# HIGHLAND GOLD MINING LIMITED

**Report and Financial Statements to 31 December 2002**


## Highland Gold Mining Limited:

- Strategy is to acquire, consolidate and develop a portfolio of gold mining projects in the Russian Federation with good growth potential
- Owner and operator of Mnogovershinnoe (MNV), one of Russia's largest producing gold mines in 2002, and two development projects - Darasun and Novoshirokinskoye (Novo)
- Annual production at MNV during 2002 was 178,000 oz of gold. MNV has reserves and resources of 2.3 million oz and 3.0 million oz of gold respectively
- The Group has a successful Russian executive management team whom, together with the Directors, is committed to the expansion of the Group's production base

# Contents



# Financial Highlights

The table below summarises the pro forma results of Highland Gold Mining Limited's main trading subsidiary, MNV, for the four years ended 31 December 2002, which includes periods prior to acquisition by the Company on 23 May 2002.

The derivation of the pro forma result is described in the Financial Review on page 9.

| | 12 months to 31 December | | | |
|---|---|---|---|---|
| | 1999<br>US$'000 | 2000<br>US$'000 | 2001<br>US$'000 | 2002<br>US$'000 |
| Turnover | 9,986 | 25,498 | 40,108 | 55,684 |
| Gross profit | 4,190 | 8,841 | 19,359 | 30,324 |
| Operating profit | 3,845 | 5,929 | 13,588 | 25,846 |

The Town of Nikolaevsk-Na Amur where MNV receives shipments from the Amur river and has a large warehouse complex

# MNV plays a major role in providing opportunities for the people of the North Eastern region of Russia

The town of Mnogovershinnoe

# Directors, Company Secretary and Advisers

**Directors**

The Lord Daresbury *(Executive Chairman)*
Ivan Eugene Koulakov *(Managing Director)*
Duncan Anthony Hilder Baxter *(Executive Director)*
James Havelock Cross *(Non-executive)**
Thaddeus Steven Anthony Grobicki *(Non-executive) (resigned 10 February 2003)*
Peter McKenna *(alternate Director to Mr Grobicki) (resigned 10 February 2003)*
Christopher David Palmer-Tomkinson *(Non-executive)***
Michael Frank Pleming *(Non-executive) (appointed 10 February 2003)*

*All of:*
Le Gallais Chambers
54 Bath Street
St Helier
Jersey JE4 8YD

**Company Secretary**

Paternoster Secretaries Limited
Le Gallais Chambers
54 Bath Street
St Helier
Jersey JE4 8YD

**Head Office and Registered Office**

Le Gallais Chambers
54 Bath Street
St Helier
Jersey JE4 8YD

**Nominated Adviser and Broker**

W.H. Ireland Limited
11 St James's Square
Manchester M2 6WH

**Auditors to the Company and Group**

Ernst & Young LLP
Becket House
1 Lambeth Palace Road
London SE1 7EU

**Bankers**

Royal Bank of Canada
(Channel Islands) Limited
19-21 Broad Street
St Helier
Jersey JE4 8RR

**Solicitors to the Company**

*As to English Law*
Fox Brooks Marshall
Century House
St Peter's Square
Manchester M2 3DN

*As to Russian Law*
PricewaterhouseCoopers
Kasmodamianskaya Nab. 52
Bld. 5
115054 Moscow
Russia

*As to Jersey Law*
Bedell Cristin
PO Box 75
26 New Street
St Helier
Jersey JE4 8PP

**Registrars**

Capita IRG Offshore Limited
Victoria Chambers
Liberation Square
1-3 The Esplanade
St Helier
Jersey JE4 0FF

**Transfer Agents**

Capita Registrars
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

*Chairman of the Audit Committee
**Chairman of both the Remuneration and Nomination Committees

# Chairman's Statement

It gives me great pleasure to present Highland Gold's first Report and Financial Statements to shareholders, for the six month period to 31 December 2002. We have made substantial progress since the Company's incorporation in May 2002 and the subsequent acquisition of a suite of gold producing and development assets in Russia centred on MNV, one of Russia's largest producing gold mines in 2002.

We successfully completed the admission of the Company's shares to AIM in December and, in doing so, became the second largest company on AIM by market capitalisation. A total of US$39 million was raised in difficult market conditions (of which US$25 million was new money for the Company) and it is testament to the quality of the assets and the Company's management team that such a significant capital raising was achieved.

## Results and progress since admission to AIM

In the six months to 31 December 2002 the Group reported revenue of $27.4 million, operating cash flow before capital expenditure of US$9.4 million and profit after tax of US$7.1 million. The Company reported earnings per share for the period of 6.9 cents per share. The Company's operating mine at MNV produced 87,300 oz during the period at an average recovered grade of 6.5 grammes per tonne.

It is perhaps more appropriate to comment on the pro forma results of MNV for the full year. Pro forma turnover rose by 39% to US$55.7 million – for the twelve months to 31 December 2002 (US$40.1 million in 2001) and pro forma operating profit rose by 90% to US$25.8 million (US$13.6 million in 2001). Annual production at MNV for the year ended 31 December 2002 was 178,000 oz of gold, ahead of our expectations, with an average recovered grade of 6.9 grammes per tonne.

MNV reported pro forma operating profits of US$10.1 million for the six month period against US$15.7 million for the first half of the year. Absolute operating costs have increased in the second half and the reasons are more fully explained in the Managing Director's Review and the Financial Review.

Proceeds from the placing in December, available bank facilities and the operating cash flow from MNV, provide the Group with sufficient financial resources to continue the development of MNV and to bring the Darasun and Novo projects into full production.

At the time of Admission we stated the Group's intention to adopt a progressive dividend policy whilst maintaining a close watch on the capital requirements of the business and taking a prudent view on the Group's debt position. I believe this is an important element of the investment proposition and I am pleased to recommend the Company's first dividend of US$0.01 per share.

With regard to our assets, as envisaged at the time of Admission, long-term licences have been secured at two key deposits at the Darasun development and the registration of important assets at MNV has now been completed. We are continuing to consolidate our key strategic assets and are on track to bring our development projects into full production.

## The economic and regulatory environment

Since 1998 the Russian gold industry has undergone a period of fundamental change that has created a more favourable climate for the development and operation of gold mines in Russia. Furthermore, continued structural reform has led to a more open environment for overseas initiatives, and a number of recent investments by foreign companies and the improvement of Russia's credit rating support this.

Despite Russia's significant gold reserves, there is no single gold company producing in excess of 1 million oz of gold per annum. Russia's gold assets have not been fully developed and remain under-capitalised. In our view, this reflects the slow evolution of the regulatory environment governing the gold mining industry, compared with other mineral and resource sectors.

This environment, coupled with the recent positive developments both in Russia and in the Russian gold industry, provides an opportunity for Highland Gold to follow a strategy of establishing a portfolio of Russian gold projects that fulfil the Group's technical and economic development criteria. In actively pursuing this strategy, the Group is able to apply the considerable experience it has accumulated during the development of the MNV mine.

Much has changed in the regulatory environment and the Group has made progress in moving towards major aspects of the Combined Code and best practice initiatives. Principally we have focused on: the constitution of the Board of Directors to ensure there is an appropriate balance of executive and non-executive directors with suitable experience; relations with shareholders; social and environmental risks; and internal control and risk management.

## Board and management

On 10 February 2002, after our financial year end, we announced the resignation of Ted Grobicki from the Board (together with Peter McKenna, his alternate) and Mike Pleming replaced him as a non-executive director. At the time I expressed our gratitude for the considerable input from Ted and Peter, both of whom are executives of Harmony Gold Mining Company, in developing our strategy and welcomed Mike, a non-executive director of both Harmony Gold Mining Company and Impala Platinum Holdings who comes with many years' mining and exploration experience.

The Group has a successful Russian executive management team which, together with the Directors, is committed to the expansion of the Group's production base whilst ensuring rigorous financial and operational controls.

I would like to take the opportunity to thank the management and the entire work force for a successful year in 2002. Without them we would not be so ideally placed to take our business forward.

## Strategic development

The Directors currently envisage that, in the near term, emphasis will be placed on the optimisation of the existing operations at MNV, the development of the Darasun project, and the completion and development of Novo. We look forward to first gold production at Darasun in the first half of 2004, and based on the successful completion of the Darasun and Novo projects, the Group has the potential to increase production by a further 160,000oz of gold per year.

Mining acquisition opportunities are being pursued which should add further to our record of profitable growth and deliver more value to shareholders. We look forward to updating the market on these developments.

## Outlook

The overall market for gold producers has recently been affected by the weakening of the US dollar and the reduction in the gold price from its recent high, but we are pleased with the Company's overall performance since admission to AIM. Macroeconomic factors such as the gold price and the US dollar/Russian rouble exchange rate will continue to influence our results and it is therefore important that the Company maintains a firm control of its own costs.

In recent months, operating costs, some external, have risen and we expect certain of these costs to continue to rise in 2003. In part this reflects planned increases in expenditure which will enable the Group to continue to optimise the performance of the mining operations at MNV. Furthermore, it is important to note that Russia remains a low cost environment for gold mining. This is illustrated by the Group's average annual cash operating costs of US$149/oz. In the first quarter of 2003, I am pleased to report that the Company processed 209,000 tonnes of ore, a like-for-like increase of 11% against 2002.

In carrying out our intended strategy of developing the Group as a platform for further growth and consolidation in the Russian gold mining industry, we have made a number of improvements to the Group's processes and controls and made appointments at the executive management level. We will continue to review the composition of the Board and executive management team.

Highland Gold's existing platform of operational and development assets in Russia, together with its financial, technical and operational expertise, provides a firm foundation for the achievement of the Group's strategic goals. The Board is confident that with the number and quality of opportunities that it is pursuing and the access to international capital that the admission to AIM has provided, the Group has all that is necessary to allow it to become a mid-tier gold producer.

Peter Daresbury,
*Chairman*

Visitors from Harmony Gold Mining Company Limited on an underground tour of MNV

# The Group has, and access to, an outstanding body of mining and metallurgical expertise and experience

Underground at MNV

# Managing Director's Review

It gives me great pleasure to comment on the results of the Group in our first year as a publicly quoted company. After the success of our AIM admission and placing, the pro forma results for the full year to 31 December 2002 are particularly pleasing and show the continued progress of the Group.

## Group operations and reserves

The Group has an aggregate resource base of 8.0 million oz of gold, comprising 7.2 million oz of gold and approximately 0.8 million oz of gold equivalents at the gold and polymetallic deposit at Novo.

Highland Gold owns and operates the MNV gold mine which is situated near to Nikolaevsk in the Khabarovsk Region of Far East Russia, approximately 650km north of the city of Khabarovsk. MNV owns the licence for gold mining which is valid until the end of 2018. Operations at MNV consist of both underground and open-pit mining of several high grade gold deposits. MNV was one of Russia's largest gold producers in 2002 and has reserves of 2.3 million oz of gold at an average grade of 8.9 grammes per tonne and resources of 3.0 million oz of gold at an average grade of 9.7 grammes per tonne.

During the year we produced 806,000 tonnes of ore at MNV (of which 388,000 tonnes were from open pit operations and 375,000 were from the underground mine, the remaining 43,000 tonnes being released from the stockpile) at an average recovered grade of 6.9 grammes per tonne and average recovery of 91.7%. A total of 178,000 oz of gold was produced, an increase of 16% over our 2001 production of 153,000 oz. I am pleased to add that this performance has continued into 2003 with 209,000 tonnes of ore processed in the first quarter, a like for like increase of 11% against the same period in 2002.

We continue to seek to optimise the performance of operations at MNV and to develop the gold reserves there. We spent a total of US$4.5 million on capital expenditure during the second half of 2002 and plan to spend approximately US$6.1 million during 2003, mainly on the upgrading of mining equipment.

The Darasun project is situated in the Chita Region of Eastern Russia and consists of an existing, but currently non-operational, gold mining complex having open-pit and underground mining development and mineral processing facilities. It consists of three deposits, Darasun, Teremky and Talatui. The Company holds a 100% interest in Darasun which holds certain assets of the Darasun project including the gold mining licences at Darasun and Teremky which expire in 2023 and which were recently awarded to Darasun. It is anticipated that mining production will commence in the first half of 2004 with full production of an estimated 450,000 tonnes of ore in 2005. We are planning to spend approximately $22.6 million on capital expenditure at Darasun in 2003, predominantly on mill construction and development of the underground infrastructure.

The Novo gold and polymetallic mining project is also located in the Chita region, close to Darasun. The Group acquired an 81.29% interest in Novo, which holds certain key assets essential to the future development of this project. A further 2.17% had been acquired by the end of 2002 and a further 3.62% has since been acquired in 2003. We continue to work closely with Irkutsk Scientific Research Institute on the feasibility study for the Novo project and we expect to complete this work by the end of the year. In addition, we are also working closely with the local administration in Chita to ensure that the Group fully complies with all aspects of the gold mining licence. We expect to spend approximately US$2.0 million of capital expenditure at this project in 2003 and assuming that the above-mentioned work programmes are completed to our satisfaction, we anticipate being able to bring the mine into production during 2005.

Operating costs at MNV have increased in the period. This can be attributed to a number of factors including: certain planned cost increases relating to the transition of mining operations to a new ore body; increased production costs associated with processing of higher volumes of lower grade ore; increases in the price of consumables used in the extraction process; and increased electricity and transportation costs. Furthermore, a higher proportion of our production came from the relatively more expensive underground mining in the second half of the year.

We have continued to analyse our cost base to ensure that cost increases are mitigated. We have already commenced the construction of our own power supply at MNV to ensure both the efficiency and reliability of our power supply.

# Managing Director's Review continued

We continue to maintain excellent working relationships with the local governments of Khabarovsk and Chita. The mining operations have a significant impact on the local economies as the major employers in the area and we look forward to continuing to provide opportunity and prosperity in these regions.

## Future projects and acquisitions

The Group has an outstanding body of proven mining and metallurgical expertise and experience. With this skills base Highland Gold is well positioned to capitalise on any acquisition the Board identifies as value enhancing for shareholders.

Ivan Koulakov
*Managing Director*

# Financial Review

Highland Gold was incorporated on 23 May 2002 and its first accounting period was the 37 days to 30 June 2002. These Financial Statements include the results for the accounting period for the six months ended 31 December 2002, the first accounting period following the successful admission to the Alternative Investment Market of the London Stock Exchange (AIM).

During this period, the only significant contributor to Highland Gold's results has been its main operating subsidiary, MNV. Therefore, in addition to its reported results, Highland Gold is also presenting pro forma results for the six months ended 30 June 2002 and the twelve months ended 31 December 2002, in order to enable shareholders to assess the current performance in the context of the past performance of MNV. The pro forma results include adjustments for specified items and have been derived from the UK GAAP accounting information, but is not in itself a recognised UK GAAP measure.

Reconciliation of reported profit to pro forma result

| | Reported<br>US $'000 | Administrative expenses of other group companies (a)<br>US $'000 | Impact of fair value adjustments (b)<br>US $'000 | Pro forma result six months ended 31 December 2002<br>US $'000 | MNV Six months to 30 June 2002 (c)<br>US $'000 | Pro forma result year to 31 December 2002<br>US $'000 | MNV Year to 31 December 2001 (c)<br>US $'000 |
|---|---|---|---|---|---|---|---|
| **Turnover** | 27,420 | – | – | 27,420 | 28,264 | 55,684 | 40,108 |
| Cost of sales | (15,329) | – | 419 | (14,910) | (10,450) | (25,360) | (20,749) |
| **Gross profit** | 12,091 | – | 419 | 12,510 | 17,814 | 30,324 | 19,359 |
| Administrative expenses | (3,479) | 1,109 | – | (2,370) | (2,108) | (4,478) | (5,771) |
| **Operating profit** | 8,612 | 1,109 | 419 | 10,140 | 15,706 | 25,846 | 13,588 |

(a) Jersey and Moscow head office expenses

(b) Impact of amortisation of fair value adjustment to fixed assets

(c) Previously reported UK GAAP figures for MNV (issued with a qualified audit opinion)

## Financial performance

For the period ending 31 December 2002 the Group reported revenue of US$27.4 million, operating profit of US$8.6 million and profit after taxation of US$7.1 million. This includes a one-off gain of US$2.0 million from the renegotiation of a loan with a supplier of fixed assets to MNV.

Pro forma revenue for the full year rose by 39% from US$40.1 million in 2001 to US$55.7 million.

Tonnes of ore processed rose from 389,000 in the first half of the year to 417,000 in the second half.

Pro forma cost of sales have increased by 42% from US$10.5 million to US$14.9 million in the second half of the year. As outlined in the Managing Director's Review, this can be attributed to a number of factors including:

- Certain planned cost increases relating to the transition of mining operations to a new ore body;
- Increased production costs associated with processing of higher volumes of lower grade ore;
- Increases in the price of consumables used in the extraction process;
- Increased electricity and transportation costs.

Furthermore, a higher proportion of our production came from the relatively more expensive underground mining in the second half of the year.

The Group is taking a number of steps to mitigate its exposure to such cost fluctuations including development of a proprietary power supply, consideration of more efficient transportation routes and improvement in production processes through a full review of its cost structure to be commissioned in 2003.

Pro forma operating profit increased by 90% from US$13.6 million in 2001 to US$25.8 million in 2002. Savings in administration costs of 22% were achieved at MNV. However, additional administration expenses were incurred on the introduction of certain costs at Highland Gold necessary to create the platform for future growth and consolidation and to address the requirements of becoming a publicly quoted company.

# Director's Profiles

## EXECUTIVE DIRECTORS

**The Lord Daresbury (Aged 48) – Executive Chairman – appointed to the Board on 18 June 2002.** Peter Daresbury, MA, DL, was educated at Cambridge and London Business School. He joined Greenalls Group plc in 1977, becoming a director in 1984, Managing Director in 1993 and Chief Executive in 1996. After the sale of the Pubs & Restaurants arm in 1999, he was appointed non-executive Chairman of the group which was renamed, De Vere Group plc. He is also non-executive Chairman of Aintree Racecourse Company Limited.

**Ivan Koulakov (Aged 34) – Managing Director – appointed to the Board on 18 June 2002.** Ivan Koulakov graduated as a mechanical engineer from the Department of Materials and Technology at Moscow State Technical University, Bauman. He became Chairman of ZAO Oil Finance in 1995, and then Chairman of the board of directors of ZAO MNV in 1998. Since then he has led the management team in the development of MNV into one of Russia's largest gold mine operators. He has been instrumental in the development of MNV and is now a substantial shareholder in the Company.

**Duncan Anthony Hilder Baxter (Aged 51) – Executive Director – appointed to the Board of Directors on 8 December 2002.** Duncan Baxter commenced his career in banking in 1973 with Barclays International Bank in Harare, Zimbabwe before moving to the treasury department of RAL Merchant Bank, a subsidiary of Anglo American plc in 1978. He moved to Jersey in 1984 joining Commercial Bank (Jersey) Limited where he was appointed a director in 1985. After its acquisition by Swiss Bank Corporation in 1988, he was appointed Managing Director and was thereafter responsible for developing the bank's operations in Jersey. In 1998, he left Swiss Bank Corporation to pursue a number of consultancy projects for various international banks and investment management companies.

## NON-EXECUTIVE DIRECTORS

**James Havelock Cross (Aged 54) – Non-Executive Director – appointed to the Board on 9 October 2002.** James Cross graduated from the University of Witwatersrand in South Africa. He has been involved in banking since 1968. His first senior position was with Nedbank in 1978. He was appointed in 1985 in London as Head of Trading at Union Bank of Switzerland, and then returned to South Africa in 1987 as General Manager of the South African Reserve Bank, responsible for the marketing of all South Africa's gold production. He was promoted to Deputy Governor of the South African Reserve bank in 1997, and Senior Deputy Governor in 1999. Mr Cross is the Chairman of the Audit Committee.

**Christopher Palmer-Tomkinson (Aged 60) – Non-Executive Director – appointed to the Board on 17 September 2002.** After graduating from Oxford University with a law degree, Christopher Palmer-Tomkinson joined Cazenove in 1963, where he served as a partner from 1972 until May 2001 and a Managing Director of Corporate Finance until May 2002. During his career with Cazenove he was involved in the firm's international business and was responsible at various times for Cazenove's Australasian and African business which enabled him to focus on the resources sector. Mr Palmer-Tomkinson is the Chairman of both the Remuneration and Nomination Committees.

**Michael Frank Pleming (aged 67) – Non-Executive Director – appointed to the Board on 10 February 2003.** Mike Pleming started his career in mining engineering on the Zambian Copperbelt. He joined Trans Natal Coal (now Ingwe) in 1975 as general manager: at Optimum Collieries, and was later appointed project manager and consulting engineer. He joined Liberty Asset Management in 1982 where he was responsible for mining investment research. He retired in 1995 and has since undertaken a series of mining investment-related assignments. For the last five years Mr Pleming has been a non-executive director of Harmony Gold Mining Limited and Impala Platinum Holdings Limited and serves on the Health and Safety Executive and Audit Committees of both companies.

# Directors' Report

The Directors of Highland Gold Mining Limited submit their Report together with the audited Financial Statements for the 184 day period ended 31 December 2002.

## Principal Activities

Highland Gold Mining Limited ("Highland Gold") was incorporated in Jersey on 23 May 2002 for the purpose of acquiring, consolidating and developing a portfolio of quality gold mining projects in the Russian Federation with good growth potential. It is the holding company of a group comprising MNV, one of Russia's largest gold producers in 2002, and two development projects, Darasun and Novo. The foundation of the Group's business has centred on the rehabilitation of the former gold mining operations at MNV following its closure in 1997. Following a change of ownership, attention was focused on restoration of workforce morale, the recommissioning of the fixed assets, reconstruction of mining infrastructure and the completion of new feasibility studies.

Production recommenced at MNV in 1999 and since that time the executive team has successfully modernised the plant, reduced operating costs and increased recoveries and productivity.

In May 2002, MNV was acquired by Highland Gold. Highland Gold placed new shares representing some 42% of its enlarged share capital principally, with new investors including gold funds, other institutional investors and Harmony Gold Mining Company Limited.

The Group is now positioned to apply the experience and skills of the Russian management team and the strong Board of Directors, combined with the Group's international capabilities, to the continued development of MNV and the development projects and the realisation of the potential of other underperforming gold assets in Russia.

## Group Structure

Highland Gold holds its interests in its operations through its wholly-owned direct subsidiary Stanmix Holding Limited, incorporated in Cyprus. The majority of the senior management of the Group is based in Moscow where a number of the Group's centralised functions are based. Further details on the Group structure is set out on page 36 of this Report.

## Group Operating Companies

Details of the Group's operations, developments and possible future developments are given in the Chairman's Statement and Managing Director's Review.

## Results and Dividends

An overview of the Group results for the period to 31 December 2002 is given in the Financial Review.

The Directors intend to pursue a progressive dividend policy of increasing the amount of annual dividends whilst taking a prudent view of the Group's cash flows and capital requirements. The Directors recommend a final dividend in respect of the 184 day period ended 31 December 2002 of US$0.01 per share. Subject to approval of shareholders at the forthcoming Annual General Meeting, the final dividend will be paid on 13 June 2003, to shareholders on the Company's register at the close of business on 9 May 2003.

## Accounting Policies

Highland Gold consolidated Financial Statements are presented in accordance with UK generally accepted accounting principles with the US$ as its principal operating and reporting currency.

## Directors' shareholdings

The interests of the Directors, and of persons connected with them, in the Ordinary Shares as at 31 December 2002, all of which are beneficial, are as follows:

| Director | Ordinary Shares | % |
|---|---|---|
| Lord Daresbury | 1,800,000 | 1.63 |
| Ivan Koulakov | 22,550,000 | 20.40 |
| Duncan Baxter | 10,000 | 0.01 |
| Christopher Palmer-Tomkinson | 510,962 | 0.46 |
| James Cross | 250,000 | 0.23 |

The Directors have entered into arrangements in respect of their shareholdings whereby they have each agreed in respect of themselves and their related parties that for a period of 6 months from Admission to trading on AIM, on 17 December 2002 (or such shorter time as they remain a Director of the Company), they will not dispose of any interest in Ordinary Shares, and that for a further period thereafter of 6 months they will not dispose of any Ordinary Shares other than through WH Ireland or the Company's broker from time to time.

Mr Koulakov has agreed not to dispose of any of his holding of Ordinary Shares until 31 December 2004, other than 182,500 Ordinary Shares as disclosed in the Admission Document published on 12 December 2002.

The Company intends, subject to receiving the necessary approvals, to implement a share option scheme in due course.

## Report on Directors' Remuneration

The remuneration policy is designed to attract, motivate and retain directors with necessary skills and experience. Remuneration packages of Executive Directors currently comprise basic salary and bonus (no bonus was paid in 2002). At present there is no Company pension plan or share incentive scheme or other benefits. The Non-Executive Directors fees are reviewed periodically, in line with comparable companies and market practice.

The Company has entered into certain agreements with:

Lord Daresbury commencing on 18 June 2002. Lord Daresbury's salary will be reviewed annually by the Company's remuneration committee. Lord Daresbury may terminate the service agreement by giving 12 months' notice in writing. The Company may terminate the service agreement either by giving 12 months' notice in writing or a payment of 12 months' salary in lieu of notice equivalent to such period of notice together with any bonus payable.

Mr Ivan Koulakov commencing on 18 June 2002. Mr Koulakov's salary will be reviewed annually by the Company's remuneration committee. Mr Koulakov may terminate the service agreement by giving 12 months' notice in writing. The Company may terminate the service agreement either by giving 12 months' notice in writing, or a payment of 12 months' salary in lieu of notice equivalent to such period of notice together with any bonus payable. On termination Mr Koulakov has covenanted with the Company that he will not directly or indirectly seek to procure orders from or do business with any individual, firm or company who has done business with the Company during the period of 1 year preceding termination or endeavour to entice away any of the Company's employees employed by the Company during the period of 1 year immediately preceding such termination. Mr Koulakov has also entered into a labour contract with the Company's subsidiary, RDM, for a term of 2 years in respect of his services as the head of the management team of the Group's business in Russia.

Mr Duncan Baxter commencing on 8 December 2002. Mr Baxter's salary will be reviewed annually by the Company's remuneration committee. Mr Baxter may terminate the service agreement by giving 6 months' notice in writing. The Company may terminate the service agreement either by giving 6 month's notice in writing, or a payment of 6 month's salary in lieu of notice equivalent to such period of notice together with any bonus payable. From 2003, a pension contribution will be made to Mr Baxter's self administered pension scheme.

the Non-Executive Directors for an initial fixed term commencing from their date of their appointment and continuing until 31 December 2003. The term may be renewed by the Board.

The remuneration paid to the Directors in the financial period to 31 December 2002 is as follows:

| | Company salary/fees US$ | Subsidiary salary US$ | Total for the 184 day period to 31 December 2002 US$ | Total for the 37 day period to 30 June 2002 US$ |
|---|---|---|---|---|
| **Executives** | | | | |
| Lord Daresbury | 40,000 | – | 40,000 | 2,500 |
| Ivan Koulakov | 26,667 | 80,000 | 106,667 | 1,666 |
| Duncan Baxter* | 8,333 | – | 8,333 | – |
| **Non-Executives** | | | | |
| Christopher Palmer-Tomkinson | 12,875 | – | 12,875 | – |
| James Cross | 10,162 | – | 10,162 | – |
| Michael Pleming | – | – | – | – |
| Thaddeus Grobicki** | 24,000 | – | 24,000 | – |

* Prior to Mr Baxter being appointed to the Board on 8 December 2002, he received a consultancy fee of £10,000.
** Mr Grobicki's fees (and those if any attributable to Mr McKenna, Mr Grobicki's alternate) are paid to Harmony Gold Mining Company Limited in line with that company's executive management's external directorships policy.

## Corporate Governance

The Directors support the principles of good governance and a code of best practice. Whilst not mandatory for an AIM listed company, the Directors have implemented, where practicable for a company of this size and nature, the main provisions of the Principles Of Good Governance And Code Of Best Practice ("the Combined Code"). The Company has three Non-Executive Directors to bring an independent outlook to the Board and to provide a balance to the Executive Directors.

An Audit Committee consisting of the Non-Executive Directors has been appointed with defined terms of reference and duties. The Audit Committee is chaired by Mr. Cross. It will meet at least twice a year and will be responsible for ensuring that the appropriate financial reporting procedures are properly maintained and reported on and for meeting the auditors and reviewing their reports relating to the accounts and internal control systems.

A Remuneration Committee, consisting of the Non-Executive Directors, has been appointed and the committee is chaired by Mr. Palmer-Tomkinson, will meet at least twice a year and will be responsible for reviewing the performance of the Executive Directors, and where appropriate, other senior executives and for determining their appropriate levels of remuneration.

In addition a Nominations Committee, consisting of the Chairman and the Non-Executive Directors, has been appointed to decide upon the appointment of senior management and directors to Group companies. The Nominations Committee is chaired by Mr. Palmer-Tomkinson in addition to his role as Chairman of the Remuneration Committee.

The Company has adopted and will operate a share dealing code for Directors and relevant employees on the same terms as were previously set out in the London Stock Exchange Model Code for companies whose shares have been admitted to AIM.

The Board has also considered the guidance published by the Institute of Chartered Accountants in England and Wales (commonly known as the Turnbull Report) concerning the internal control requirements of the Combined Code. In line with the Turnbull Report, the Board intends to regularly review key business risks in addition to the financial risks facing the Group in the operation of its business.

Additionally there is a Risk Committee established in Moscow, which meets regularly to consider health, safety and environmental issues in relation to the Group's mining operations.

## Internal Controls

The Directors have overall responsibility for the Group's internal control and effectiveness and in safeguarding the assets of the Group. Internal control systems are designed to reflect the particular type of business, operations and safety risks and to identify and manage risks, but not entirely all risks to which the business is exposed. As a result internal controls can only provide a reasonable, but not absolute, assurance against material misstatements or loss. The Group is making good progress in the development of the appropriate processes for identifying, evaluating and managing risks faced by the Group for regular review by the Board. The processes used by the Board to review the effectiveness of the internal controls are through the Audit Committee and the executive management reporting to the Board on a regular basis where business plans and budgets are appraised and agreed. The Board is also at liberty to engage independent professional advice on risk assessment matters. It is the Board's policy to ensure that the management structure and the quality and integrity of the personnel are compatible with the requirements of the Group.

## Relations with Shareholders

The Board is mindful of the importance of maintaining and communicating the Group's objectives with shareholders. The Directors have regular meetings with institutional shareholders where it is felt that it is prudent and in the interests of shareholders generally. Shareholders are encouraged to use the Annual General Meeting as a forum in which to participate. The Group is in the process of designing and developing a website to enhance communication for both Highland Gold and RDM.

## Going Concern

The Directors believe it is appropriate to adopt the going concern basis in preparing the Financial Statements as the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Specific risks do exist in respect of rights of possession and use of certain tangible fixed assets of MNV. This is discussed in more detail in Note 1 to the Financial Statements.

## Auditors

A resolution for the re-appointment of Ernst & Young LLP as auditors of the Company will be proposed at the forthcoming Annual General Meeting.

## Annual General Meeting

The Annual General Meeting will be held at 12.00 pm on Thursday 22 May 2003 at the De Vere Grand Hotel, Esplanade, St Helier, Jersey JE4 8WD. The notice convening the Annual General Meeting is as set out on page 37 of this Report.

The following special business will be conducted at the meeting:

***Authority to Allot Shares and Disapplication of Pre-Emption Rights***

A Special Resolution (set out as Resolution 7 in the Notice of Annual General Meeting) will be proposed to empower the Directors to allot up to 33% of the authorised but unissued share capital of the Company comprising 189,474,179 Ordinary Shares without having to obtain prior approval from shareholders on each occasion and to allot these Ordinary Shares without being first required to offer such shares to existing shareholders. The authority, when given, will expire at the conclusion of next year's Annual General Meeting.

## Directors' responsibilities in respect of the Report and Financial Statements

The Directors have elected to prepare Financial Statements for the 184 day period ended 31 December 2002 which give a true and fair view of the state of affairs of the Company and of the Group and of the profit and loss of the Group for that period. In preparing those Financial Statements, the Directors have selected suitable accounting policies and have applied them consistently. They have made judgements and estimates that are reasonable and prudent and have stated whether applicable accounting standards have been followed. The Directors have prepared the Financial Statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Directors are responsible for ensuring that proper accounting records are kept, which disclose with reasonable accuracy at any time the financial position of the Company and Group and to enable them to ensure that the Financial Statements comply with the Companies (Jersey) Law 1991, as amended. They are also responsible for safeguarding the assets of the Company and Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors acknowledge that their responsibility to present a balanced and understandable assessment extends to interim and other price sensitive public reports.

By Order of the Board

Paternoster Secretaries Limited
*Company Secretary*

28 April 2003

Gold Pour

# The Group is conscious of its environmental and safety responsibilities

Tailing Pond

# Independent Auditors Report to the Members of Highland Gold Mining Limited

We have audited the Group's Financial Statements for the 184 day period ended 31 December 2002 which comprise Consolidated Profit and Loss Account, Consolidated Balance Sheet, Company Balance Sheet, Consolidated Cash Flow Statement, Consolidated Statement of Total Recognised Gains and Losses and the related Notes 1 to 24. These Financial Statements have been prepared on the basis of the accounting policies set out therein.

This Report is made solely to the Company's members, as a body, in accordance with Article 110 of the Companies (Jersey) Law 1991, as amended. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this Report, or for the opinions we have formed.

## Respective responsibilities of Directors and Auditors

As described in the Statement of Directors' Responsibilities the Group's Directors are responsible for the preparation of the Financial Statements in accordance with applicable Jersey law.

Our responsibility is to audit the Financial Statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the Financial Statements give a true and fair view and are properly prepared in accordance with the Companies (Jersey) Law 1991, as amended. We also report to you if, in our opinion, the Directors' Report is not consistent with the Financial Statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the AIM Rules regarding Directors' remuneration and transactions with the Group is not disclosed.

We read other information contained in the Report and consider whether it is consistent with the audited Financial Statements. This other information comprises the Directors' Report, Chairman's Statement, Managing Director's Review and Financial Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Financial Statements. Our responsibilities do not extend to any other information.

## Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Financial Statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Financial Statements.

### Fundamental uncertainty

In forming our opinion, we have considered the adequacy of the disclosures made in the Financial Statements concerning the Group's title to certain assets and the recoverability of those assets and therefore its ability to continue trading as a going concern, which is dependent on the Group's ability to continue operating the mine at MNV. Certain of the more important mine assets are currently leased from the Khabarovsk Administration and could be subject to a future privatisation.

# Independent Auditors Report continued

This uncertainty is detailed in Note 1 to the Financial Statements. In view of the significance of this uncertainty we consider that it should be drawn to your attention, but our opinion is not qualified in this respect.

## Opinion

In our opinion the Financial Statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2002 and of the profit of the Group for the 184 day period then ended and have been properly prepared in accordance with the Companies (Jersey) Law 1991, as amended.

Ernst & Young LLP
*London*

28 April 2003

# Consolidated Profit and Loss Account and Statement of Total Recognised Gains and Losses

| | Notes | 184 day period to 31 December 2002 US$000 | 37 day period to 30 June 2002 US$000 |
|---|---|---|---|
| TURNOVER | | | |
| Continuing operations | 2 | 27,420 | 4,711 |
| Cost of sales – ongoing | 3 | (15,329) | (1,836) |
| GROSS PROFIT | | 12,091 | 2,875 |
| Administrative costs – acquisitions | | (55) | – |
| Administrative costs – ongoing | | (3,424) | (370) |
| | | (3,479) | (370) |
| OPERATING PROFIT | | | |
| Continuing operations – acquisitions | | (55) | – |
| Continuing operations – ongoing | | 8,667 | 2,505 |
| GROUP OPERATING PROFIT | 4 | **8,612** | **2,505** |
| Bank interest receivable | | 41 | 2 |
| Gain on renegotiation of loan | | 2,032 | – |
| Bank interest payable and similar charges | 6 | (1,192) | (24) |
| Foreign exchange (losses)/gains | | (59) | 137 |
| PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION | | **9,434** | **2,620** |
| Tax on profit on ordinary activities | 7 | (2,338) | (800) |
| PROFIT FOR THE FINANCIAL PERIOD | | **7,096** | **1,820** |
| Dividends: | | | |
| Final proposed dividend on equity shares (US$0.01) | | (1,105) | – |
| PROFIT RETAINED FOR THE FINANCIAL PERIOD | | **5,991** | **1,820** |
| RETAINED EARNINGS BROUGHT FORWARD | | **1,820** | **–** |
| RETAINED EARNINGS CARRIED FORWARD | | **7,811** | **1,820** |
| Basic earnings per share (US$) | 23 | 0.069 | 0.018 |
| Diluted earnings per share (US$) | 23 | 0.069 | 0.018 |

There are no recognised gains and losses other than those in the profit and loss account. There is no material difference between the reported profit and the historical cost profit for the period to 31 December 2002.

# Consolidated Balance Sheet

| | Notes | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|---|
| **FIXED ASSETS** | | | |
| Tangible assets | 8 | 55,874 | 48,314 |
| Investments | 9 | – | 1,052 |
| | | 55,874 | 49,366 |
| **CURRENT ASSETS** | | | |
| Stocks | 10 | 13,355 | 8,919 |
| Debtors | 11 | 10,931 | 13,011 |
| Cash at bank and in hand | | 26,525 | 1,782 |
| | | 50,811 | 23,712 |
| **CREDITORS:** amounts falling due within one year | 12 | (24,242) | (14,591) |
| **NET CURRENT ASSETS** | | **26,569** | **9,121** |
| **TOTAL ASSETS LESS CURRENT LIABILITIES** | | **82,443** | **58,487** |
| **CREDITORS:** amounts falling due after more than one year | 13 | (8,570) | (12,602) |
| **PROVISIONS FOR LIABILITIES AND CHARGES** | 14 | (10,722) | (14,372) |
| **MINORITY INTERESTS – EQUITY** | | (482) | – |
| | | **62,669** | **31,513** |
| **CAPITAL AND RESERVES** | | | |
| Called up share capital | 19 | 162 | 146 |
| Share premium | 20 | 54,696 | 29,919 |
| Share issue costs reserve | 20 | – | (372) |
| Profit and loss account | | 7,811 | 1,820 |
| | | **62,669** | **31,513** |

Approved by the Board on 28 April 2003

The Lord Daresbury
*Chairman*

Ivan Koulakov
*Managing Director*

# Company Balance Sheet

| | Notes | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|---|
| **FIXED ASSETS** | | | |
| Investments | 9 | 30,901 | 30,901 |
| | | 30,901 | 30,901 |
| **CURRENT ASSETS** | | | |
| Debtors | 11 | 1,814 | 56 |
| Cash at bank and in hand | | 25,933 | 24 |
| | | 27,747 | 80 |
| **CREDITORS:** amounts falling due within one year | 12 | (3,770) | (1,109) |
| **NET CURRENT ASSETS/(LIABILITIES)** | | 23,977 | (1,029) |
| **TOTAL ASSETS LESS CURRENT LIABILITIES** | | **54,878** | **29,872** |
| **CREDITORS:** amounts falling due after more than one year | 13 | – | (178) |
| | | **54,878** | **29,694** |
| **CAPITAL AND RESERVES** | | | |
| Called up share capital | 19 | 162 | 146 |
| Share premium | 20 | 54,696 | 29,919 |
| Share issue costs reserve | 20 | – | (372) |
| Profit and loss account | | 20 | 1 |
| | | **54,878** | **29,694** |

Profit for the period for the Company after dividends payable was US$19,000.

Approved by the Board on 28 April 2003

The Lord Daresbury
*Chairman*

Ivan Koulakov
*Managing Director*

# Consolidated Cash Flow Statement

| | Notes | 184 day period to 31 December 2002 US$000 | 37 day period to 30 June 2002 US$000 |
|---|---|---|---|
| NET CASH INFLOW FROM OPERATING ACTIVITIES | 22(a) | **9,399** | **3,748** |
| RETURNS ON INVESTMENT AND SERVICING OF FINANCE | | | |
| Interest received | | 41 | 2 |
| Interest paid on bank loans | | (686) | (11) |
| Interest paid on finance leases | | – | (8) |
| NET CASH OUTFLOW FROM RETURNS ON INVESTMENT AND SERVICING OF FINANCE | | (645) | (17) |
| TAXATION | | | |
| Russian profits tax paid | | (3,913) | (800) |
| CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT | | | |
| Payments to acquire tangible fixed assets | | (10,799) | (322) |
| Receipts from sale of tangible fixed assets | | 350 | – |
| Payments to acquire investments | | (541) | (477) |
| Receipts from repayment of investments | | 768 | 44 |
| NET CASH OUTFLOW ON CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT | | (10,222) | (755) |
| ACQUISITIONS AND DISPOSALS | | | |
| Purchase of subsidiary undertakings | 9 | (2,430) | (30,000) |
| Net cash acquired with subsidiary undertakings | 9 | – | 71 |
| NET CASH OUTFLOW ON ACQUISITIONS AND DISPOSALS | | (2,430) | (29,929) |
| NET CASH OUTFLOW BEFORE FINANCING | | **(7,811)** | **(27,753)** |
| FINANCING | | | |
| Issue of ordinary share capital | | 31,838 | 31,529 |
| Share issue costs | | (7,045) | (1,510) |
| New loans | | 8,932 | – |
| Repayment of capital element of finance leases | | (1,379) | (498) |
| CASH INFLOW FROM FINANCING | | 32,346 | 29,521 |
| INCREASE IN CASH | | **24,535** | **1,768** |
| RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT | | | |
| Increase in cash | | 24,535 | 1,768 |
| Repayment of capital element of finance leases | | 1,379 | 498 |
| Cash inflow from increase in loans | | (8,932) | – |
| MOVEMENTS IN NET DEBT ARISING FROM CASH FLOWS | | 16,982 | 2,266 |
| Re-negotiation of loan | | 2,032 | – |
| New finance leases and fair value adjustment | | (585) | – |
| Finance leases acquired with subsidiary undertakings | | – | (7,634) |
| Loans and other long term creditors acquired with subsidiary undertakings | | – | (10,972) |
| Exchange differences | | 208 | 14 |
| MOVEMENT IN NET DEBT | | **18,637** | **(16,326)** |
| NET DEBT AT BEGINNING OF PERIOD | | (16,326) | **–** |
| NET CASH/(DEBT) AT END OF PERIOD | 22(b) | **2,311** | **(16,326)** |

# Notes to the Financial Statements

## 1 Accounting policies

### *Basis of consolidation*
The Financial Statements present the accounts of Highland Gold Mining Limited (the "Company") and its subsidiary undertakings, (the "Group") drawn up for the 184 day period to 31 December 2002. The results of subsidiaries acquired are consolidated for the periods from the date on which control passes. On the acquisition of a subsidiary, or an associate, fair values reflecting conditions at the date of acquisition are attributed to the identifiable net assets acquired.

### *Basis of preparation*
These Financial Statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards.

### Russian political and economic risks
Over the past decade Russia has undergone substantial political, economic and social changes. As an emerging market, Russia does not possess a fully developed business and regulatory infrastructure that would generally exist in a more mature market economy. The current Government is attempting to address these issues; however, it has not yet fully implemented the reforms necessary to create banking, judicial and regulatory systems that usually exist in more developed markets. As a result, and as reflected in the Government's debt default and rouble devaluation in 1998, operations in Russia involve risks that are not typically associated with those in more developed markets. Such risks persist in the current environment with results that include but are not limited to, a currency that is not freely convertible outside of the country, various currency controls, low liquidity levels for debt and equity markets, and continuing inflation. Furthermore, substantially all privatisations in Russia in the early 1990s were flawed in some manner, and even the most minor and administrative flaw in the privatisation documents may be invoked as a basis for challenging the validity of the privatisation process as a whole and thus the title to assets acquired as a result of privatisation. The environment is such that the state, local authorities and administration, the former owners of property and other interested parties can attempt to obstruct normal business operations of a company. Accordingly, the stability and success of the Russian economy, and the Group's business, will depend upon the Government's ability to institute supervisory, judicial and other regulatory reforms.

### Risks specific to MNV
MNV's tangible fixed assets substantially consist of the gold mining operations at Mnogovershinnoe. Certain of the more important operational assets are currently leased from the Khabarovsk Administration. It is possible that these assets might be privatised in the future and that MNV might not be successful in winning any open tender and hence another party might become the lessor of the assets. Such an outcome might affect MNV's ability to continue to operate these assets in the future and hence its and the Group's ability to continue to operate as a going concern.

Some of MNV's other tangible fixed assets were acquired through a sale and purchase agreement by and between MNV and AP Nizhneamurzoloto ("NAZ"). The substantial majority of these assets have not been formally registered with the Khabarovsk Administration. The Directors have been advised that MNV has a legally enforceable right of use and possession of these assets but will not have the full rights of ownership (ie the right to dispose of the asset, lease or otherwise encumber the assets and otherwise deal with them) under Russian legislation until they are registered in the name of MNV. NAZ and MNV commenced the process of registering certain other immovable property used in MNV's operations that has not been registered to date. There is a risk that the vendors or other interested parties could challenge MNV's rights of use and possession or its ownership of any assets that are not registered in the name of MNV. There can be no assurances that such a challenge will not occur in the future. If such a challenge were made and was successful, the operations of MNV might be impaired such that MNV may not be able to continue to operate as a going concern. MNV has taken legal advice on these matters on the basis of which the Directors are of the opinion that a) MNV has sufficient protection under the lease from the Khabarovsk Administration to ensure that it will be able to continue to operate the assets under the lease for the foreseeable future, b) the fixed asset agreements already concluded and approved by the relevant authorities; the procedures MNV has in place for registration; and the relations that it has built up with the federal and local authorities and administration, and former owners, are sufficient to ensure that, should any challenge occur, it would be expected to be unsuccessful and the effect on the operations would be negligible. The Directors therefore believe that it is appropriate to prepare the Financial Statements on a going concern basis, and that it is appropriate not to record any impairment in respect of MNV's tangible fixed assets.

### *Foreign currency*
These Financial Statements use the United States dollar ("US$") as the reporting currency by translating all transactions into dollars at the historic exchange rate, and by retranslating monetary assets and liabilities into dollars at the current rate at each balance sheet date. All differences are taken to the profit and loss account. The accounting records of the Company's trading subsidiary undertakings are maintained in Russian roubles ("RUR"), the Group's functional currency. The following exchange rates have been applied:

| | 31 December 2002 | July–December Average 2002 |
|---|---|---|
| RUR:US$1 | 31.780 | 31.670 |
| GBP:US$1 | 0.624 | 0.641 |

# Notes to the Financial Statements continued

### *Turnover*

Revenue is recognised when the legal title of the asset sold is transferred. Sales revenue represents proceeds receivable from the customer, net of value added tax (VAT) and sales discounts.

### *Cost of sales*

Cost of sales represents material cost, determined by means of either the weighted average or first in first out ("FIFO") method, and by applying full absorption costing, plus any other costs directly attributable to the acquisition of materials as well as manufacturing overheads.

### *Investments*

Investments, other than investments in subsidiaries and associates, are measured at cost less any impairment losses.

### *Other financial assets*

Other financial assets originated by the Group are stated at cost less a provision for doubtful debts.

### *Tangible fixed assets*

Tangible fixed assets comprise mainly mining assets including mineral rights, development expenditure, shafts, buildings, equipment and vehicles. Tangible fixed assets are stated at cost less accumulated depreciation.

### *Mineral properties and mine development expenditure*

Once a mining project has been established as commercially viable, expenditure other than that on buildings, plant and equipment is capitalised under mineral properties and mine development expenditure account.

Mineral properties and deferred costs are, upon commencement of production, amortised using the unit of production method based on the volumes of proved and probable reserves of ore and are written off if the property is abandoned.

All existing mine sites are established as commercially viable and hence are included in tangible fixed assets.

### *Other tangible assets*

The cost of a tangible fixed asset comprises its purchase price and any costs directly attributable to bringing it into working condition for its intended use. Costs associated with a start up period are capitalised where the asset is available for use but incapable of operating at normal levels without a commissioning period.

### *Depreciation, depletion and amortisation*

Depreciation of tangible fixed assets, other than mineral properties and mine development expenditure, is calculated on a straight line basis. Assets are fully depreciated over their economic lives, or over the remaining life of the mine if shorter. The estimated useful lives of the assets are as follows:

| | |
|---|---|
| Buildings | 17 years |
| Plant and equipment | 7-17 years |

Changes in estimates are accounted for over the estimated remaining economic life.

### Construction work in progress

Assets in the course of construction are capitalised in the construction work in progress account. On completion, the cost of construction is transferred to the appropriate category of tangible fixed assets.

No depreciation is charged on assets in the capital work in progress account. These assets are depreciated upon their transfer to the appropriate category of tangible fixed assets.

### Impairment

If the carrying amount of a fixed asset exceeds the recoverable amount, a provision is recorded to reflect the asset at the lower amount. In assessing recoverable amount for property, plant and equipment and investments, the relevant future cash flows expected to arise from the continuing use of such assets and from their disposal have been discounted to their present value using a market-determined, risk-adjusted discount rate.

### *Stocks*

Stocks are stated at the lower of cost and net realisable value, less any provision for slow moving and obsolete items. Cost includes all costs incurred in bringing each product to its present location and condition. Stock is categorised as follows:

- Raw materials and consumables : Materials, goods or supplies (including energy sources) to be either directly or indirectly consumed in the production process.
- Work in progress : Items stored in an intermediate state that have not yet passed through all stages of production.
- Finished goods : Products and materials that have passed all stages of the manufacturing process.

Net realisable value is based on estimated selling price less any further costs expected to be incurred to completion and disposal.

### *Provisions for liabilities and charges*
Provisions are recognised when the Group has a present obligation, as a result of past events, and it is probable that an outflow of resources that can be reliably estimated will be required to settle such obligation.

### Environmental protection, rehabilitation and closure costs
Provision is made for close down and restoration and for environmental clean up costs, where there is a legal or constructive obligation to do so, (which includes the dismantling and demolition of infrastructure, removal of residual materials and remediation of disturbed areas) in the accounting period when the related environmental disturbance occurs, based on the estimated future costs. The provision is discounted where material and the unwinding of the discount is shown as a finance cost in the profit and loss account. At the time of establishing the provision, a corresponding asset, is capitalised and depreciated on a unit of production basis.

The provision is reviewed on an annual basis for changes in cost estimates or lives of operations.

### *Deferred taxation*
The tax charge is based on the profit for the period and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, with the exception that deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on a non discounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

### *Leasing and hire purchase commitments*
Assets held under finance leases, which are leases where substantially all the risks and rewards of ownership of the asset have passed to the Group, and hire purchase contracts, are capitalised in the balance sheet and are depreciated over their useful lives. The capital elements of future obligations under leases and hire purchase contracts are included as liabilities in the balance sheet. The interest elements of the rental obligations are charged in the profit and loss account over the periods of the leases and hire purchase contracts and represent a constant proportion of the balance of capital repayments outstanding.

Rentals payable under operating leases are charged in the profit and loss account on a straight line basis over the lease term.

### *Pensions*
Contributions to the pension funds are expensed as incurred. The Group does not contribute to any defined benefit pension schemes.

### *Capital instruments*
Shares are included in shareholders' funds. Other instruments are classified as liabilities if they contain an obligation to transfer economic benefit and if not they are included in shareholders' funds.

## *2 Turnover and segmental analysis*
The Group operates in one principal area of activity, that of exploration and production of gold. It also operates within a single geographical market, being the Russian Federation. All sales are made within the Russian Federation.

## *3 Cost of sales*

| | **184 day period to 31 December 2002 US$000** | **37 day period to 30 June 2002 US$000** |
|---|---|---|
| Operating costs | 12,247 | 920 |
| Depreciation, depletion and amortisation | 1,730 | 406 |
| Taxes other than income tax | 1,352 | 510 |
| | 15,329 | 1,836 |

## 4 Operating profit

This is stated after charging:

| | 184 day period to 31 December 2002 US$000 | 37 day period to 30 June 2002 US$000 |
|---|---|---|
| Depreciation of owned assets | 1,345 | 252 |
| Depreciation of assets held under finance leases and hire purchase contracts | 385 | 154 |
| Total depreciation charge | 1,730 | 406 |

## 5 Auditors' remuneration

| | 184 day period to 31 December 2002 US$000 | 37 day period to 30 June 2002 US$000 |
|---|---|---|
| Auditors' remuneration – Ernst & Young LLP | | |
| Group audit | 321 | – |
| Fees for other services | 2,678 | – |
| | 2,999 | – |

The fees for other services were incurred in connection with the flotation of the Group on AIM in December 2002. These costs have been set against the share premium account (see Note 20).

## 6 Bank interest payable and similar charges

| | 184 day period to 31 December 2002 US$000 | 37 day period to 30 June 2002 US$000 |
|---|---|---|
| Bank loans | 686 | 11 |
| Finance charges payable under finance leases | 253 | 8 |
| Unwinding of discount on provisions for liabilities and charges | 253 | 5 |
| | 1,192 | 24 |

## 7 Tax on profit on ordinary activities

### (a) Analysis of tax charge in the period

| | 184 day period to 31 December 2002 US$000 | 37 day period to 30 June 2002 US$000 |
|---|---|---|
| Current tax: | | |
| Russian profits tax of the period | 2,320 | 518 |
| Total current tax | 2,320 | 518 |
| Deferred tax: (Note 15) | | |
| Adjustment to prior period | (1,662) | – |
| Origination and reversal of timing differences | 1,680 | 282 |
| Total deferred tax | 18 | 282 |
| Tax on profit on ordinary activities | 2,338 | 800 |

### (b) Factors affecting tax charge for the period

The differences between the effective provision for Russian profits tax and the statutory tax provision at the statutory rate is reconciled as follows:

| | 184 day period to 31 December 2002 US$000 | 37 day period to 30 June 2002 US$000 |
|---|---|---|
| Profit on ordinary activities before tax | 9,434 | 2,620 |
| Standard tax rate | 24% | 24% |
| Profit on ordinary activities multiplied by standard rate | 2,264 | 629 |
| Effects of: | | |
| Deferred tax provided in the Financial Statements (Note 7(a)) | (1,680) | (282) |
| Unrecognised deferred tax | 2,176 | 34 |
| Non deductible expenses | 107 | 50 |
| Foreign exchange difference on profit and loss account translation | (117) | – |
| Gain on loan renegotiation | (355) | – |
| Other permanent differences | (75) | 87 |
| Current tax charge for the period | 2,320 | 518 |

### 7 Tax on profit on ordinary activities (continued)

#### (c) Factors affecting tax charges

Russia has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax, corporate income tax (profits tax), a number of turnover based taxes, and payroll (social) taxes, together with others. In addition, the subsidiaries of the Company are also subject to various industry taxes including excise and mineral extraction taxes. Laws related to some of these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, regulations are often unclear or non-existent. Accordingly, few precedents with regard to issues have been established. Often, differing opinions regarding legal interpretation exist both among and within government ministries and organisations (like the Ministry of Taxes and Levies and various inspectorates); thus creating uncertainties and areas of conflict. Tax declarations, together with other legal compliance areas (as examples, customs and currency control matters), are subject to review and investigation by a number of authorities, who are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia substantially more significant than typically found in countries with more developed tax systems.

Generally, tax declarations remain open and subject to inspection for a period of three years. As of 31 December 2002, a substantial portion of the tax declarations of the Group have been reviewed through to 31 December 2002. Management believes that the Group is in substantial compliance with the tax laws affecting its operations; however, the risk remains that the relevant authorities could take differing positions with regard to interpretative issues and the effect could be significant. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review during the three-year period.

### 8 Tangible fixed assets

Tangible fixed assets comprise mining assets:

| | Freehold buildings US$000 | Plant and equipment US$000 | Mineral properties and mine development expenditure US$000 | Construction in progress US$000 | Total US$000 |
|---|---|---|---|---|---|
| **Cost:** | | | | | |
| At 1 July 2002 | 5,941 | 12,621 | 25,864 | 4,294 | 48,720 |
| Exchange adjustments | (62) | (131) | (269) | (45) | (507) |
| Additions | 293 | 3,283 | – | 8,944 | 12,520 |
| Acquisitions | – | – | 3,485 | – | 3,485 |
| Disposals | (216) | (134) | – | – | (350) |
| Fair value adjustments | – | (2,100) | (4,473) | – | (6,573) |
| Transfer from investments (see Note 9) | – | 715 | – | – | 715 |
| Transfers | – | – | 2,869 | (2,869) | – |
| At 31 December 2002 | 5,956 | 14,254 | 27,476 | 10,324 | 58,010 |
| **Depreciation:** | | | | | |
| At 1 July 2002 | (72) | (188) | (146) | – | (406) |
| Provided during the period | (243) | (874) | (613) | – | (1,730) |
| At 31 December 2002 | (315) | (1,062) | (759) | – | (2,136) |
| **Net book value:** | | | | | |
| At 31 December 2002 | 5,641 | 13,192 | 26,717 | 10,324 | 55,874 |
| At 30 June 2002 | 5,869 | 12,433 | 25,718 | 4,294 | 48,314 |

The net book value of plant and equipment above includes an amount of US$8,632,000 (at 30 June 2002 – US$9,491,000), relating to leased assets.

# Notes to the Financial Statements continued

## 9 Investments

*Group:*

| | Total US$000 |
|---|---|
| **Cost:** | |
| At 1 July 2002 | 1,052 |
| Additions | 541 |
| Transfer to fixed assets | (715) |
| Repayment of loans | (768) |
| At 31 December 2002 | 110 |
| Amounts provided | |
| At 1 July 2002 | – |
| Provided during the period | (110) |
| At 31 December 2002 | (110) |
| **Net book value:** | |
| At 31 December 2002 | – |
| At 30 June 2002 | 1,052 |

Investments consist of loans given to third parties and have been provided against to the extent that they are not expected to be recovered. During the period, fixed assets to the value of US$715,000 were received in consideration for settlement of certain loan balances.

*Company:*

| | Total US$000 |
|---|---|
| **Cost and net book value:** | |
| At 1 July and 31 December 2002 | 30,901 |

No investments are listed.

Details of the investments in which the Group and the Company (unless indicated) controls 20% or more of the nominal value of any class of share capital are as follows:

| Name of Company | Country of incorporation | Proportion of voting rights | Nature of Business |
|---|---|---|---|
| Held indirectly via 100% owned subsidiaries | | | |
| ZAO Mnogovershinnoe (MNV) | Russia | 100% | Gold exploration and production |
| OOO Darasunsky Rudnik (Darasun) | Russia | 100% | Gold exploration and production |
| OAO Novoshirokinskaya Rudnik (Novo) | Russia | 83.46% | Gold exploration and production |
| ZAO Talatui (Talatui) | Russia | 100% | Gold exploration and production |
| OOO Russdragmel (RDM) | Russia | 100% | Management Company |
| Trade House Mnogovershinnoe (THM) | Russia | 100% | Services Company |
| Held directly by the Company | | | |
| Stanmix Holding Limited (Stanmix) | Cyprus | 100% | Holding Company |
| Stanmix Investments Limited (STIL) | Cyprus | 100% | Financing Company |

On 11 September 2002, the Group acquired an 81.29% interest in Novo. Novo is located in the Chita region of Russia and holds certain assets which are required for the future development of the gold and polymetallic mine. A further 2.17% interest was acquired during the period and since 31 December 2002, the Group has acquired an additional 3.62% taking its total holding to 87.08%.

## 9 Investments (continued)

### Novo – Net Assets Acquired

| | Book value US$000 | Fair value adjustments US$000 | Provisional fair value US$000 |
|---|---|---|---|
| Tangible fixed assets | 20,024 | (16,539)(a) | 3,485 |
| Stocks | 18 | – | 18 |
| Debtors | 55 | – | 55 |
| Creditors due within one year | (646) | – | (646) |
| Fair value of net assets acquired | 19,451 | (16,539) | 2,912 |
| Less: minority interest | | | (482) |
| Group share of net assets (83.46%) | | | 2,430 |
| Goodwill arising on acquisition | | | – |
| | | | 2,430 |
| Discharged by: | | | |
| Cash | | | 2,430 |

(a) reassessment of fixed asset value

Novo contributed a loss of US$55,000 during the period to 31 December 2002.

The fair values of the assets and liabilities of MNV and Darasun included in the financial statements for the period ended 30 June 2002 have been subject to further investigation and review during 2002, as permitted by Financial Reporting Standard No. 7 'Fair Values in Acquisition Accounting'. The revisions to the previously reported fair values are set out below:

### MNV and Darasun – Net Assets Acquired

| | Fair value as previously reported US$000 | Revisions US$000 | Final fair value US$000 |
|---|---|---|---|
| Tangible fixed assets | 47,845 | (6,573)(a) | 41,272 |
| Investments | 2,701 | – | 2,701 |
| Stocks | 7,877 | 1,503 (b) | 9,380 |
| Debtors | 10,028 | – | 10,028 |
| Cash | 71 | – | 71 |
| Creditors due within one year | (9,335) | – | (9,335) |
| Creditors due after one year | (14,220) | 1,270 (c) | (12,950) |
| Provisions – deferred tax | (2,402) | – | (2,402) |
| Provisions – environmental | (11,664) | 3,800 (d) | (7,864) |
| Net assets | 30,901 | – | 30,901 |
| Goodwill arising on acquisition | – | – | – |
| Consideration | 30,901 | – | 30,901 |

(a) revised following further technical studies (US$2,773,000 at MNV and US$3,800,000 at Darasun)

(b) revised following reassessment of work in process valuation at MNV

(c) revised following reassessment of finance lease liabilities at MNV

(d) revised following further technical studies at Darasun

## 10 Stocks

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| Raw materials and consumables | 9,639 | 6,255 |
| Work in progress | 3,711 | 1,220 |
| Finished goods and goods for resale | 5 | 1,444 |
| | 13,355 | 8,919 |

The difference between purchase price or production cost of stocks and their replacement cost is not material.

### 11 Debtors

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| **Group:** | | |
| Trade debtors | 119 | 275 |
| VAT receivable | 3,595 | 2,616 |
| Prepayments | 4,228 | 5,803 |
| Tax refunds receivable | – | 1,742 |
| Other debtors | 2,989 | 2,575 |
| | 10,931 | 13,011 |
| **Company:** | | |
| Trade debtors | – | 56 |
| Prepayments | 264 | – |
| Dividends receivable | 1,550 | – |
| | 1,814 | 56 |

### 12 Creditors: amounts falling due within one year

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| **Group:** | | |
| Trade creditors | 4,011 | 3,293 |
| Profits tax | 1,018 | 2,611 |
| Taxes other than profits tax | 1,741 | 2,762 |
| Other creditors | 723 | 419 |
| Short-term loans (Note 16) | 13,896 | 4,058 |
| Obligations under finance leases and hire purchase contracts (Note 17) | 1,748 | 1,448 |
| Proposed final dividend | 1,105 | – |
| | 24,242 | 14,591 |

Short-term loans are US dollar and rouble denominated, are secured by future sales of gold.

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| **Company:** | | |
| Other creditors | 2,665 | 1,109 |
| Proposed final dividend | 1,105 | – |
| | 3,770 | 1,109 |

### 13 Creditors: amounts falling due after more than one year

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| **Group:** | | |
| Other creditors (Note 16) | 3,976 | 6,914 |
| Obligations under finance leases and hire purchase contracts (Note 17) | 4,594 | 5,688 |
| | 8,570 | 12,602 |
| **Company:** | | |
| Loan from subsidiary undertaking | – | 178 |

### 14 Provisions for liabilities and charges

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| Deferred tax (Note 15) | 2,702 | 2,684 |
| Site restoration provision (Note 18) | 8,020 | 11,688 |
| | 10,722 | 14,372 |

## 15 Deferred tax

Deferred tax included in the balance sheet is as follows:

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| Deferred tax balance at the beginning of period | 2,684 | – |
| Acquisition of MNV and Darasun | – | 2,402 |
| Adjustment to prior period | (1,662) | – |
| Charged to the profit and loss account | 1,680 | 282 |
| Deferred tax balance at the end of period | 2,702 | 2,684 |

Deferred tax comprises:

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| Fixed asset timing differences | 2,938 | 1,951 |
| Other timing differences | (236) | 733 |
| Total deferred tax liability | 2,702 | 2,684 |

No deferred tax benefit is recognised in relation to the site restoration provision. Restoration expenses are tax deductible when incurred. However, it is not certain that there will be sufficient income towards the end of the mine's life against which the restoration expenditure can be offset and therefore future tax relief has not been assumed. The amount of the deferred tax asset not recognised at 31 December 2002 is US$1,398,000.

No deferred tax benefit is recognised in relation to the assets leased under finance leases. Due to the long period of reversal of the timing difference, future tax relief has not been assumed. The amount of the deferred tax asset not recognised at 31 December 2002 is US$516,000.

No deferred tax benefit is recognised in relation to the long-term investment loans written off. Tax relief on loan write-off is only obtained when the debtor is declared insolvent. Given the uncertainty regarding this event, no future tax relief has been assumed. The amount of the deferred tax asset not recognised at 31 December 2002 is US$429,000.

No deferred tax benefit is recognised in relation to the bad debt provision. Tax relief on bad debt write-off is only obtained when the debtor is declared insolvent. Given the uncertainty regarding this event, no future tax relief has been assumed. The amount of the deferred tax asset not recognised at 31 December 2002 is US$141,000.

No deferred tax benefit is recognised in relation to the provision for obsolete inventory. These materials are unlikely to be used for the production purposes in future and therefore future tax relief is not assumed. The amount of the deferred tax asset not recognised at 31 December 2002 is US$48,000.

## 16 Loans and other creditors

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| Amounts falling due: | | |
| Within one year | 13,896 | 4,058 |
| In one to two years | – | 782 |
| In two to five years | – | 1,460 |
| In more than five years | 3,976 | 4,672 |
| | 17,872 | 10,972 |
| Less: included in creditors: amounts falling due within one year (Note 12) | (13,896) | (4,058) |
| | 3,976 | 6,914 |

The total amount of secured loans as at 31 December 2002 is US$13,896,000. The amounts payable after more than five years are interest free.

### 17 Obligations under leases and hire purchase contracts

Amounts due under finance leases and hire purchase contracts:

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| Amounts falling due: | | |
| Within one year | 1,748 | 1,448 |
| Within two to five years | 2,324 | 2,878 |
| In more than five years | 2,270 | 2,810 |
| Total obligations under lease | 6,342 | 7,136 |
| Less: included in obligations under lease: amounts falling due within one year | (1,748) | (1,448) |
| Total | 4,594 | 5,688 |

The amounts payable after more than five years related to finance leases with an imputed interest rate of 30%.

### 18 Site restoration provision

Provisions for environmental restoration comprise:

| | Total US$000 |
|---|---|
| At 1 July 2002 | 11,688 |
| Exchange adjustments | (121) |
| Fair value adjustment | (3,800) |
| Unwinding of discount | 253 |
| At 31 December 2002 | 8,020 |

Environmental restoration provisions relate to obligations to repair and make safe mines after use and the estimated costs of cleaning up any chemical leakage. Most of these costs are expected to be incurred at the end of the mines' useful operations, approximately between 2015-2022. The extent and cost of future remediation programmes are inherently difficult to estimate. They depend on the scale of any possible contamination and the timing and extent of corrective actions. The provision has been estimated using existing technology, current prices, prudent interpretations of the relevant legislation and discounted at 5%.

### 19 Share capital – authorised, allotted, called up and fully paid

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| **Authorised** | | |
| 10,000,000 Ordinary Shares of £0.01 each | – | 146 |
| 300,000,000 Ordinary Shares of £0.001 each | 440 | – |
| **Allotted, called up and fully paid** | | |
| 10,000 Ordinary Shares of £0.01 each | – | 146 |
| 110,525,821 Ordinary Shares of £0.001 each | 162 | – |

At an Extraordinary General Meeting of the Company held on 25 November 2002, the Company increased the Authorised Share Capital to £300,000 divided into 300,000,000 Ordinary Shares of £0.001 each by creating 200,000,000 new Ordinary Shares of £0.001 each and converting each of the 10,000,000 existing Ordinary Shares of £0.01 into ten Shares of £0.001 each.

Highland Gold was admitted to The Alternative Investment Market of the London Stock Exchange on 17 December 2002 with the placing of a further 10,525,821 new Ordinary Shares for cash of US$31.8 million at £1.90 per share. Issue costs of US$7.0 million were incurred.

## 20 Reserves

*Group:*

| | Share premium account US$000 | Share issue cost reserve US$000 | Profit and loss account US$000 |
|---|---|---|---|
| Balance at 1 July 2002 | 29,919 | (372) | 1,820 |
| Arising on share issues | 31,822 | – | – |
| Share issue costs incurred in the period | (6,673) | – | – |
| Transfer share issue costs incurred in prior period | (372) | 372 | – |
| Retained profit for the period | – | – | 5,991 |
| Balance at 31 December 2002 | 54,696 | – | 7,811 |

*Company:*

| | Share premium account US$000 | Share issue cost reserve US$000 | Profit and loss account US$000 |
|---|---|---|---|
| Balance at 1 July 2002 | 29,919 | (372) | 1 |
| Arising on share issues | 31,822 | – | – |
| Share issue costs incurred in the period | (6,673) | – | – |
| Transfer share issue costs incurred in prior period | (372) | 372 | – |
| Retained profit for the period | – | – | 19 |
| Balance at 31 December 2002 | 54,696 | – | 20 |

## 21 Reconciliation of shareholders' funds

*Group:*

| | 184 day period to 31 December 2002 US$000 | 37 day period to 30 June 2002 US$000 |
|---|---|---|
| Shareholders' funds at the beginning of period | 31,513 | – |
| Share issues during the period | 25,165 | 30,065 |
| Share issue costs relating to future share issues | – | (372) |
| Profit and loss retained for the period | 5,991 | 1,820 |
| Shareholders' funds at end of period | 62,669 | 31,513 |

## 22 Notes to the cash flow statement

(a) Reconciliation of operating profit to net cash inflow from operating activities

| | 184 day period to 31 December 2002 US$000 | 37 day period to 30 June 2002 US$000 |
|---|---|---|
| Operating profit | 8,612 | 2,505 |
| Depreciation | 1,730 | 406 |
| Write down of investments | 110 | – |
| Decrease/(increase) in debtors | 1,306 | (2,983) |
| Increase in stock | (3,113) | (1,047) |
| (Decrease)/increase in creditors | (273) | 4,867 |
| Increase in stock and debtors provisions | 1,027 | – |
| Net cash inflow from operating activities | 9,399 | 3,748 |

(b) Analysis of net debt

| | At 1 July 2002 US$000 | Cash flow US$000 | Exchange differences US$000 | Other non-cash movements US$000 | At 31 December 2002 US$000 |
|---|---|---|---|---|---|
| Cash at bank and in hand and short-term deposits | 1,782 | 24,535 | 208 | – | 26,525 |
| Capital element of finance leases | (7,136) | 1,379 | – | (585) | (6,342) |
| Loans and other long term creditors | (10,972) | (8,932) | – | 2,032 | (17,872) |
| | (16,326) | 16,982 | 208 | 1,447 | 2,311 |

### 23 Earnings per share

| | 184 day period to 31 December 2002 | 37 day period to 30 June 2002 |
|---|---|---|
| Profit for the period attributable to shareholders (US$000) | 7,096 | 1,820 |
| Weighted average number of shares in issue | 102,116,605 | 100,000,000 |
| Basic and diluted earnings per share (US$) | 0.069 | 0.018 |

The weighted number of Ordinary Shares in issue during the period to 30 June 2002 has been adjusted to take into account the share split on 25 November 2002 (see Note 19).

### 24 Financial instruments

The Group's financial instruments comprise borrowings, investments, cash and various items, such as trade debtors, trade creditors and contractual provisions arising in the ordinary course of its operations. The Group does not acquire, hold or issue derivative instruments for trading purposes.

The main risks arising from the Group's financial instruments are interest rate risk.

#### *Interest rate risk*

The Group finances its operations through a mixture of retained earnings and bank borrowings. Borrowings are denominated in Russian roubles and US dollars. These borrowings bear interest at fixed rates as disclosed below.

The carrying values of the financial assets and liabilities are materially equal to their fair value. With the exception of the analysis of currency exposure, the analysis below excludes short term debtors and creditors.

#### *Financial liabilities – interest rate profile for the Group as at 31 December 2002*

| | Currency | Bearing interest at fixed rate US$000 | Weighted average rate % | Interest free US$000 | Total US$000 |
|---|---|---|---|---|---|
| Short-term loans | USD | 13,896 | 9.5% | – | 13,896 |
| Other long term creditors | RUR | – | – | 3,976 | 3,976 |
| Capital element of finance leases | RUR, USD | 6,342 | 16.2% | – | 6,342 |
| | | 20,238 | | 3,976 | 24,214 |

The weighted average period for of the capital element of finance leases is four years.

#### *Financial liabilities – interest rate profile for the Group as at 30 June 2002*

| | Currency | Bearing interest at fixed rate US$000 | Weighted average rate % | Interest free US$000 | Total US$000 |
|---|---|---|---|---|---|
| Short-term loans | RUR, USD | 4,058 | 18.0% | – | 4,058 |
| Other long term creditors | RUR | – | – | 6,914 | 6,914 |
| Capital element of finance leases | RUR, USD | 7,136 | 10.0% | – | 7,136 |
| | | 11,194 | | 6,914 | 18,108 |

The weighted average period for of the capital element of finance leases is four years.

#### *Financial assets – interest rate profile for the Group as at 31 December 2002*

| | Currency | Fixed rate financial assets US$000 | Interest free US$000 | Total US$000 |
|---|---|---|---|---|
| Cash at bank and in hand | RUR, USD, GBP | 26,525 | – | 26,525 |
| Loans to third parties | RUR | – | – | – |
| | | 26,525 | – | 26,525 |

The weighted average period during which interest rates are fixed on financial assets is less than one year.

### 24 Financial instruments (continued)

*Financial assets – interest rate profile for the Group as at 30 June 2002*

| | Currency | Fixed rate financial assets US$000 | Interest free US$000 | Total US$000 |
|---|---|---|---|---|
| Cash at bank and in hand | RUR, USD, GBP | – | 1,782 | 1,782 |
| Loans to third parties | RUR | 1,052 | – | 1,052 |
| | | 1,052 | 1,782 | 2,834 |

The weighted average period during which interest rates are fixed on financial assets is less than one year. The weighted average period during which loans, on which no interest is earned, are outstanding is one year.

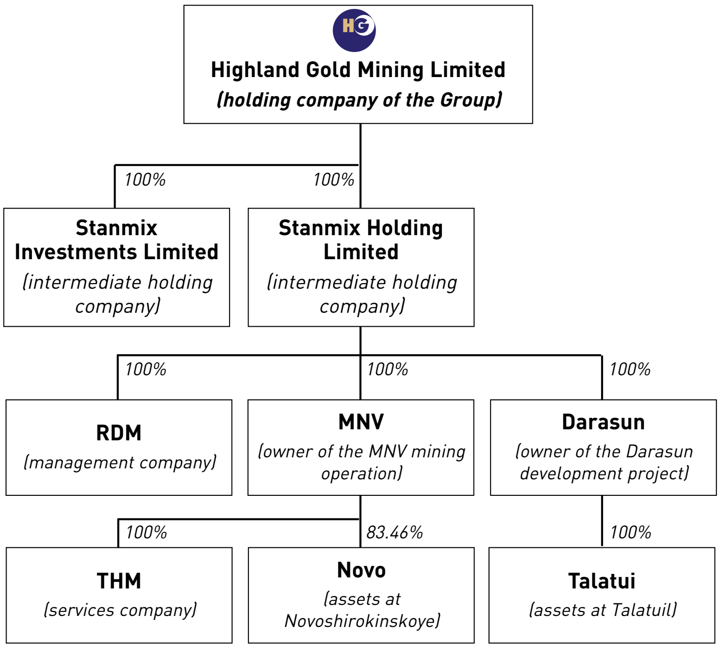
*Currency exposures*

The table below shows the Group's net monetary assets/(liabilities) currency exposures:

| | At 31 December 2002 US$000 | At 30 June 2002 US$000 |
|---|---|---|
| Net monetary liabilities | | |
| RUR | (3,615) | (5,770) |
| GBP | 9,269 | (1,109) |
| | 5,654 | (6,879) |

# Principal Group Companies

## Group Structure




The Company holds 100% of the equity share capital of the following companies:

| Name | Country of incorporation | Principal activity and place of business |
|---|---|---|
| Stanmix Holding Limited | Cyprus | Holding Company, Cyprus |
| Stanmix Investments Limited | Cyprus | Finance Company, Cyprus |

Stanmix Holding Limited holds 100% of the equity share capital of the following companies:

| Name | Country of incorporation | Principal activity and place of business |
|---|---|---|
| ZAO Mnogovershinnoe (MNV) | Russia | Mining and mineral exploration, Mnogovershinnoe |
| OOO Darasun Rudnik (Darasun) | Russia | Mineral exploration, Durasan |
| OOO Russdragmet (RDM) | Russia | Management services, Moscow |

MNV holds the following interests in the equity share capital of the following companies:

| Name | % | Country of incorporation | Principal activity and place of business |
|---|---|---|---|
| OAO Novoshirokinskoye Rudnik (Novo) | 83.46 | Russia | Mineral exploration, Novoshirokinskoye |
| Trade House Mnogovershinnoe (THM) | 100 | Russia | Retail shops and catering for employees |

Since 31 December 2002 MNV has acquired 3.62% of Novo taking its total holding to 87.08%.

Darasun holds 100% of the equity share capital of the following companies:

| Name | % | Country of incorporation | Principal activity and place of business |
|---|---|---|---|
| ZAO Talatui (Talatui) | 100 | Russia | Mine exploration, Talatui |

## Management Team in Russia

Ivan Koulakov – Managing Director

Dmitri Korobov – Commercial Director

Gennady Nevidomi – Mining Director

Mikhail Cheine – Chief of Finance

Igor Gaponenko – International affairs

Yuri Borsh – General Director MNV mine

Alexander Mikhaluk – Chief Geologist

Yuri Filtsev – Technical Director

Denis Ălexandrov – Internal Audit Manager

# Notice of Annual General Meeting

Notice is hereby given that the first Annual General Meeting of Highland Gold Mining Limited (the Company) will be held on Thursday 22 May 2003 at the De Vere Grand Hotel, The Esplanade, St Helier, Jersey JE4 8WD at 12.00 pm to consider and, if thought fit, pass the following resolutions;

### Ordinary Business

1. That the Directors' Report and Financial Statements for the 184 day period ended 31 December 2002, be adopted.
2. That a final dividend of US$0.01 for each Ordinary Share of £0.001 in the Company be declared.
3. That The Lord Daresbury who retires by rotation as a Director of the Company be re-elected.
4. That Mr Ivan Koulakov who retires by rotation as a Director of the Company be re-elected.
5. That Ernst & Young LLP be re-elected as Auditors of the Company, to hold office until the conclusion of the next Annual General Meeting.
6. That the Directors be authorised to fix the Auditor's remuneration.

### Special Business

To consider and if thought fit to pass the following special resolution:

7. That the Directors be and they are hereby generally and unconditionally authorised to allot up to 33% of the authorised but unissued share capital of the Company being, 189,474,179 Ordinary Shares of £0.001 each to such persons at such times and on such terms as they think proper, such authority to expire at the conclusion of the next year's Annual General Meeting, save that the Company may, before such expiry make an offer or agreement which would or might require Ordinary Shares to be allotted after such expiry and the Directors may allot Ordinary Shares pursuant to any such offer or agreement as if the authority had not expired, and the authority referred to above shall be exercised in accordance with all powers set out in the Articles of Association of the Company and the Companies (Jersey) Law 1991, as amended.

By Order of the Board

Paternoster Secretaries Limited

*Company Secretary*

28 April 2003

**Notes**

1. A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and, on a poll, vote instead of him. A proxy need not be a member of the Company. A form of proxy is enclosed with this notice.
2. The form of proxy, the power of attorney or other authority (if any) under which it is signed or an office or notarially certified copy of it, should be lodged with the Transfer Agents, Capita Registrars (Proxies), PO Box 25, Beckenham, Kent BR3 4BR, no later than 48 hours before the time fixed for the holding of the meeting.
3. Completing and returning a form of proxy will not prevent a member from attending the meeting and voting in person should he so wish.
4. Director's Service contracts and register of Directors' interests in the Share Capital of the Company are available at the registered office of the Company for inspection during usual business hours on weekdays from the date of this notice until the date of the meeting and at the meeting until the conclusion of the meeting.

**THIS PAGE IS INTENTIONALLY LEFT BLANK**

# Proxy Form

## HIGHLAND GOLD MINING LIMITED

Form of Proxy - Annual General Meeting

(For the use of holders of Ordinary Shares holding shares in their own name)

Please complete in block capitals

I/We (Note 4)..........................................................................................................................................

of..........................................................................................................................................

being (a) member(s) of Highland Gold Mining Limited hereby appoint (Note 3) the Chairman of the meeting

..........................................................................................................................................

as my/our proxy to vote for me/us on my/our behalf at the Annual General Meeting of the Company to be held at the De Vere Grand Hotel, Esplanade, St. Helier, Jersey JE4 8WD on 22 May 2003 at 12.00 p.m. and at any adjournment thereof.

I/We direct my/our proxy to vote on the resolutions as set out in the notice convening the Annual General Meeting as follows:

Please indicate how you wish your proxy to vote by placing a tick in the appropriate space. Unless otherwise indicated the proxy will vote, or abstain from voting as thought fit.

| **Ordinary Resolutions** | **For** | **Against** |
|---|---|---|
| 1. That the Directors' Report and Financial Statements be approved | | |
| 2. To declare a Final Dividend of US$0.01c per Ordinary Share | | |
| 3. To re-elect Lord Daresbury as a Director | | |
| 4. To re-elect Mr Ivan Koulakov as a Director | | |
| 5. That Ernst & Young LLP be re-appointed as Auditors | | |
| 6. That the Directors be authorised to fix the remuneration of the Auditors | | |
| **Special Resolution** | **For** | **Against** |
| 7. That the Directors be authorised to issue up to 33% of the authorised but unissued share capital of the Company | | |

Signed ..................................................this ..................................day of................................................2003

Notes:

1. To be valid this Form of Proxy must reach the Transfer Agent, Capita Registrars (Proxies) P.O. Box 25, Beckenham, Kent BR3 4BR not later than 48 hours before the time of the meeting.
2. Where this form is executed by a corporation it must be either under its seal or under the hand of an officer or attorney duly authorised.
3. If any other proxy is desired strike out the words "the Chairman of the meeting" and insert the name or names preferred. Any alteration must be initialled. Appointment of a proxy will not preclude a member from attending the meeting and voting in person. A proxy need not be a member of the Company.
4. In the case of joint holders the signature of any one holder will be sufficient but the names of all the joint holders should be stated.

Third Fold and Tuck In

BUSINESS REPLY SERVICE
Licence No. MB 122

1

**Capita Registrars (Proxies)**
**PO Box 25**
**Beckenham**
**Kent**
**BR3 4BR**

First Fold

Second Fold