If any of our initiatives are successfully challenged by the Russian tax authorities, we would face significant losses associated with the assessed amount of tax underpaid and related interest and penalties. These losses could have a material impact on our financial condition and results of operations. See Note 29 to our Consolidated Financial Statements included under Item 18. Financial Statements.

In addition, the Russian tax authorities audited the Tsaritsino Dairy Plant for the period covering 2000 through 2003. This audit resulted in a tax assessment of approximately \$3.7 million relating to the plant's calculation of its profit tax and value-added tax, or VAT, liability and a reduction in the amount of VAT refundable to the Tsaritsino Dairy Plant by approximately \$1.0 million. The Tsaritsino Dairy Plant filed a claim with the Moscow Arbitration Court challenging these decisions in December 2004. In February 2005, the Moscow Arbitration Court ruled in our favor, except for the profit tax exemption in the amount of approximately \$0.1 million paid by the Tsaritsino Dairy Plant as a charity donation. The court's decision was thereafter affirmed, and the appeal by the Russian tax authorities was dismissed by the Appellate Arbitration Court.

In November 2004, Fruit Rivers was assessed approximately \$3.0 million relating to its calculation of VAT. Fruit Rivers challenged this assessment and the Moscow Arbitration Court voided the assessment in April 2005. The tax authorities did not appeal the decision and the period for appeal has expired.

As court decisions in Russia do not constitute precedent for subsequent cases, the court decisions described above do not prevent the Russian tax authorities from filing similar claims against us or our subsidiaries or preclude the possibility that courts would rule in their favor on such claims. Thus, while we believe that our subsidiaries have complied and continue to comply with their profit tax and VAT obligations, the Russian tax authorities may in the future make claims against other of our subsidiaries for additional profit tax or VAT amounts with respect to sales of their products. These claims could be significantly larger than the claims described above, and our ability to recover VAT owed by the Russian tax authorities could also be jeopardized. The resulting losses could have a material adverse impact on our financial condition and results of operations.

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

Our juice producing subsidiaries have benefited from small enterprise tax legislation. If we had not taken advantage of this benefit in 2003, 2004 and 2005, our tax expenses would have increased by \$3.0 million, \$1.2 million and \$0.3 million, respectively. This tax benefit was eliminated as of January 1, 2002. However, under the amended legislation, our small enterprises that were formed prior to January 1, 2002 were able to continue and did continue to use this benefit for two years from the date on which they were formed, and in the third and fourth years after they were formed, income tax was levied at a rate of 25% and 50% of the income tax rate, respectively. Although none of our subsidiaries currently takes advantage of the small enterprise tax benefits, we cannot guarantee that the tax authorities may not retroactively challenge previous tax benefits enjoyed by our subsidiaries pursuant to small enterprise tax legislation. Such challenges, if successful, could materially adversely affect our results of operations. See Item 5. Operating and Financial Review and Prospects A. Operating Results Provision for Income Taxes.

In addition, our use of the small enterprise tax exemption has been subject to challenge by the Russian tax authorities.

In January 2005, our Novosibirsk subsidiary, Nectarin, was assessed approximately \$0.9 million (including required profit tax advance payments and penalties) by the local tax authorities. The assessment related to Nectarin's use of the small enterprise tax exemption in calculating its profit tax liability during 2004. Nectarin filed a claim with the Moscow Arbitration Court challenging this assessment, and the assessment was subsequently declared invalid by the court, which decision was thereafter affirmed on appeal.

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

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

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

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

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

We have also experienced problems with transmitting tax payments through certain Russian banks and, as a result, are experiencing difficulties with the Russian tax authorities. For example, in 2004 and

2005, our subsidiaries Wimm-Bill-Dann Purchaser, Ramenskoe Moloko and Tsaritsino Dairy Plant each received a tax assessment from the Russian tax authorities for tax arrears totaling approximately \$100,000, \$100,000 and \$750,000, respectively. Each of these tax assessments resulted from the failure of the subsidiaries' banks to transfer tax payments to the state budget upon receiving the relevant payment orders. We challenged these assessments and, in each instance, the assessments were declared invalid by Russian Arbitration Courts. Nevertheless, in May 2005, the tax authorities issued a new tax assessment in the amount of \$750,000 against the Tsaritsino Dairy Plant relating to the tax payment that was the subject of their prior \$750,000 assessment. The tax authorities subsequently filed a tax claim in the Moscow Arbitration Court, though they reduced the amount of the claim to \$510,000. The Moscow Arbitration Court ruled in our favor with respect to this claim, a decision which was thereafter upheld on appeal in the Ninth Arbitration Appeals Court, as well as on appeal in the Moscow District Arbitration Court. In addition, in April and May 2006 several of our subsidiaries received demands from the tax authorities seeking to recognize such subsidiaries as acting in bad faith for the failure of their banks to transfer tax payments to the state budget upon receiving the relevant payment orders. The total amount of the demands from the tax authorities is \$3,690,190. In response, we have filed claims seeking the invalidation of these tax demands and assessments with the Moscow Arbitration Court, in some cases, and directly with the tax authorities in others. All the cases are currently pending. In June 2006, Lianozovo Dairy Plant received a new assessment from the Russian tax authorities for approximately \$90,000, and we are currently in the process of challenging this assessment with the Moscow Arbitration Court.

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

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

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

Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to control prices for transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions or transactions with significant price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and arbitration courts and their use in politically motivated investigations and prosecutions. We believe that the prices used by our group are market prices and, therefore, comply with the requirements of Russian tax law on transfer pricing. However, due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and propose adjustments. If such price adjustments are upheld by the Russian arbitration courts and implemented, our results of operations could be materially adversely affected. In addition, we could face significant losses associated with the assessed amount of prior tax underpaid and related interest and penalties, which would have a material adverse effect on our financial condition and results of operations.

Risks Relating to our Shares and ADSs and the Trading Market

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

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

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

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

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

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

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

In addition, although securities regulations expressly permit the depositary to split the votes with respect to the shares underlying the ADSs in accordance with instructions from ADS holders, there is little court or regulatory guidance on the application of such regulations, and the depositary may choose to refrain from voting at all unless it receives instructions from all ADS holders to vote the shares in the same manner. ADS holders may thus have significant difficulty in exercising voting rights with respect to the shares underlying the ADSs. There can be no assurance that holders and beneficial owners of ADSs will (i) receive notice of shareholder meetings to enable the timely return of voting instructions to the

depository, (ii) receive notice to enable the timely cancellation of ADSs in respect of shareholder actions or (iii) be given the benefit of dissenting or minority shareholders' rights in respect of an event or action in which the holder or beneficial owner has voted against, abstained from voting or not given voting instructions.

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

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

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

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

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

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

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

In accordance with Russian legislation, dividends paid to a non-resident holder generally will be subject to Russian withholding at a rate of 15% for legal entities and organizations and at a rate of 30% for individuals. This tax may be reduced to 5% or 10% for legal entities and organizations and to 10% for individuals under the Convention between the United States of America and the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital (the United States-Russia income tax treaty) for U.S. tax residents. However, the Russian tax rules applicable to ADS holders are characterized by significant uncertainties. In 2005, the Ministry of Finance expressed an opinion that ADS holders (rather than the depository) should be treated as the

beneficial owners of the underlying shares for the purposes of the double tax treaty provisions applicable to taxation of dividend income from the underlying shares, provided that tax residencies of the ADS holders are duly confirmed. However, in the absence of any specific provisions in the Russian tax legislation with respect to the concept of beneficial ownership and taxation of income of beneficial owners, it is unclear how the Russian tax authorities and courts will ultimately treat the ADS holders in this regard. Thus, we may be obliged to withhold tax at standard rates when paying out dividends, and U.S. ADS holders may be unable to benefit from these treaties. See Item 10. Additional Information E. Taxation Russian Income and Withholding Tax Considerations for additional information.

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

Under Russian tax legislation, gains realized by non-resident legal entities or organizations from the disposition of Russian shares and securities, as well as financial instruments derived from such shares, such as the ADSs, may be subject to Russian profits tax or withholding income tax if immovable property located in Russia constitutes more than 50% of our assets. However, no procedural mechanism currently exists to withhold and remit this tax with respect to sales made to persons other than Russian companies and foreign companies with a registered permanent establishment in Russia. Gains arising from the disposition at foreign stock exchanges of the foregoing types of securities listed on these exchanges by foreign holders who are legal entities or organizations are not subject to taxation in Russia.

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

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

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

Foreign judgments may not be enforceable against us.

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

There is no treaty between the United States and the Russian Federation providing for reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters. These limitations may deprive you of effective legal recourse for claims related to your investment in the ADSs. The deposit agreement provides for actions brought by any party thereto against us to be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, provided that any action under the U.S. federal securities laws or the rules or regulations promulgated thereunder may, but need not, be submitted to arbitration. The Russian Federation is a party to the United Nations

(New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, but it may be difficult to enforce arbitral awards in the Russian Federation due to a number of factors, including the inexperience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors and Russian courts' inability to enforce such orders and corruption.

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

Ownership of Russian joint stock company shares (or, if the shares are held through a nominee or custodian, then the holding of such nominee or custodian) is determined by entries in a share register and is evidenced by extracts from that register. Currently, there is no central registration system in Russia. Share registers are maintained by the companies themselves or, if a company has more than 50 shareholders or so elects, by licensed registrars located throughout Russia. Regulations have been issued regarding the licensing conditions for such registrars, as well as the procedures to be followed by both companies maintaining their own registers and licensed registrars when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced, and registrars generally have relatively low levels of capitalization and inadequate insurance coverage. Moreover, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company's shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence, official and unofficial governmental actions or oversight by registrars incapable of compensating shareholders for their misconduct. This creates risks of loss not normally associated with investments in other securities markets.

Risks Relating to the Russian Federation

Economic Risks

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

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

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

- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the population.

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

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

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

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

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

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

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and Russian businesses could face severe liquidity constraints, further materially adversely affecting the Russian economy. Additionally, because Russia produces and exports large amounts of oil, the Russian economy is especially vulnerable to the price of oil on the world market and a decline in the price of oil could slow or disrupt the Russian economy or undermine the value of the ruble against foreign currencies. Recent military conflicts and international terrorist activity have also significantly impacted oil and gas prices, and pose additional risks to the Russian economy. Russia is also a major producer and exporter of metal products and its economy is vulnerable to fluctuations in world commodity prices and the imposition of tariffs and/or antidumping measures by the United States, the European Union or by other principal export markets.

Political and Social Risks

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

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

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

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

The Russian Federation is a federation of 88 sub-federal political units, consisting of republics, territories, regions, cities of federal importance and autonomous regions and districts. The delineation of authority and jurisdiction among the members of the Russian Federation and the federal government is, in many instances, unclear and remains contested. Lack of consensus between the federal government and local or regional authorities often results in the enactment of conflicting legislation at various levels and may lead to further political instability. In particular, conflicting laws have been enacted in the areas of privatization, land legislation and licensing. Some of these laws and governmental and administrative decisions implementing them, as well as certain transactions consummated pursuant to them, have in the past been challenged in the courts, and such challenges may occur in the future. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from effectively and efficiently implementing our business strategy.

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

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

The political and economic changes in Russia in recent years have resulted in significant dislocations of authority. The local and international press have reported that significant organized criminal activity has arisen, particularly in large metropolitan centers. Property crime in large cities has increased substantially. In addition, the local press and international press have reported high levels of corruption, including the bribing of officials for the purpose of initiating investigations by government agencies. Press reports have

also described instances in which government officials engaged in selective investigations and prosecutions to further the commercial interests of government officials or certain individuals. Additionally, some members of the Russian media regularly publish disparaging articles in return for payment. The depredations of organized or other crime, demands of corrupt officials or claims that we have been involved in official corruption could result in negative publicity, could disrupt our ability to conduct our business effectively and could thus materially adversely affect our financial condition and results of operations and the value of the shares and ADSs.

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

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

Legal Risks

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

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

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

Furthermore, several fundamental laws have only recently become effective. The recent nature of much of Russian legislation, the lack of consensus about the scope, content and pace of economic and political reform and the rapid evolution of the Russian legal system in ways that may not always coincide with market developments place the enforceability and underlying constitutionality of laws in doubt and results in ambiguities, inconsistencies and anomalies. In addition, Russian legislation often contemplates implementing regulations that have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. All of these weaknesses could affect our ability to enforce our rights under our permits and under our contracts, or to defend ourselves against claims by others. We cannot assure you that regulators, judicial authorities or third parties will not challenge our internal procedures and by-laws or our compliance with applicable laws, decrees and regulations.

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

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

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

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

Developing corporate and securities laws and regulations in Russia may limit our ability to attract future investment.

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

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

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

In addition, Russian corporate and securities rules and regulations can change rapidly, which may materially adversely affect our ability to conduct securities-related transactions. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. It is often unclear whether or how regulations, decisions and letters issued by the various regulatory authorities apply to our company. As a result, we may be subject to fines or other enforcement measures despite our best efforts at compliance.

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

The independence of the judicial system and its immunity from economic, political and nationalistic influences in Russia remains 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 organized in a manner that facilitates understanding. The Russian judicial system can be slow or unjustifiably swift. Enforcement of court orders can in practice be very difficult in Russia. Additionally, court claims are often used in furtherance of political aims or infighting. We may be subject to such claims and may not be able to receive a fair hearing. Additionally, court orders are not always enforced or followed by law enforcement agencies, and the government may attempt to invalidate court decisions by backdating or retroactively applying relevant legislative changes. Judicial decisions in Russia can be unpredictable and may not provide effective redress.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Generally, taxes payable by Russian companies are substantial and numerous. These taxes include, among others:

- income taxes;
- VAT;

- unified social tax; and
- property tax.

The tax environment in Russia historically has been complicated by the fact that various authorities have often issued contradictory tax legislation. This uncertainty potentially exposes us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could result in a greater than expected tax burden and the suspension or termination of our licenses.

Recently, there have been significant changes to the Russian taxation system. Global tax reforms commenced in 1999 with the introduction of Part One of the Tax Code of the Russian Federation, or the Tax Code, which sets general taxation guidelines. Since then, Russia has been in the process of replacing legislation regulating the application of major taxes such as corporate income tax, VAT and property tax with new chapters of the Tax Code.

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

Moreover, financial results of Russian companies cannot be consolidated for tax purposes. Therefore, each of our Russian subsidiaries pays its own Russian taxes and may not offset its profit or loss against the loss or profit of any of our other subsidiaries. In addition, intercompany dividends are subject to a withholding tax of 9%, if being distributed to Russian companies, and 15%, if being distributed to foreign companies. If the receiving company itself pays a dividend, it may offset tax withheld against its own withholding liability of the onward dividend although not against any withholding made on a distribution to a foreign company. These tax requirements impose additional burdens and costs on our operations, including management resources.

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

Other Risks

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

We have sourced certain information contained in this document from third parties, including private companies and Russian government agencies, and we have relied on the accuracy of this information without independent verification. The official data published by Russian federal, regional and local governments may be substantially less complete or researched than those of Western countries. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia in this document must, therefore, be subject to uncertainty due to concerns about the completeness or reliability of available official and public information. In addition, the veracity of some official data released by the Russian government may be questionable. In 1998, the Director of the Russian State Committee on Statistics and a number of his subordinates were arrested and subsequently sentenced by a court in 2004 in connection with their misuse of economic data.

Item 4. Information on Our Company

A. History and Development

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

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

- In 1995, we acquired majority control of the Lianozovo Dairy Plant;
- In 1996 and 1997, we acquired majority stakes in the Moscow Baby Food Plant, the Tsaritsino Dairy Plant and the Ramenskiy Plant;
- In 1998 and 1999, we began to expand into regions outside Moscow, acquiring dairy plants in Novosibirsk, Nizhny Novgorod and Vladivostok;
- In 2000, 2001 and 2002, we acquired majority stakes in dairy plants in Ufa, Bashkortostan and the Krasnodar region in Russia, as well as dairy plants in Kiev, Ukraine and Bishkek, Kyrgyzstan;
- In 2001, we acquired 100% interests in dairy plants in the Altaisky and Voronezh regions of Russia;
- In 2002, we acquired control of three dairy plants in the Krasnodar, Belgorod and Samara regions of Russia;
- In 2002, we acquired control of a dairy plant in Kharkov, Ukraine;
- In 2002, we acquired a 100% interest in the Roska Dairy Plant (renamed Baltic Milk in 2004) in St. Petersburg;
- In 2002, we acquired control of Depsona (since renamed Fruktopak) in Tula and a large warehouse complex in the Moscow region;

- In 2002, we acquired control of a dried milk plant in Buryń, Ukraine;
- In January 2003, we acquired a 100% interest in Siberian Cheese, a refrigeration and warehousing facility in Novosibirsk adjacent to our principal Siberian dairy production facility;
- In August 2003, we acquired underground wells in the Essentuki area of Russia and a water processing and bottling factory which produces Essentuki brand mineral water through our purchase of 100% interests in the companies Healing Springs and Geiser;
- In December 2004, we acquired Atamanskoe farm, a raw milk production company;
- In April, July and September 2005, we acquired three raw milk production companies, Plemzavod Za Mir i Trud, Zavety Ilyicha and Trud Farms;
- In July 2005, we acquired control of the Obninsk Dairy Plant in the Kaluga region;
- In July 2005, we acquired a 100% interest in the Experimental Baby Food Plant in the Kursk region;
- In October 2005, we acquired a 100% interest in the Essentuki Mineral Water Plant at CMW (Caucasian Mineral Waters) in the town of Essentuki in the Stavropol region;
- In December 2005, we acquired a controlling stake in Nazarovskoe Milk in the Krasnoyarsk region;
- In December 2005, we acquired a 100% interest in the Pervouralsk City Dairy Plant in the Sverdlovsk region; and
- In January 2006, we increased our aggregate ownership in the Moscow Baby Food Plant to 97.3%.

In the latter part of 2000, we began a corporate and organizational restructuring to facilitate our initial public offering and our future expansion, both within Russia and into other countries of the CIS. As part of this restructuring, we disposed of our interests in Expobank and four breweries. Since then, we have continued our restructuring efforts with the aim of enhancing our operating efficiency, reducing costs and creating synergies between our existing businesses. For example, in 2005, we merged our juice and water segments into a single beverage segment and created a separate baby food segment. Prior to 2005, baby food was part of our dairy segment. Hence, our operations are currently organized into three separately reported segments: dairy products, beverages and baby food, all operating under the umbrella of our holding company, Wimm-Bill-Dann Foods OJSC, which was incorporated on May 31, 2001.

In addition, in response to increasing raw milk prices, which have put strong pressure on our dairy margins and the overall profitability of the dairy division in recent years, we created a separately managed business unit called Agro at the end of 2004 for the purpose of buying and managing a select number of dairy farms in certain Russian regions. The aim of this new non-core business unit is to develop a guaranteed supply of raw milk at stable prices for use by our dairy division. Agro is currently reported as part of our dairy division. Furthermore, we are in the process of restructuring our business with the aim to increase efficiency and optimize our current operations.

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

From 2003 to 2005, we spent a total of \$254.9 million in capital expenditures for projects in Russia, Ukraine, Kyrgyzstan and Uzbekistan where we have production facilities. Specifically, we improved our existing dairy and cheese production and dairy warehouse facilities, as well as the quality control procedures for the raw milk used in our production. In addition, we installed new production lines and other operating equipment at the Ramenskiy Plant, modernized our recently acquired Experimental Baby Food Plant and updated our IT infrastructure and software. As of March 31, 2006, our capital

commitments amounted to approximately \$35 million primarily for construction projects at our production sites and the purchase of farm-production equipment. We plan to finance these capital commitments from operating cash flow. For a further description of our principal capital expenditures and divestitures since the beginning of our last three financial years to March 31, 2006, as well as those currently in progress, see Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources.

Our legal name is Wimm-Bill-Dann Foods OJSC, and we are incorporated as an open joint stock company under the laws of the Russian Federation and registered with the Moscow Inter-District Inspectorate No. 39 of the Russian Ministry of Taxes and Duties under the state registration number 1037700236738. We operate in the Russian Federation and the CIS under a number of different trademarks and brand names, as more fully described below in B. Business Overview Current Operations Our products and brands. Our business objectives, set forth in Article 4 of our charter, include the production and sale of food products, including milk and sour milk products, mineral water, fruit and vegetable juices and beverages and children's food. Our head office is located at 16 Yauzsky Boulevard, Moscow 109028, Russian Federation, and our telephone number is +7 495-733-9726. We maintain a website at <http://www.wbd.com>. The information on our website is not a part of this report. We have appointed CT Corporation System, 111 Eighth Avenue, New York, New York 10011, as our authorized agent for service of process for any suit or proceeding arising out of or relating to our shares, ADSs, or the deposit agreement.

B. Business Overview

We are one of the largest Russian manufacturers of dairy and juice products. In 2005, approximately 72% of our net revenues were derived from the sale of dairy products, approximately 22% from the sale of juice and water products and approximately 6% from the sale of baby food products.

Since our founding in 1992, we have become the market leader in Russia in the dairy market and one of the market leaders in the juice market. In the dairy market, according to an AC Nielsen study of 24 major cities located throughout Russia, including Moscow and St. Petersburg, we were the market leader (with the exception of open-air markets) during 2005 with 34.1% of the total market in all packaged dairy markets except for pasteurized milk. According to Rosstat, our total market shares in these markets was lower than the AC Nielsen study. Our market shares were 31.3% in traditional dairy products and 40.7% in yogurt and dessert dairy products in terms of value. In the Russian juice market, according to a Business Analytica survey of all of Russia, we had a 21.7% market share in terms of value during 2005. We currently have 30 manufacturing facilities in Russia and other countries of the CIS, as well as distribution centers in 26 cities throughout Russia and the CIS.

Our goal is to offer our consumers quality food and beverage products through the use of carefully selected raw materials, modern production technology and strict quality control. All of our products are made according to our own recipes and reflect our understanding of consumer demand.

Our principal dairy products include:

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

Our principal beverage products include:

- Juice and nectars produced from juice concentrate;

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

Our baby food products include:

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

Our principal geographic market is Russia. In 2005, our dairy product sales were highest in the Central region of Russia, which includes Moscow, the South region, Siberia and the Far East. Our juice sales were highest in the Central region, Siberia and the Volga region. Approximately 95% of our baby food sales were in Moscow and the Moscow region. Each of our production and distribution facilities is owned by a separate subsidiary of ours.

Business Strategy

We aim to retain our position as a leading nationwide producer of quality food and beverage products and to expand our production and sales in order to attain higher revenues, cash flow and earnings. To achieve these objectives, we use the following strategies:

- Expand our geographic reach and production capacity.
- Improve operating efficiencies and reduce costs.
- Brand building and innovation.
- Strengthen human resource capability.

Expand our geographic reach and production capacity. Since 2000, we have acquired production units in various regions of Russia and the CIS. By establishing large production facilities in regions with high population density and available raw materials, we have been able to avoid high transportation costs and take advantage of lower cost labor and milk resources, which can be cheaper in the regions than in Moscow. While we believe that we have achieved national reach and anticipate fewer acquisitions in the future, the fragmented nature of the dairy industry in Russia and the CIS will continue to give rise to opportunities for strategic acquisitions, constructing new capacity and attracting new customers. In turn, we expect these combined factors, along with the geographic expansion of our distribution network, to bring about an increase in our geographic coverage. We intend to continue to implement this strategy through acquisition and construction of production capacity and new equipment, including the selective acquisition of plants, as follows:

- *Dairy.* We have developed and have been actively implementing since 2002 a regional expansion program which contemplates the acquisition of prominent dairy enterprises in Russia and the CIS, as well as significant investment, as necessary, into their modernization. We strive to ensure that our products are produced close to the markets where they are sold, reducing transportation costs and allowing us to respond more rapidly to changing consumption patterns. Following acquisitions, we review and optimize the local product portfolios and replace their management

systems with our own.

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- *Beverages.* Over the past three years, we have increased our juice production capacity at existing plants that we believe have the potential to become supply centers for those regions that offer substantial potential for sales growth. For example, we converted our Ramenskiy Plant in Moscow into a juice-only production plant in 2004. We have also been revising our juice distribution network, aiming to make it more efficient with a wider geographical reach. We will consider carefully selected opportunities in the beverage segment should attractive opportunities arise.
- *Baby Food.* In line with our strategy to develop our baby food sales, we have been investing in the modernization of the Moscow Baby Food Plant and acquired the Experimental Baby Food Plant in Kursk, Central Russia in order to diversify into other categories of baby food and to further expand into the regions of Russia. We are currently undertaking a modernization program for our new plant, and in March 2006, we launched our first line producing juice for babies.

Improve operating efficiencies and reduce costs. We intend to maintain the high quality of our products, reduce our costs, increase our cash flow and improve employee productivity through:

- *Modernizing existing production facilities.* Following the overhaul of several of our production facilities during 2003 and 2004, we will continue to modernize our plants as required in order to reduce our production, raw material and labor costs through higher operating efficiencies and lower raw material wastes.
- *Controlling costs.* We routinely review our cost base to identify costs that may be reduced by improving technology, modernizing production assets, replacing high-cost suppliers, streamlining our management structure and reducing administrative expenses. We intend to continue to increase gradually the share of our raw materials acquired from local suppliers, which tend to be cheaper than imported materials. We also regularly review our workforce, particularly at newly-acquired plants, to help ensure productivity. In Russia's current macroeconomic climate, wage inflation has become a major cost factor, particularly as we have rapidly expanded overall headcount since 2000 with a large number of acquisitions. We have sought to maximize employee efficiency by reducing employee numbers while increasing production capacity through installing new equipment and changing production patterns to meet production needs on a local, regional and group level.
- *Supply chain system.* We intend to implement a nationwide supply chain system that will enable us to maintain our products' integrity, freshness and nutritional value, monitor delivery logistics at all stages, and thereby optimize efficiency while minimizing delivery costs.
- *Improving working capital.* We will continue our efforts aimed at decreasing our stocks of raw materials, packaging materials and finished goods at all of our production facilities while endeavoring to negotiate the most favorable payment terms possible with our suppliers.
- *Increasing direct distribution to retail chains.* We will continue our efforts to increase our direct distribution to retail chains while maintaining or reducing our relationships with independent distributors. Direct distribution can enable us to more efficiently monitor supply and demand and respond to market fluctuations with greater flexibility.
- *Minimizing dairy distribution costs through local production.* We intend to continue to pursue a strategy of manufacturing dairy products in the same region in which they are consumed, decreasing our distribution costs, while at the same time increasing our profit margins for such products.
- *Creating our own raw milk base.* To counterbalance the general and seasonal increases in raw milk prices, we are taking a number of steps, including the leasing of milking and refrigeration equipment to selected dairy farms, in order to ensure consistent quality and quantities of milk at pre-determined prices.

Brand building and innovation. In an increasingly competitive marketplace, we believe effective brand management is key to maintaining our leading positions in the market segments where we operate. We have developed key brands in specific segments into umbrella brands. This allows us to launch new products and enter new product niches with recognized and trusted brands. At the same time, we have elevated some strong local brands into regional and national brands. Maintaining long-established regional brands allows us to fit our marketing approach to specific regional tastes and leverage existing brand identities:

- *Maintaining a leading market position through key core brands.* We believe that, as the Russian dairy and beverages markets mature, only leading national and regional brands will be able to maintain their competitive positions, and that significant consolidation is likely. We will continue to focus on our brands and products with leading market shares in their respective segments. At the same time, we will continue to develop and launch new products and occupy new product niches.
- *Reviewing our brand portfolio and focusing our marketing efforts on key brands.* We will continue to review our brand portfolio with a view towards maintaining only our best-known brands, brands with high operating margins and new brands with significant potential. We intend to build upon and strengthen our best-known brands by consolidating them under our various existing product groups. Our umbrella brands are also instrumental in entering new markets and launching new products. As part of this process, we are shifting our branding focus from specific product categories to specific consumer segments. For example, our Neo branded enriched and juice-containing dairy products, launched in 2004, have established market leadership in these value-added niches around a wider brand identity promoting fitness and a healthy diet.
- *Increasing share of innovative, value-added products.* We intend to continue to invest in developing new value-added products and to increase our marketing and new product development expenditures in order to increase our production and sales volume of value-added products and brands, as opposed to commodity products often associated with narrower operating margins. In particular, we are seeking to increase our sales of yogurt, premium cheese, juice-based products, mixed juices and new flavor juice products as a percentage of our total sales volume through new product launches and management of our existing portfolio of brands and products.
- *Leveraging local brands.* While we believe in consolidating and rationalizing the product groups of businesses and eliminating poorly performing local brands, we also maintain a small number of well-established local and regional brands that have a strong existing identity and appeal to local preferences and cultural identities. For example, our Kubanskaya burenka brand has a strong resonance in southern Russia where certain national brands such as Little House in the Country have less cultural relevance.

Strengthen human resource capability. Operating in both maturing markets, such as Moscow and St. Petersburg, and emerging markets, such as Russia's regions and CIS markets, we are developing our human resource capability on the central group and regional levels to attract and retain skilled management with global consumer industry experience. At the same time, we believe in promoting talented people within the organization, moving people not only up the career ladder, but also into other parts of the business and other regions. In our production facilities, we have sought to make our existing employees more efficient through installation of new equipment and training.

- *Attracting world-class management talent.* In recent years we have recruited both Russian and foreign managers with experience working at multinational consumer goods firms in order to bring international best practices to the company. We have appointed a CEO with many years experience running Coca-Cola bottling companies in the CIS, Western and Eastern Europe.

- *Creating incentives for our employees.* We fully understand that the success of our business is a direct result of the work of our employees and we have had considerable success in fostering future management talent on the enterprise and group level. We have instituted success-based incentives for managers on the regional and group level. At the same time, we have worked with outside providers and our own team of professional trainers, as well as coaches chosen from a pool of the most experienced managers to provide resources for continued educational opportunities within the Corporate University. We aim to ensure that we continue to be seen as one of Russia's most attractive employers for promising graduates while retaining talented employees.
- *Maximizing efficient use of personnel.* We are introducing a performance appraisal system linked to the creation of individual development plans for all management. We are currently starting work on putting in place management assessment and succession planning throughout the company. We are also working on developing an open and trusted environment that enables effective performance.

Current Operations

Dairy industry

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

We estimate, based on combined data from Comcon, AC Nielsen and Goskomstat, that per capita consumption of packaged dairy products in Russia was 54.9, 58.3 and 60.6 liters per year in 2003, 2004 and 2005, respectively, levels that are relatively low compared to the majority of European countries. The demand for dairy products remained relatively stable in the aftermath of the 1998 Russian financial crisis and the ensuing decline in per capita income, as dairy products are generally considered to be staple consumer goods. Additionally, increasing per capita income following 1998 has positively affected dairy consumption, particularly of higher-priced products such as yogurt and dessert dairy products.

According to our estimates, consumption of traditional packaged dairy products in Russia increased between 2004 and 2005 by 3% from 47.8 to 49.2 liters per person. We believe that packaged dairy product consumption levels will continue to increase at a moderate pace in Russia as the consumption of bulk liquid milk decreases due to increasing per capita incomes, the growing desire and demand for sterilized milk and the greater convenience of packaged products. Consumption of bulk liquid milk, which generally consists of unpackaged milk sold in markets to consumers who bring their own packaging, is still relatively common in Russia.

Additionally, a number of packaged dairy products are relative newcomers to the Russian market. For instance, yogurt is a relatively new product for Russian consumers. Since its first widespread commercial appearance in Russia in the early 1990s, yogurt's popularity has increased. Per capita consumption, however, remains low. According to our estimates, annual per capita consumption of yogurt and dairy desserts in Russia increased to about 7.2 kilograms in 2005 from 6.7 kilograms in 2004, reflecting an increase of 7.5%. Other new dairy products in Russia include dairy desserts, mousse, fruit-flavored traditional products, flavored milk, flavored yogurt drinks and combined juice-dairy products.

According to our estimates, annual cheese consumption (yellow, white and processed) in Russia increased by 10.5% between 2004 and 2005, from 3.8 kilograms per capita to 4.2 kilograms per capita, respectively. We believe that cheese consumption levels will continue to grow due to increasing per capita incomes and the greater variety of cheese products available to Russian consumers.

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

The result of this decline was a drop in processing volumes and an increased reliance upon imported dairy products. While the financial crisis of 1998 aided Russian producers to some extent, as it pushed imported foods out of the Russian market, it also caused difficulties for Russian companies that depended on imported materials for production. In general, producers that were able to limit their exposure to fluctuations in the value of the ruble and to establish links with Russian suppliers survived the crisis and took leading positions in the marketplace. The milk processing sector, however, still remains fragmented, and currently includes over 1,500 large, medium and small enterprises, according to IKAR (the Institute of the Agricultural Market). There is evidence, though, that the process of consolidation is continuing, with the less efficient producers going out of business or being acquired by larger companies. For example, in addition to our dairy plant acquisitions in 2005, our competitor Unimilk acquired various dairy plants in the course of 2004, 2005 and thus far in 2006 throughout Russia. See Dairy products and brands Market trends and competition for a description of Unimilk's acquisitions.

Additionally, foreign, particularly European, producers have recognized the potential for growth in the demand in Russia for milk, yogurt and dairy desserts and are investing in the Russian market. A number of European producers, such as Danone, Parmalat, Campina, Lactalis and Ehrmann, produce dairy products in Russia, principally in the Moscow region, and comprise our principal competition in the yogurt and dairy dessert segment of the dairy product market.

Juice and mineral water industries

Consumption. Before the early 1990s, consumption of juice products in Russia was limited. Juice products manufactured in the Soviet Union included only vegetable juices and fruit juices made of locally grown fruits such as apples and pears. Most Russian households tried orange, pineapple, grapefruit and other exotic fruit juices for the first time in 1991 and 1992, following the dissolution of the Soviet Union. Russian juice consumption grew each year until 1998, when it fell following the 1998 financial crisis, which led to a reduction in Russian incomes and a significant increase in the cost of juice products due to the increase in the ruble cost of imported juice packaging and ingredients. While Russian juice consumption has recovered from the effects of the 1998 financial crisis, it is still relatively low compared to most European countries. The following table shows annual per capita juice product consumption in liters in Russia and selected European countries in 2004, according to the most current estimates available from Combibloc, one of our suppliers of packaging materials:

| Country | 2004 |
|----------------|------|
| Germany | 58 |
| Poland | 36 |
| Hungary | 35 |
| Spain | 27 |
| Czech Republic | 25 |
| France | 25 |
| Slovakia | 18 |
| Italy | 14 |
| Russia | 14 |

Source: Combibloc, 2004

We estimate the annual per capita juice product consumption in Russia in 2005 and 2004 was approximately 16 liters and 14 liters, respectively.

The volume of bottled water consumption in Russia is now on par with the consumption of juice products. In 2005, we estimate, based on data from Business Analytica, that the average per capita consumption of bottled water in Russia was 16 liters per year. This figure is significantly lower than consumption levels elsewhere in Europe. For example, according to Euromonitor, the current per capita consumption of bottled water in the United Kingdom is close to 30 liters per year, and over 140 liters per year in Italy and France.

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

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

Additionally, a number of Russian producers that survived the 1998 financial crisis managed to restructure their production facilities using Western technologies and to strengthen their market positions. In 2005, according to a Business Analytica survey of 18 cities located throughout Russia, referred to hereinafter as the Business Analytica survey, the four largest Russian producers had a market share of approximately 88% of the juice product market. Russian producers often use cheaper domestic inputs and modern packaging technologies, and they increasingly promote their brands on a national scale. The industry is now experiencing consolidation, as demonstrated by the increase in acquisition activity and the decrease in the number of brands on the market over the last few years. According to the Business Analytica survey, during 2005, there were more than 100 brands of juice products in the Russian juice market, though only 10 of these brands accounted for 81% of the market.

The bottled water market in Russia is characterized by a large number of brands, including local brands that are strong in the regions where they are produced. In addition, the leading brands in Moscow differ from those with leading market shares in many of the regions outside of Moscow. According to the Business Analytica survey, in 2005, the top ten bottled water producers in Russia had a 75% market share in Moscow and a 69% market share in the ten largest cities of Russia in terms of value for the first two months of 2006. This difference is largely due to the prominence of local or regional producers in certain regions outside of Moscow whose water products are less expensive than those of national brands. The market shares in Moscow of the two largest international bottled water providers, Pepsi and Coca Cola, decreased from 34% in 2004 to 29% in 2005 in terms of value, according to the Business Analytica survey. In terms of market share, Pepsi remained the market leader in Moscow in 2005 followed by domestic producer GG&MW Co N.V. and Coca Cola.

Baby food industry

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

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

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

From 2003 to 2005, the baby food market in Russia grew by 47%, according to our estimates. Three regions of Russia currently account for over 70% of nationwide baby food product sales, including the Central region (including Moscow), the Northwest region (including St. Petersburg) and the Volga region, according to our estimates. In 2005, the Moscow market accounted for approximately 34% of sales in the Russian baby food market, according to our estimates, a 5 - 6% decline from 2003 due to dynamic growth in baby food sales in the regions. Among the markets exhibiting the fastest growth in baby food sales has been the Northwest region, mainly due to active expansion by St. Petersburg-based Petmol, our competitor in the dairy segment and producer of liquid dairy products for infants, the increased presence of our baby food products in this market and active product promotion by leaders in the supplemental infant food segments.

Our baby food division is primarily focused on the production and sale of liquid dairy products. According to our estimates, in 2005, sales of liquid dairy products for children up to 3 years of age in Russia increased by 17 - 18%.

Production.

The baby food market began in Russia in the early 1990s with a government plan to build approximately 110 production sites throughout the country to develop baby food products such as meat, fruit, vegetable, grain and fish purees and various dairy products. Although only a small number of these government-sponsored production sites were ever built, domestic and foreign producers of baby food started acquiring production facilities in Russia in the second half of the 1990s. Since 2000, the baby food market has grown substantially with additional types of products being introduced and increased consumption due, in large part, to the population growth of children aged three and under in Russia.

Today, both Russian and foreign producers have a presence in the baby food market in Russia, with foreign producers generally operating in each of the market's four main product categories and Russian producers generally operating in individual categories.

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

The market share of domestic producers has grown in recent years, with domestic products accounting for approximately 70% of the Russian baby food market by volume in 2005, according to our estimates. In contrast, the market share of Western brands has generally been shrinking, and stood at approximately 30% by volume in 2005, according to our estimates. However, in terms of value, foreign brands currently have an approximately 50% market share, according to our estimates due to the higher average selling prices as compared with domestic products. Notwithstanding the declining market share for foreign baby food products, the sales volumes for these products have continued to increase in recent years due to the continued overall annual growth of the baby food market in Russia.

Our products and brands

Our dairy, beverage and baby food products accounted for 72.0%, 21.7% and 6.3% of our net sales in 2005, respectively. Our principal geographic market is Russia, with the Moscow market being among the most significant. The following table sets forth our annual consolidated net sales, the proportion of consolidated net sales accounted for by our main business lines, our reported annual production volume and the growth rate by production volume of our business lines:

| | 2005 | | 2004 | | 2003 | |
|--|----------------|---|----------------|---|--------------|-----|
| Dairy products | | | | | | |
| Sales (in millions) | 1,007.7 | | 822.9 | | 616.3 | |
| Annual sales growth (% year on year) | 22.5 | % | 33.5 | % | n/a | (1) |
| Percent of total sales | 72.0 | % | 69.2 | % | 65.7 | % |
| Sales volume (in thousand metric tons) | 1,195.3 | | 1,098.5 | | 960.0 | |
| Annual volume growth (% year on year) | 8.8 | % | 14.4 | % | n/a | (1) |
| Beverage products | | | | | | |
| Sales (in millions) | 303.8 | | 301.7 | | 276.0 | |
| Annual sales growth (% year on year) | 0.7 | % | 9.3 | % | n/a | (1) |
| Percent of total sales | 21.7 | % | 25.4 | % | 29.4 | % |
| Sales volume (in million liters) | 436.2 | | 462.6 | | 478.6 | |
| Annual volume growth (% year on year) | (5.7) | % | (3.3) | % | n/a | (1) |
| Baby food products | | | | | | |
| Sales (in millions) | 87.8 | | 64.7 | | 46.0 | |
| Annual sales growth (% year on year) | 35.7 | % | 40.7 | % | n/a | (1) |
| Percent of total sales | 6.3 | % | 5.4 | % | 4.9 | % |
| Sales volume (in million liters) | 57.8 | | 50.0 | | 45.9 | |
| Annual volume growth (% year on year) | 15.5 | % | 8.9 | % | n/a | (1) |
| Total net sales (in millions) | 1,399.3 | | 1,189.3 | | 938.5 | |

(1) Growth data for 2002 based on new segmentation is unavailable.

Dairy products and brands

Our principal dairy product lines, types of products, principal brands, and their approximate percentage of our total dairy revenue in 2005, 2004 and 2003 are as follows:

| Product line | Types of products | Main brands | Approximate percentage of total dairy revenue in 2005 | Approximate percentage of total dairy revenue in 2004 | Approximate percentage of total dairy revenue in 2003 |
|----------------------------|--|--|---|---|---|
| Traditional products | Sterilized and pasteurized milk, butter, cream, traditional sour-milk products such as kefir, cottage cheese, soft cottage cheese and sour cream | Little House in the Village, Happy Milkman, M, Kuban Cow, Zavetny Bidonchik, Bio-Max, and Our Doctor | 58.8% | 57.4% | 58.2% |
| Yogurts and dairy desserts | Traditional and drinking yogurt and dairy desserts, including mousse, fruit-flavored milk and kefir, puddings and flavored cottage cheese | Bio-Max, Neo, Happy Milkman, Chudo, Frugurt, Ginger Up and Lada | 38.9% | 38.1% | 36.1% |
| Cheese | Traditional cheese products | Lamber, Ginger Up and Happy Milkman | 2.3% | 4.5% | 5.7% |

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

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

In general, we seek to maintain at least one brand within most dairy market segments, and we intend to develop new brands to expand our coverage of attractive segments. For example, in 2002 we developed the Ginger Up brand, which is targeted at children and includes dairy products, as well as juices, and in 2003 we launched the premium NEO brand and the mass-market Zavetny Bidonchik. We expanded our NEO brand in 2004 and 2005 to offer a broader selection of products in the attractive premium segment.

Market trends and competition. Overall, the Russian dairy market has been growing over the last three years. According to our estimates, the total market for packaged dairy products in Russia was 7.9 billion liters in 2003, 8.4 billion liters in 2004 and 8.7 billion liters in 2005. We believe that consumption may continue to increase at a more moderate pace, as rising household incomes in Russia may tend to bring about higher protein consumption and preferences for value-added products. In particular, Russian households have proven receptive to yogurt, enriched dairy products and dessert dairy products. Given the existing low per capita consumption, we see this market segment as providing an opportunity for growth. We also expect continued growth in the consumption of products with long shelf lives, including sterilized milk.

Though some measure of consolidation is occurring in the Russian dairy industry, the milk processing sector in Russia remains fragmented and currently includes over 1,500 large, medium and small enterprises, according to IKAR. Due to the high degree of fragmentation, the market is very price competitive. In 1999, we responded to this competitive challenge by holding our prices constant in an inflationary environment. In addition, from 2000 to the present, we have expanded our distribution service, reduced our sales to wholesalers, increased our sales to retailers and increased advertising. We also remain committed to our regional expansion strategy and are constantly widening our regional product offerings as consumer spending is growing steadily in the regions. For example, in order to increase our market share in regional markets for our new premium segment yogurts and dairy desserts, we began selling these products during 2004 in several regions at introductory prices, making them more attractive both to distributors, retailers and final consumers. We believe that these strategies have increased public awareness of our products and helped us to continue to expand our market share without aggressive pricing.

In the traditional dairy product markets, we compete primarily with local producers, such as Unimilk and Ochakovo Dairy Plant, as well as with a number of smaller producers in other regions of Russia. In the enriched dairy product market, we compete primarily with Groupe Danone, the Ochakovo Dairy Plant and Petmol. In the yogurt and desserts market and, to some extent, in the children's product market, we compete with foreign producers such as Danone, Campina, Onken and Ehrmann who continue to invest in their businesses in Russia. We view the following producers as our primary competitors:

- *Groupe Danone*, a French company which is the most active foreign producer in Russia and aggressively promotes its products. It has a dairy plant in the Volga region where it produces yogurt, fruit yogurts and kefir, as well as a dairy plant in the Moscow region. Its domestically produced and imported products are sold under the Danone brand name across Russia through its own distribution network. According to the 24 city AC Nielsen study, in 2005, Danone had a 25.8% market share in yogurt and dessert dairy products and a 14.3% overall market share in the Russian dairy product market in terms of value. Danone owns 9.9% of our outstanding shares in the form of ADSs.
- *Unimilk*, the second largest dairy holding company in Russia, founded in 2002 as a dairy division of Planeta Holding, controlled by Millhouse Capital. Unimilk has 17 dairy production facilities in Russia and two in Ukraine. Its largest production facility, St. Petersburg-based Petmol, produces a wide range of dairy products. According to the 24 city AC Nielsen study, in 2005, Unimilk had a 8.9% market share in traditional dairy products, a 2.3% market share in yogurt and dessert dairy products and a 6.7% overall market share in the Russian dairy product market in terms of value.
- *Ochakovsky Dairy Plant*, a Moscow based company and one of the largest dairy plants in Russia. It produces traditional dairy products and yogurts and desserts. According to the 24 city AC Nielsen study, in 2005, the Ochakovsky Dairy Plant had a 6.0% market share in traditional dairy products, a 2.3% market share in yogurt and dessert dairy products and a 4.5% overall market share in the Russian dairy product market in terms of value.
- *Ehrmann*, a German company producing yogurt products at its plant located in the Moscow region. Its brand names Ehrmigurt, Yogurtovich, Fruktovich and Uslada were developed specifically for Russian consumers. According to the 24 city AC Nielsen study, Ehrmann had an 8.2% market share by sales in yogurt and dessert dairy products in 2005 in terms of value.

We believe that we generally have several advantages over other Russian producers, including a larger production capacity and higher quality products, as well as greater innovation, new product development, geographical coverage, centralized management and marketing capabilities. However, many other domestic producers tend to benefit in comparison to us from lower cost bases, including lower advertising and distribution costs, and, for certain consumers, a preferred image.

Recent trends also indicate that industry consolidation may lead to the appearance of larger domestic producers, which could become significant competitors. For example, in addition to our dairy plant acquisitions in 2005, our competitor Unimilk acquired various dairy plants in the course of 2004, 2005 and thus far in 2006, including the Kostroma Dairy Plant, Vladimir Dairy, Volgograd Dairy Plant No. 3 and Rosa (Smolensk) in central Russia; the Shadrinsky Dairy Plant in the Kurgansk region; and Tom-Mac (Tomsk), Novosibirsk City Dairy Factory and Solti (Kemerovo) in Siberia. In addition, in 2006, Unimilk acquired 55% of Permmoloko, a dairy plant in Perm (Ural region). In 2005, Unimilk completed the main phase of upgrading its production capacities at the Petmol factory (St. Petersburg) at a cost of over \$15 million. These acquisitions and investments by Unimilk have heightened its competitive position substantially in the Russian and CIS dairy product market.

Foreign dairy manufacturers generally have large promotional budgets and advanced production know-how, allowing them to offer quality and innovative products, and strong distribution networks. While foreign manufacturers generally tended in the past to focus on niche markets, usually in the premium segment, they are now increasingly concentrating on producing products for the average Russian consumer with an average income. Moreover, whereas our foreign competitors tended in the past to rely primarily on imported products, which are more expensive, a number of these companies, such as Danone, Parmalat, Campina and Ehrmann, have invested and continue to invest in domestic production facilities, reducing the competitive advantages that we have over foreign competitors without domestic production capability. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry Increased domestic production by our foreign competitors could reduce our competitive advantages against them, which would have a material adverse effect on our market share and results of operation.

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

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

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

Beverage products and brands

Our beverage products consist of juice and bottled mineral water products. In 2005, approximately 98% of the net revenues of our beverage segment were derived from the sale of juice products and approximately 2% from the sale of bottled mineral water products.

Our juices are produced primarily at the Ramenskiy Plant and at Fruktopak, and we have also installed juice lines at our dairy production facilities in Vladivostok, Novosibirsk and at the Tsaritsino Dairy Plant. Our mineral water is produced at our plant in the Novgorod region and at our two plants in the Essentuki area.

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

| Product Line | | Brands and Types of Products |
|---|--|------------------------------|
| Juice and nectars produced from juice concentrate | <ul style="list-style-type: none"> • J-7, covering 12 kinds of fruit, berry and vegetable juices and nectars • Rio Grande, covering 7 kinds of fruit and berry juices and nectars • 100% Gold, covering 8 kinds of fruit, vegetable and berry juices and nectars • Lovely Garden, covering 11 kinds of fruit, vegetable and berry juices and nectars, 5 kinds of juices and nectars enriched with vitamins and 3 kinds of traditional Russian berry drinks | |
| Enriched juice-based drinks | <ul style="list-style-type: none"> • J-7 Idea, an innovative juice-based drink with real fruit pieces • J-7 Bio, an innovative juice-based drink enriched with prebiotics • J-7 Exotic, an exotic fruit juice and nectar range | |
| Traditional berry-juice-based drinks | <ul style="list-style-type: none"> • Wonder Berry, covering 7 kinds of berry-juice based drinks and 2 kinds of berry compote | |
| Other juice-based drinks | <ul style="list-style-type: none"> • DJ, covering 4 kinds of fruit and berry drinks | |
| Mineral water | <ul style="list-style-type: none"> • Essentuki, covering 3 kinds of therapeutic mineral water (Essentuki #4, #17 and #20) • Sanctuary Valday, covering 2 kinds of mineral water rich with natural mineralization • Sanctuary Beshtau, covering 2 kinds of mineral water rich with natural mineralization • Novoessentukskaya, covering 1 kind of therapeutic mineral table water | |

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

| Segment | General Purchaser Characteristics | Juice and nectars produced from juice concentrate | Traditional berry-juice-based drinks | Other juice-based drinks | Mineral water |
|--------------|---|---|--------------------------------------|--------------------------|-------------------------------------|
| Premium | <ul style="list-style-type: none"> • Aged 20-45 • Mainly working women with high incomes • Consumers who appreciate and care about quality | Rio Grande | | | |
| Upper-middle | <ul style="list-style-type: none"> • Aged 20-45 • Men and women in the middle to upper-middle income bracket • Active, optimistic and open-minded | J-7 | Wonder Berry | J7 Bio, J7 Idea and DJ | Essentuki |
| Middle | <ul style="list-style-type: none"> • Aged 25-45 • Primarily married men and women with children in the middle income bracket • Self-confident, rational, but not trend setters | 100% Gold | | | Sanctuary Valday, Sanctuary Beshtau |
| Lower-middle | <ul style="list-style-type: none"> • Aged 25-45 • Men and women typically with children and below average incomes; family oriented • Optimistic | Lovely Garden | Lovely Garden | | Novoessentukskaya |

In 2003, we commenced the repositioning of our Lovely Garden and J-7 brand products with new packaging and marketing approaches. In 2004, we turned J-7 into an umbrella brand and launched J-7 Idea in PET bottles (plastic bottles), as well as J-7 Exotic, which are marketed to appeal to people on the move with fast and healthy lifestyles. We also introduced new packaging and marketing approaches for J-7 brand products, including a change from Tetra Brik and Tetra Slim packaging to Tetra Prizma packaging and the launch of PET packaging. When launched, the new products with PET bottle packaging were unique for the Russian market. We also launched a new product under our Lovely Garden brand in 2004 called Lovely Garden 10 Vitamins. In 2005, we released J-7 Bio, a prebiotic drink sold in PET

bottles. We also began selling berry compotes under the Wonder Berry brand and at the end of 2005, and began producing 3 types of mors, a traditional Russian berry drink, under the Lovely Garden brand. We also began producing J7 and 100% Gold juices and nectars in 1.5 liter formats, and Lovely Garden juices and nectars in 2.0 liter containers. In 2006, we added a new 0.425 liter container size to the Lovely Garden range, and began selling certain juices and nectars in PET bottles.

We launched our water operations in March 2003, when we began operations at our new water processing and bottling factory in the Novgorod region, and extended our operations in August 2003 and October 2005 with the acquisition of mineral water factories and underground wells in the Essentuki area of Russia. Our mineral water products are positioned in the upper-middle segment of the market and cater to consumers who prefer bottled natural mineral water to purified or ordinary tap water. In 2005, we merged our water and juice businesses into a single beverage business unit to further reduce costs and benefit from natural synergies.

In August 2003, we acquired underground wells and a factory that produces Essentuki mineral water and acquired an additional Essentuki mineral water plant in October 2005. Essentuki brand water is mineral water from the Essentuki area of Russia, which is known for its mineral waters and spas. Essentuki was a famous Soviet brand, and is still one of Russia's best known mineral water brands. It is produced and bottled by several manufacturers in the Essentuki area in recognizable 0.5 liter dark green bottles long associated with the brand. We also produce Essentuki in 1.5 liter plastic bottles. We remain committed to expanding our Essentuki production capacity.

We obtain natural mineral water from an underground source near the Valdai National Preserve, which is bottled at our factory in the town of Okulovka in the Novgorod region. This plant is capable of processing up to 360,000 liters of bottled water per day. The still and sparkling natural drinking water bottled at our Okulovka plant became commercially available during May 2003 and is marketed nationally in Russia under the Sanctuary Valdai brand name. Our Sanctuary brand portfolio was broadened in 2004 to include water from the Caucasus region, sold under the Sanctuary Beshtau brand. Sanctuary Beshtau is sold in 0.5 liter and 0.33 liter glass bottles and in 5 liter plastic bottles for home consumption.

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

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

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

Market trends and competition. The Russian juice market grew steadily from the time of the dissolution of the Soviet Union until the 1998 financial crisis, following which there was a significant decrease in consumption from which the market had substantially recovered by 2000. The total market for juice products, defined as the total consumption of domestically produced and imported products, increased to 2,270 million liters in 2005, according to Business Analytica, from 2,030 million liters in 2004. We believe that rising household incomes in Russia and the increasing preference for juice over fresh

fruits, which generally accompanies increased incomes, will encourage the consumption of vitamin-rich, value-added products with different tastes and nutritional characteristics. For example, according to the Business Analytica survey, in Moscow, which enjoys higher average per capita incomes than most other parts of Russia, the average consumption of juice in 2005 was approximately 40 liters per capita, as opposed to national per capita consumption of approximately 16 liters per capita. The most dynamic growth in recent years has been in the lower-middle price bracket, which we expect will continue to drive market growth in the foreseeable future.

The markets for juice products in Moscow, the Moscow region and St. Petersburg are relatively mature compared to other regions of Russia, and are expected to exhibit relatively modest growth rates in the future, with particular growth expected in the upper-middle product segment. We believe that growth opportunities lie in the regions of Russia with lower fresh fruit availability or rising household income, where we expect particular growth in the lower-middle product segment. We also believe that potential for growth lies in other CIS countries, which are relatively undeveloped in terms of juice consumption, such as Ukraine and countries in Central Asia. Given these market characteristics, we are pursuing a marketing strategy aimed at promoting juice drinking habits by emphasizing the health benefits.

The operating environment has been challenging since the 1998 financial crisis. Competitive pressures have intensified because of the low purchasing power of households outside of Moscow and St. Petersburg and the rising number of domestic producers. We initially responded to this competitive challenge by holding our prices constant in an inflationary environment, as well as by introducing two new brands, one targeted at the middle-market price segment and the other at the mass-market price segment. In addition, we have been revising our juice distribution network, reducing the number of distributors we work with and maintaining relationships with distributors having direct distribution capabilities. We believe that, together with the launch of new products, the increased share of higher-priced products in our product mix, increased advertising, new packaging and increased production capacity, these strategies will increase public awareness of our products and our sales, which will allow us to expand our market share at acceptable prices. At the same time, however, while our profit margins on our beverage products increased in 2003, 2004 and 2005, our sales volumes decreased during these periods due to vigorous market competition from domestic and foreign producers and our ongoing overhaul of our juice distribution network. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry Increased competition among juice producers in Russia has caused our sales volumes in our beverage segment to decline, which has adversely affected and may continue to adversely affect our results of operations and Consumer preference for low-price juice products and the volatility of certain raw materials required for juice production may cause our profit margins to decline and have a material adverse affect on our results of operations.

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

- *Multon* is a St. Petersburg-based company that, according to the Business Analytica survey, had a 23.3% market share in Russia during 2005. Its Rich, Kind and Niko brands entered the Moscow market in 1998 and since then have gained significant market shares primarily through aggressive pricing policies and advertising. Multon was purchased by Coca-Cola in 2005.
- *Lebedyansky* is based in the Lipetsk region and, according to the Business Analytica survey, had a 27.6% market share in Russia during 2005. Its Tone, I, Fruit Garden and other brands have become well-known among Russian consumers. Lebedyansky recently acquired a majority stake in Progress, a juice concentrate producer. Lebedyansky raised over \$150 million in its initial public offering in Russia in 2005.
- *Nidan* is a Novosibirsk-based Russian company that, according to the Business Analytica survey, had a 15.4% market share in Russia during 2005.

Several foreign companies invested in domestic production facilities during 2001, including Coca-Cola, which purchased local producer Multon, one of our primary competitors, in 2005. During 2004, PepsiCo aggressively entered the Russian market with its Tropicana brand juices, which it produces domestically at the Nidan plant in the Novosibirsk region. Domestic production by foreign producers in Russia reduces the competitive advantages that we have over foreign competitors without domestic production capability. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry Increased domestic production by our foreign competitors could reduce our competitive advantages against them, which would have a material adverse effect on our market share and results of operation.

However, we believe that we can compete successfully against foreign producers. We offer our customers quality juice products with a range of different tastes and nutritional characteristics. Further, we have a quality brand portfolio which ranks highly in almost all market segments, and we plan to continue to devote significant resources to advertising and marketing our leading brands.

The market for mineral water is characterized by rising consumption, as well as many local brands that are strong in their respective home regions. According to Business Analytica, the total market for bottled water in Russia increased to approximately 2,237 million liters in 2005 from 2,033 million liters in 2004. Russian bottled water producers dominated the market, with a 68.5% market share in terms of value, while the share of the two market leaders, PepsiCo and Coca-Cola, accounted for 31.5%, according to a Business Analytica survey of Russia's 10 largest cities in September through October 2005. According to the same survey, we were among the top ten water producers in Russia, with a 3.2% market share by value. The market growth in recent years has been driven mainly by the increased consumption of bottled water sold in large packaging, which is consumed for drinking, as well as cooking purposes. We believe that this market will continue to expand in the coming years due to the growing income per capita in Russia and increasing concern among the population regarding food and water quality.

Baby food products and brands

Our baby food products consist of products sold under the Agusha brand, including liquid dairy baby food, juice, meat purees and products for pregnant and nursing women. These products are mainly produced at the Moscow Dairy Baby Food Plant and, starting in the Spring of 2006, the Experimental Baby Food Plant. In 2005, baby food products comprised 6% of our total sales.

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

We are currently developing our baby food division by focusing on the regional expansion of our sales and increased production, including through co-packing arrangements with certain third-party facilities. We also plan to launch new products, as well as expand the range of our existing products.

To further our development strategy, we acquired the Experimental Baby Food Plant in the Kursk region in July 2005 and are currently modernizing the facility. The plant sources certain of its raw materials from its own fruit orchards, and our acquisition of the plant will allow us to expand our baby food product range to include fruit and vegetable purees.

Market trends and competition. The baby food market in Russia has been experiencing dynamic growth in recent years, supported by improved market conditions, including rising average incomes, more stringent government regulation of baby food production and the introduction of various state-supported social programs aimed at improving domestic birth rates and providing maternity assistance. As a result of these improved conditions and increased consumer demand, domestic production of baby food products has increased over the last few years, with certain of Russia's major juice and dairy producers increasing their production capacity and introducing new baby food brands. Foreign producers are also active in the market and, similar to the dairy and juice markets, several such producers have begun to focus on establishing local production capacity in Russia. We believe that market consolidation is likely over the

next several years, with the largest foreign and domestic baby food producers acquiring smaller regional producers in order to increase their production capacity. In addition, we believe continued market growth will lead to the emergence of product price segments similar to those in the juice and dairy markets.

Overall, the Russian baby food market has been growing over the last three years. According to our estimates, the total market for baby food products in Russia was 803,000 tons in 2003, 842,000 tons in 2004 and 869,000 tons in 2005. Given the existing low per capita consumption of products specifically produced for babies and the fact that spending on such products increases as family incomes grow, we see this market segment as providing an opportunity for growth. Another factor driving the growth of the Russian baby food market is the increase in the number of infants aged four and under by 4% in 2005.

We were the market leader in liquid dairy products for infants in Russia in 2005, with an approximately 56% market share, followed by Unimilk with an approximately 14% market share. Nestlé and Nutricia were the market leaders for powdered formula and cereals, with approximately 50% and 25% market shares, respectively. The preceding market data, in each case, is according to MEMRB. Local producers of baby food products are also active in regional markets, the largest of which are the Zelenodolsk Baby Food Dairy Plant, Ekaterinburg Dairy No. 1, Novosibirsk Dairy and Ratmir Tver Dairy.

According to a consumer study conducted in August 2004 by GfK Rus, a marketing research institute, price is currently not the main factor considered by purchasers of baby food products when it comes to choosing brands and forming brand loyalties. Rather, the main factors influencing consumer decisions are quality, brand image, product uniqueness, convenience, availability of desired flavors and product hypoallergenicity. In addition, as competition within the market has increased, factors such as flavor and product innovations, beneficial additives and package formats have also begun to influence consumer choice.

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

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

New Product Development

We invest significant financial and human resources in new product development, focusing on long-term strategic development projects that are expected to create innovative products and technologies. As of December 31, 2005, our product and technologies development departments located at Lianozovo Dairy Plant had 46 employees and our juice product and quality department at the Ramenskiy Plant had 31 employees. These departments often cooperate with third parties such as Russian research institutions, specialized research firms and suppliers.

Much of our new product development effort over the past three years has focused on higher-margin, value-added yogurt and dessert products to help ensure that we can offer products which match the quality and variety offered by our main foreign competitors in Russia. At present, we are focused on the

development of value-added dairy products oriented towards Russian consumers, taking into consideration the general deficit of micro- and macro-nutrients in the diets of the average Russian consumer. We attempt to link new product development with marketing and sales in an effort to create innovative products and technologies.

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

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

In addition to new product development, recent technological innovations include the development of our own stabilizers and bacteria cultures for the production of certain dairy products. The stabilizers and bacteria cultures, which we began using in 2004 and 2005, respectively, allow us to partially replace some of the raw materials we otherwise import.

Advertising and Marketing

Our advertising and promotional strategies are prepared internally by our marketing and advertising departments who work closely with advertising agencies and design studios. Our general policy and overall aim is to promote our brands nationally and strengthen our image as a leading Russian producer of high quality products. To implement this policy, we create brand-oriented, national advertising campaigns for consumers throughout Russia. This advertising primarily consists of television commercials, which allows us to reach the largest number of Russian consumers.

Additionally, given the diversity of the regions in which we operate and in order to enhance flexibility in responding to regional market trends, we supplement our national television advertising campaigns with regional advertising and marketing, consisting primarily of advertisements on local TV, promotions, point-of-sale displays, merchandising and billboards. To the extent that this regional advertising is based on national campaigns, our regional marketing managers are responsible for adapting it to regional consumption patterns and needs. Regional campaigns can also be created by regional brand managers, subject to central coordination and approval.

Our advertising and marketing expenditures of \$43.8 million in 2003, \$54.3 million in 2004 and \$57.9 million in 2005 constituted 4.7%, 4.6% and 4.1% of net sales, respectively. Though we are, in some instances, able to obtain volume discounts, we expect these expenditures, as a percent of net sales, to increase due to market competition and annual media inflation. According to Gallup, in Russia, we were the second largest advertiser in 2003, the third largest advertiser in 2004 and the ninth largest advertiser in 2005.

A majority of our advertising expenditures are for the promotion of our leading nationwide juice brands, such as J-7 and Lovely Garden. We plan to continue to allocate the bulk of our advertising budget to a limited group of strategic brands which are highly ranked in their respective markets. We also plan to continue our aggressive advertising and marketing of selected new products.

We continually seek fresh outlets for promoting our brands. For example, in 2001 and in 2003, we sponsored the television program *The Last Hero* (the Russian version of *Survivor*), the first reality-based series on Russian television. In this connection, our J-7 brand products were featured in virtually all public relations and marketing relating to the show on billboards, J-7 packaging, television and print advertisements, as well as on the show itself. We also sponsored two other reality-based television programs using our NEO and Zapovednik brands. In 2005, we sponsored and promoted our Lovely Garden brand through a popular television sitcom, and in 2005 and 2006 we featured a popular Russian actress in our advertising, including in television commercials and print advertisements. In cooperation with one of Russia's national television channels, we also sponsored a Russian cinema festival and related events in 2005, through which our Chudo products were prominently featured in television commercials and at the festival itself. Another example of innovative marketing is our promotion of the Ginger Up brand, which is targeted at children, with a unique Ginger Up magazine for children.

Pursuant to turning J-7 into an umbrella brand, we launched new products, packaging and an advertising campaign aimed at people on the move with fast and healthy lifestyles. We also promoted our Lovely Garden brand by including a ticket on each package that could be cut out by the purchaser to participate in a drawing for a cash prize.

We have also built brand awareness through charitable work and sponsored events. For example, in 2004, 2005 and 2006, we sponsored the Tefi National Television Awards program. For several years, we have sponsored International Charity Foundation events benefiting orphans through its Hope Around the World program. We have also sponsored Internal Protection of Children Day in Russia, as well as events of Ronald McDonald's Sports and Recreation Center for Children, which helps mentally and physically disabled children. We also support several other charitable organizations and serve as a trustee of the Charity Foundation for Special Grants, which is headed by Mstislav Rostropovich, a prominent Russian musician.

Sales and Distribution

The broad distribution of our products is an important element in maintaining sales growth and providing services to our customers. We attempt to meet the changing and increasing demands of our customers by planning appropriate stock levels and reasonable delivery times consistent with achieving the optimal economics of distribution. In order to achieve these objectives, we have developed a proprietary network of 27 distribution centers and sales offices throughout Russia and other countries of the CIS. Specifically, we have 11 dairy distribution centers and 16 beverage distribution centers that provide us with a broad national presence and facilitate the sale of our products in populous regions and in certain regions where we do not own production facilities. These distribution centers function as distribution points in their respective regions, and also coordinate certain local trade marketing. We also sell our products directly from our production facilities.

For the purposes of establishing pricing policies, coordinating interaction with local authorities, production and raw material purchase planning, we divide Russia into two sales and distribution areas: European Russia and Asian Russia.

Distribution

Due to different consumption patterns and product characteristics, our dairy and beverage businesses require different distribution strategies. We have therefore built two largely independent distribution systems for our dairy and beverage products, although we use the same marketing approach in each business and take advantage of synergies between the systems to the extent possible. Distribution of our baby food products is handled partially through our dairy distribution centers and partially through independent distributors.

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

Our infant dairy products produced by the Moscow Baby Food Plant are largely purchased by the Moscow City Government, which, in turn, distributes them through specialized milk kitchens located around Moscow and the Moscow region. In 2003, 2004 and 2005, approximately 62%, 61% and 56%, respectively, of our baby food product sales volumes were distributed through these milk kitchens, with the remaining sales volumes sold through our distributors. The baby food product sales volume distributed through the milk kitchens has been decreasing while, at the same time, the volume of commercial sales of our dairy products has increased. For a description of the risk relating to our reliance on the Moscow City Government to purchase of our infant dairy products, see Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry. In the event that the Moscow City Government were to reduce significantly the prices or the amount of products it purchases from our baby food business, then our revenues and profits from this business could be reduced.

Our beverage products have longer shelf lives than dairy products, which allows us to distribute these products to customers across the country. We have established a broad proprietary distribution network, with distribution centers in all key Russian cities with populations of more than one million and representative offices and sales agents in smaller regions. Typically, a distribution center includes sales and marketing personnel dedicated to serving each customer group separately, and accounting and logistics personnel. Further, in order to build strong relationships with major customers, we have adopted a concept of key account management which enables us to negotiate better trade terms with such customers.

Customer base and pricing

We distribute our products through a variety of channels, including independent distributors and wholesalers, supermarket chains, small- and medium-sized grocery stores, open-air markets and restaurants. As a percentage of total revenue during 2005, in terms of product value, approximately 66% of our dairy products, 81% of our beverage products and 43% of our baby food products were sold through independent distributors and wholesalers; approximately 26% of our dairy products, 12% of our beverage products and 18% of our baby food products were sold through supermarket chains by direct delivery; approximately 3% of our dairy products, 2% of our beverage products and 3% of our baby food products were sold through direct delivery to retailers other than supermarket chains; and approximately 5% of our dairy products, 5% of our beverage products and 36% of our baby food products were sold through other channels, including hotels, restaurants, schools, airlines, milk kitchens (for baby food) and other establishments.

Our general distribution strategy for dairy products is to increase the share of direct distribution to retail chains such as supermarket chains, grocery shops and restaurants while maintaining our relationships with independent distributors. Increased direct distribution to retailers allows for greater flexibility with short-lived dairy products and should improve gross margins and increase our marketing potential, although direct distribution will also result in higher transportation and sales costs. To this end, we have expanded our proprietary distribution network.

Our distribution strategy for beverage products is to sustain and enhance our relations with independent distributors, with whom we have generally developed long-standing, beneficial relationships.

Our distribution strategy for baby food products is to actively develop our regional sales with a focus on Russia's largest cities and population centers with relatively high income levels by increasing sales through retail chains and independent producers. We are also seeking to actively develop sales to government-funded welfare programs, such as milk kitchens that provide baby food products to families with infants during the child's first two years of life.

Independent distributors. As a percentage of our total sales during 2005, in terms of product value, we sold approximately 66% of our dairy products, 81% of our beverage products and 43% of our baby food products through large networks of independent distributors, structured as follows:

- As of December 31, 2005, our dairy distribution network consisted of six large independent distributors in Moscow and one independent distributor in the Moscow region. All of our dairy distributors in Moscow distribute only our products and do not distribute the dairy products of our competitors. We also implemented a segmentation program among the six Moscow distributors whereby each distributor controls the distribution of a particular segment or segments of the dairy product market and distributes in accordance with our unified pricing scheme. In St. Petersburg and the surrounding areas, we have three large independent distributors who purchase products from us in accordance with the segmentation program, and we plan to expand this structure and our distributors to cover the entire Northwest region. We believe that this strategy increases the quality and efficiency of distribution while allowing distributors a larger financial stake and incentive to operate high-quality distribution channels. As of December 31, 2005, we had approximately 240 independent dairy distributors throughout Russia.
- As of December 31, 2005, our beverage product distribution network consisted of 16 affiliate offices throughout Russia which, in turn, work with more than 160 independent distributors throughout their respective territories. In Moscow, for example, our distribution affiliate office worked with four local independent distributors. We have reduced the number of distributors we work with and broadened the scope of sales made through the distributors to include sales to sub-distributors, wholesalers and small retailers. In Moscow, our independent distributors act principally as logistical coordinators, as our sales representatives work directly with retail outlets and other customers in making sales but rely on the distributors to execute the orders through delivery and payment collection. Outside of Moscow, we rely more heavily on our independent distributors to make sales in addition to coordinating payment and delivery logistics. Some of our beverage distributors have teams devoted exclusively to the sale and distribution of our products, with such teams compensated by us and the relevant distributor.
- As of December 31, 2005, our baby food product distribution network consisted of eight independent distributors in Moscow and the Moscow region and 27 distributors covering the Central and Ural regions. In other regions we used distributors that work with our dairy division.

A number of independent distributors with whom we work purchase both dairy and beverage products from us. We offer our independent distributors certain discounts off our base prices. A long-term tariff plan is developed with each independent distributor that provides the terms of the discount and deferred payment plans. The terms of these tariff plans may be adjusted from time to time based on the performance of a distributor.

Independent distributors purchase directly from us and then resell our products through their own distribution centers. Given the importance of these customers, we process orders from independent distributors relatively quickly. The Lianozovo Dairy Plant computer center launched its Internet order system in January 2000, and all orders by our dairy product distributors in Moscow and the Moscow region are now placed through the Internet. In 2001, we started to use an automated order system with all of our independent distributors who purchase our products in large volumes, and in 2002, we began using this automated order system with our smaller independent distributors as well.

During 2004, we worked and invested with our independent distributors in Moscow to establish warehouses and transportation capable of supporting a cold supply chain in order to maintain our products' integrity, freshness and nutritional value.

Supermarket chains. As a percentage of total sales in 2005, in terms of product value, we sold approximately 26% of our dairy products, 12% of our beverage products and 18% of our baby food products to supermarket chains in Russia. We believe that the importance of these customers will continue to grow in the coming years. Our approach to supermarket chains is to increase our share in this sector by becoming the supplier of choice to the major retailers by developing key supplier relationships and improving customer service standards. We also sell our products to wholesaler Metro, whose customers are mainly small- and medium-sized businesses that purchase our products in bulk for resale or everyday business use. Similar to independent distributors, supermarket chains receive a discount based on the volumes they purchase during each month. We aim to maintain retail price control with supermarkets in the same manner as with independent distributors.

We have several field sales managers throughout Russia who personally monitor the inventory of our dairy products at supermarket chains and work closely with stores' dairy product managers in placing orders to ensure consistent inventory and allow us to execute orders expeditiously and efficiently.

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

Direct sales. As a percentage of total sales in 2005, in terms of product value, we sold approximately 3% of our dairy products, 2% of our beverage products and 3% of our baby food products by direct sales to retailers other than supermarket chains. We have a dedicated sales force whose responsibility includes managing our relationships with small- and medium-sized grocery stores and open-air market retailers. These retailers are charged our base price for our products. While we do not have any formal programs to monitor the retail prices charged by these entities, we encourage them to follow our pricing guidelines.

Other sales. We are a supplier of McDonald's restaurants in Russia. Under our agreements with McDonald's, we supply sterilized milk in two liter packaging for sale under the McDonald's brand in their restaurants. We also sell our juice products directly to certain airlines, restaurants, schools, hotels and other establishments, while our baby food products are primarily sold to milk kitchens in Moscow pursuant to the terms of a Moscow City Government tender. As a percentage of total sales in 2005, in terms of product value, we sold approximately 3% of our dairy products, 5% of our beverage products and 36% of our baby food products to these other customers.

Transportation

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

Export program

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

We currently export our juice products to the United States, Canada, Australia, Israel, Latvia and Lithuania. Our juice products are distributed in these countries through independent distributors and are sold in various national and multinational retail chains. Our products are also exported and sold through various sales channels in CIS countries such as Georgia, Armenia, Azerbaijan and Moldova, and we further developed our distribution channels, marketing efforts and sales in Belarus during 2005. We also export our Essentuki brand mineral water products, principally to the United States, Canada and Moldova. Our beverage export sales totaled approximately \$2.5 million in 2003, \$2.6 million in 2004 and \$3.0 million in 2005.

We export dairy products to Germany, Belarus, Azerbaijan, Georgia, Moldova, Turkmenistan and Lithuania. Our dairy products are distributed in these countries through independent distributors, and our dairy export sales totaled approximately \$2.1 million in 2003, \$2.5 million in 2004 and \$4.2 million in 2005.

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

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

In exporting our products to a country, we attempt to meet the applicable legislation governing the import of food products into the country. Independent distributors have, in some cases, attempted to export products to other countries that did not meet applicable legislation. For instance, an independent distributor attempted to export several of our juice products into the U.S. which did not conform to Federal Drug Administration requirements in October 2000.

Production and raw materials

Production efficiency and quality

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

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

We have our own research laboratory with a team of scientists and experts. Samples of all our primary ingredients and samples of our final products undergo microbiological analysis and in-depth testing. In addition, we have laboratories at all of our plants that perform quality checks on our products at all stages,

including quality checks on the raw milk supplied by dairies to us, the materials at our production facilities and the finished products in our warehouses.

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

In 2003, we installed new yogurt, cottage cheese and dessert production and packaging systems at the Kharkov and Timashevsk Dairy Plants; high-speed ultra clean bottling lines for milk, kefir and drinking yogurts at the Lianozovo, Kiev and Timashevsk Dairy Plants; cottage cheese dessert packaging lines at the Lianozovo Dairy Plant; and new packaging lines at the Tsaritsino Dairy Plant.

In 2004, we continued to modernize the Lianozovo Dairy Plant and installed new aseptic Tetra Pak lines for packaging cream, chocolate and fruit milk, as well as a new line for packaging fresh dairy products such as kefir, ryazhinka and drinking yogurts. We also modernized the production line for soft cottage cheese. At the Tsaritsino Dairy Plant, we added 2 new lines for packaging sour cream, an aseptic line for producing milk and a new line for bottling Imunele. At the Baltic Milk dairy plant in St. Petersburg, we installed a production line for glazed curds with biscuits, and completed the installation of cheese production lines at the Ufa, Rubtsovsk and Timashevsk Dairy Plants. The latter was also equipped with a new Tetra Fina machine. The Siberian Milk Dairy Plant was modernized with a new production line for glazed curds and a packaging line for Twist Cap packaging. We also installed a Procomac-brand juice line in order to make juice-containing drinks with pieces of real fruit under the J-7 brand bottled in PET bottles.

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

We have uniform quality standards for all our enterprises. When we enter regional markets, we seek to raise the standards of consumption to a higher level by offering a wide range of quality products at reasonable prices. We also aim to offer products in consumer-friendly and innovative packaging across a range of market sectors.

We also seek to make efficient use of our milk supply and handle surplus raw milk resulting from seasonal differences in supply by processing this milk into longer-life products such as milk powder and butter. Our ability to handle these imbalances in supply is important for cost-effective purchasing of raw milk throughout the year and maintaining our relationships with suppliers.

Food raw materials

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

- raw milk, which we generally obtain from domestic farmers;
- powder milk, which we generally obtain from small domestic producers or import;
- bacteria cultures, which we generally import, although we have begun to develop our own cultures;
- flavorings and sweeteners, which we generally import;
- juice concentrate and juice puree, which we primarily import, but also purchase domestically; and
- other ingredients such as frozen fruits and stabilizers.

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

Our purchasing policy is to increase the share of locally produced food raw materials that satisfy our quality standards. We have focused on developing partnerships with established leaders in the field of local food production, including the leading Russian raw milk, powder milk, fruit and sugar producers. In each region where we require raw milk, we establish direct supply contracts with local individual farmers and collective farms.

We have also begun entering into more purchasing arrangements with Russian suppliers of raw materials in the juice sector, and in 2002, we acquired Depsona (since renamed Fruktopak), a fruit juice and concentrate producer in Central Russia. We purchase substantially all of our raw materials directly and do not engage in a significant amount of barter transactions.

We also purchase certain raw materials such as bacteria cultures, juice concentrates and flavors from foreign manufacturers when products of appropriate quality are not available locally. We use quality raw materials supplied by producers from approximately 25 countries such as Cargill (United States), Cutrale (Brazil), Danisco (Denmark), Chr. Hansen (Denmark), Givaudan (Germany), Hahn (Germany) and Firmenich (Switzerland). Our flagship J-7 juice line was created with consulting assistance from Cargill, the world's largest supplier of juice concentrates.

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

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

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

Under the Milk Rivers program, we have rented advanced German and Swedish milking, feed production, feed-chopping and refrigeration equipment for periods from three to eight years to approximately 90 agricultural enterprises located in the Moscow and nearby regions, including the Voronezh and Nizhny Novgorod regions. The lease receivables are offset with milk supplies based on a predetermined schedule during the lease term. The lease receivables are denominated in U.S. dollars and Russian rubles. The lessees have the option to settle receivables through the delivery of milk supplies based on a predetermined schedule. The settlement is based on milk prices that are valued either in rubles or in U.S. dollars in the range of \$0.19 to \$0.29 per liter, depending upon the quality, which approximates the average cash prices at the inception of the lease, or is variable dependent upon prevailing market prices. Equipment leased out to farms includes milking and refrigeration equipment for accelerated milk freezing and the temporary storage of milk at farms, and mangers and other technical devices that increase the productivity of farms. The type of equipment provided depends on the needs of each particular farm. We have also set up a service center to assist the participants in keeping the leased equipment in good repair.

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

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

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

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

Seasonality

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

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

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

Sales of certain baby food products are affected by seasonal factors. In particular, sales of juice and purees for babies are typically 10-15% higher during the summer months, while sales of liquid dairy baby

products are typically 5-8% lower in the summer due, in part, to the fact that many Russians travel to the suburbs to vacation in the summer and are unable to transport such products, which have short shelf lives.

Packaging

Our principal packaging raw materials include materials needed for packaging our dairy and juice products, consisting mainly of composed material, polymeric material and foil. Our principal supplier of composed material for the production of milk and juice carton containers is Tetra Pak, the world leader in manufacturing equipment and materials for aseptic packaging of liquid food products. Tetra Pak supplied approximately 58.6% of our total packaging materials in 2005 (including carton, plastic, foil and other materials), and we are substantially dependent upon this packaging supplier to meet our requirements. As a major Russian consumer of Tetra Pak products, we have annual contracts with Tetra Pak, which supplies us from its Russian plants as well as from its other European plants. See Note 27 to our Consolidated Financial Statements included under Item 18. Financial Statements.

We have established similar relationships with companies such as SIG Combibloc and Elopak. As part of our strategy to increase locally produced raw materials, we are developing relationships with Russian manufacturers of packaging materials, in particular with companies such as Stora Enso Packaging, Arhbum, Polimer, Formoline, Formaplast, Eximpack, Crownpack and Lukoil-Neftekhim. We have begun using more plastic packaging for our products, and installed new plastic milk bottling lines at the Lianozovo Dairy Plant and Moscow Baby Food Plant during 2003 and at the Timashevsk, Kiev and Siberian Dairy Plants in early 2004.

Trademarks and Patents

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

Insurance

We maintain property insurance coverage for our 18 major facilities, including Lianozovo Dairy Plant, Tsaritsino Dairy Plant, Moscow Baby Food Plant, Ramenskiy Plant, Timashevsk Dairy Plant, Ufa Dairy Plant, Kiev Dairy Plant, Kharkov Dairy Plant, Bishkek Dairy Plant, Siberian Dairy Plant, Vladivostok Dairy Plant, Fruktopak, Nizhny Novgorod Dairy Plant, Rubtsovsk Dairy Plant, Healing Springs, Valdai Springs Water Plant, Baltic Milk and our warehousing facility Roselectrocenter. The coverage is a standard All Risks insurance package covering the most valuable equipment at these facilities with total coverage of \$364 million. We have insurance for business interruption at five major facilities with total coverage of \$55 million. We had product liability insurance for 17 of our facilities with \$1 million coverage per facility as of December 31, 2005. In January 2006, our product liability insurance was increased to cover 23 facilities with cumulative coverage of \$5 million. Until we obtain insurance coverage for an amount exceeding the carrying value of our property, plant and equipment, there is a risk that the loss or destruction of certain assets could have a material adverse effect on our operations and financial position. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry We do

not carry the types of insurance coverage customary in other more economically developed countries for a business of our size and nature, and a significant event could result in substantial property loss and inability to rebuild in a timely manner or at all. See Note 29 to our Consolidated Financial Statements included under Item 18. Financial Statements.

Environmental and Product Liability

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

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

Regulation

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

Government Entities Involved

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

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

The Federal Service for Supervision in the Area of Protection of Consumer Rights and Human Welfare. This Service is the principal federal body authorized to supervise sanitary and epidemiological issues in the Russian Federation. The Service enforces sanitary-epidemiological rules (which include sanitary rules,

sanitary standards and hygienic requirements), monitors the sanitary conditions of production sites and equipment, fulfillment of sanitary standards for raw material and finished product storage at manufacturing plants, compliance with sanitary standards for the storage and sale of food products, their quality and safety at wholesale and retail outlets and businesses catering to the public. The Service also carries out inspections of sellers' premises.

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

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

Applicable Food and Health Legislation

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

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

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

The Federal Law on Technical Regulation provides for the development, enactment, application and enforcement of obligatory technical requirements and the development of voluntarily standards relating to manufacturing processes, operations, storage, transportation, selling and utilization. Until such technical requirements are developed and adopted, the existing standards are mandatory to the extent they are necessary to secure the protection of safety and health, environmental protection and consumers' rights.

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

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

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

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

Registration Requirements

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

The product registration process includes:

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

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

Certification

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

Bulk Purchase of Raw Milk

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

Production and Transportation

Laboratory employees and technical specialists must verify that the condition of equipment, implements, raw materials and packaging conform to sanitary requirements. For example, in the course of

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

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

Packaging Material and Labeling Requirements

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

The Law on the Protection of Consumers' Rights and the Law on Quality and Safety of Food Products determine the scope and format of the information that should be made available to consumers. According to these laws and other applicable national standards, the packaging of finished products must contain the following information: the name of the product, information regarding its certification, conditions of use (if necessary), contraindications (if any), preservatives and food additives, net mass or volume, ingredients, nutritional value, conditions of storage, shelf life, name and address of the manufacturer and other information. The law also authorizes a wide range of government and public agencies to monitor producers' compliance with the requirements of the law and imposes sanctions and penalties if such requirements are not met.

Special Requirements for Children's Dairy Products

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

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

Competition and Pricing

The Federal Antimonopoly Service is the governmental agency that regulates the prevention and limitation of monopolistic activity and the support of competition in the market. The Russian Law on Competition and Restriction of Antimonopoly Activity on Commodity Markets prohibits the abuse of a dominant position to limit competition. Our subsidiary, the Moscow Baby Food Plant, has been included in the register of entities holding a significant share of the market, as the plant controls approximately 96% of the market for milk products for babies in Moscow and the Moscow region in volume terms and 56% of the total baby food market in Moscow and the Moscow region in volume terms. Inclusion in this register

does not impose additional reporting or other requirements on us; however, because of our significant position, the Federal Antimonopoly Service monitors our activities and we are required to notify the Federal Antimonopoly Service and/or apply for its prior approval for the acquisition of other companies.

C. Organizational Structure

The following table sets out our primary production subsidiaries, their countries of incorporation and our aggregate beneficial ownership interest and voting interest in each subsidiary as of June 1, 2006.

| Plant | Beneficial Ownership | | Voting Interest | | Country of Incorporation |
|---|----------------------|--------|-----------------|--------|--------------------------|
| | | % | | % | |
| Lianozovo Dairy Plant | | 98.02 | | 98.31 | Russian Federation |
| Annino Dairy Plant | | 99.58 | | 100.00 | Russian Federation |
| Tsaritsino Dairy Plant | | 97.64 | | 98.91 | Russian Federation |
| Vladivostok Dairy Plant | | 99.78 | | 99.83 | Russian Federation |
| Karasuk Dairy Plant | | 92.69 | | 93.80 | Russian Federation |
| Ufa Dairy Plant | | 96.47 | | 97.82 | Russian Federation |
| Siberian Dairy Plant | | 87.14 | | 88.90 | Russian Federation |
| Nizhny Novgorod Dairy Plant | | 96.40 | | 97.43 | Russian Federation |
| Rubtsovsk Dairy Plant | | 98.02 | | 100.00 | Russian Federation |
| Kiev Dairy Plant | | 98.43 | | 98.50 | Ukraine |
| Timashevsk Dairy Plant | | 98.83 | | 99.40 | Russian Federation |
| Moloko Veidelevki | | 98.02 | | 100.00 | Russian Federation |
| Novokuibyshevsk Milk | | 85.40 | | 87.13 | Russian Federation |
| Buryn Powder Milk Plant | | 76.00 | | 76.00 | Ukraine |
| Tuymazinskiy Dairy Plant | | 85.00 | | 85.00 | Russian Federation |
| Bishkek Dairy Plant | | 96.09 | | 96.09 | Kyrgyz Republic |
| Baltic Milk (formerly Roska) | | 100.00 | | 100.00 | Russian Federation |
| Gulkevichy Dairy Plant | | 52.27 | | 52.27 | Russian Federation |
| Kharkov Dairy Plant | | 99.94 | | 99.94 | Ukraine |
| WBD Tashkent | | 100.00 | | 100.00 | Republic of Uzbekistan |
| Nazarovskoe Milk | | 63.53 | | 63.53 | Russian Federation |
| Obninsk Dairy Plant | | 66.33 | | 66.33 | Russian Federation |
| Pervouralsk City Dairy Plant | | 96.47 | | 100 | Russian Federation |
| Baby Food plants | | | | | |
| Moscow Baby Food Plant | | 97.34 | | 97.34 | Russian Federation |
| Experimental Baby Food Plant | | 100.00 | | 100.00 | Russian Federation |
| Beverage plants | | | | | |
| Ramenskiy Plant(1) | | 94.77 | | 96.68 | Russian Federation |
| Valdai Springs Water Plant | | 100.00 | | 100.00 | Russian Federation |
| Healing Springs Water Plant | | 100.00 | | 100.00 | Russian Federation |
| Essentuki Mineral Water Plant at CMW (Caucasian Mineral Waters) | | 100.00 | | 100.00 | Russian Federation |
| Farms | | | | | |
| Trud OJSC | | 67.95 | | 67.95 | Russian Federation |
| Atamanskoe Farm | | 98.21 | | 99.38 | Russian Federation |
| Plemzavod Za Mir and Trud | | 98.65 | | 100.00 | Russian Federation |
| Zavety Ilyicha | | 98.18 | | 99.34 | Russian Federation |

(1) Fruktopak merged into Ramenskiy Plant in 2006.

D. Property, Plants and Equipment

Production facilities

We currently manufacture our products at 30 production facilities, including 23 plants that principally produce dairy products, two baby food plants, two plants that produce exclusively juice products and three water production plants. We have made substantial investments to maintain and enhance quality, lower costs and increase productivity. Over 2003, 2004 and 2005, we invested approximately \$284.2 million in the modernization of our existing production facilities and acquisitions of new production assets. Our main production plants are capable of managing the production of a diverse and evolving product range, enabling us to adapt quickly to changes in consumer demand on a seasonal basis or otherwise. We have completed the main phase of our extensive modernization program and have begun cost cutting programs at all of our plants.

We also review our production headcount with the aim of enhancing productivity. Sales per employee, calculated on the basis of our total headcount (excluding employees of our Agro business division, as its sales and expenses are reported as other operating income and expenses), which is a common measure of productivity used in the food industry, was \$51,192 per employee in 2003, \$67,157 per employee in 2004 and \$80,304 per employee in 2005.

In 2003, we worked with an international management consulting firm on a training, cost cutting and management program at the Nizhny Novgorod Dairy Plant in an effort to increase revenue per employee and tons of product produced per production employee per day. We also initiated a restructuring program with the aim of reducing and optimizing our employee headcount. As a result, we were able to reduce our employee headcount at our plants during 2005 other than with respect to operations we acquired during the second half of 2005, where we are still in the process of implementing our restructuring program. We expect to continue to optimize our overall employee headcount during 2006.

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The following table contains data regarding our main production facilities. It should be noted that raw milk throughput capacity and production output are not identical measures, as different dairy products require different amounts of raw milk for their production. Product output of a plant therefore depends on the types of products being produced there.

| | Year of Acquisition | Year Built | Production in 2003 (Amounts in thousands of tons, except for beverages which are in thousands of liters) | | | Production in 2004 | | Production in 2005 | | |
|---|---------------------|------------|---|--------------|-----------|--------------------|--------------|--------------------|--------------|-----------|
| | | | Dairy | Beverages(2) | Baby Food | Dairy | Beverages(3) | Dairy | Beverages(3) | Baby Food |
| Moscow and Moscow region | | | | | | | | | | |
| Lianozovo Dairy Plant | 1995 | 1989 | 401.5 | 166.7 | | 399.3 | 104.5 | 398.5 | 43.6 | |
| Tsaritsino Dairy Plant | 1996 | 1975 | 179.2 | 67.7 | | 197.4 | 57.4 | 210.8 | 67.3 | |
| Moscow Baby Food Plant | 1996 | 1982 | 2.3 | | 44.4 | 6.0 | | 48.0 | 3.6 | 52.8 |
| Ramenskiy Plant | 1997 | 1982 | | 140.5 | | | 201.1 | | 352.1 | |
| Central Russia (excluding Moscow) | | | | | | | | | | |
| Nizhny Novgorod Dairy Plant | 1998 | 1984 | 51.9 | 0.3 | | 58.6 | | 64.7 | | |
| Timashevsk Dairy Plant | 2000 | 1990 | 95.1 | | | 122.1 | | 136.6 | | |
| Ufa Dairy Plant | 2001 | 1971 | 50.4 | | | 68.7 | | 69.1 | | |
| Annino Dairy Plant | 2001 | 1978 | 19.1 | | | 47.4 | | 62.0 | | |
| Novokuybishevsk Milk | 2002 | 1975 | 5.5 | | | 8.5 | | 7.1 | | |
| Baltic Milk (former Roska) | 2002 | 1987 | 8.7 | | | 30.4 | | 48.9 | | |
| Fruktopak (formerly Depsona) | 2002 | 1996 | | 20.7 | | | 41.3 | | 8.2 | |
| Siberian Dairy Plant | 1998 | 1961 | 64.8 | 33.3 | | 63.6 | 22.9 | 65.3 | 21.9 | |
| Gulkevichy Dairy Plant | 2002 | 1928 | 2.1 | | | 1.4 | | 0.2 | | |
| Tuimazy Dairy Plant | 2002 | 1958 | 7.8 | | | 4.9 | | 8.3 | | |
| Valdai Springs Water Plant | N/A | 2003 | | 5.8 | | | 3.2 | | 3.2 | (3) |
| Healing Springs Water Plant | 2003 | 1999 | | 0.1 | | | 5.3 | | 8.9 | (3) |
| Essentuki Mineral water Plant at the CMW (Caucasian Mineral Waters) | 2005 | 2001 | | | | | | | 4.0 | |
| Obninsk Dairy Plant OJSC | 2005 | 1982 | | | | | | 12.7 | | |
| Asian Russia | | | | | | | | | | |
| Karasuk Dairy Plant | 1999 | 1952 | 11.4 | | | 3.4 | | 4.5 | | |
| Vladivostok Dairy Plant | 1998 | 1947 | 13.8 | 7.7 | | 13.8 | 10.5 | 14.5 | 16.0 | |
| Rubtsovsk Dairy Plant | 2001 | 1954 | 5.6 | | | 10.4 | | 14.9 | | |
| Other CIS countries | | | | | | | | | | |
| Kiev Dairy Plant | 2001 | 1973 | 26.1 | 9.8 | | 50.5 | 11.9 | 40.0 | 1.6 | |
| Kharkov Dairy Plant | 2002 | 1973 | 32.4 | | | 46.1 | | 53.1 | | |
| Bishkek Dairy Plant | 2000 | 1990 | 14.6 | | | 20.0 | 0.2 | 17.3 | | |
| Buryl Powder Milk Plant | 2002 | 1974 | 11.9 | | | 5.0 | | 4.9 | | |
| Total | | | 1004.2 | 452.6 | 44.4 | 1157.5 | | | | |